SUBMISSION FROM HOLON INVESTMENTS AUSTRALIA LIMITED

Hearing under section 994J of the Corporations Act 2001

Holon Ethereum Fund

Background - Holon Investments Australia Limited

Holon Investments Australia Limited ("Holon") is a wholly owned subsidiary of Holon Global Investments Limited. Holon was founded as a specialist digital asset fund manager to act as a regulated bridge between traditional financial services and digital assets.

Holon takes the role of regulation seriously and has a desire that there is greater regulation relating to digital assets in the Australian market. The Holon Ethereum Fund was founded so that Australian investors can participate in digital asset markets via a regulated Managed Investment Scheme, thereby avoiding some of the risks associated with holding digital assets directly or via an exchange.

Offering digital assets via a Managed Investment Scheme also allows digital assets to brought into the oversight of Financial Advisers, therefore further minimising the potential harm to investors participating in digital asset markets.

Holon welcomes ASIC's oversight of the industry and is hopeful that appropriate Legislation is enacted to further enhance investor protection in digital assets.

Holon TMD

In the preparation of the TMD, Holon has utilised the TMD Template and Guidance Note developed by the Financial Services Council (FSC).

The FSC has done extensive work to help members with the Design and Distribution Obligations (DDO) regime. In producing the TMD Template and Guidance, it was the intention of the FSC to improve outcomes for advisers, investment platforms and issuers.

Given the complexity that arises from potentially hundreds of inconsistent approaches, the template and data standards facilitate the necessary flow of data between financial advisers, platforms and product issuers.

The FSC consulted with ASIC on the design and content of the template TMDs.

Implementation of the TMD Operationally

In implementing the TMD for the Fund, Holon has developed a series of knock out questions so that if an investor responds in such a way that they are not part of the target market, that is, questions that have a red indicator to an attribute on the TMD, then their application is unable to proceed.

If an investor were to respond to a question that suggests that they might not be within the target market, that is, their response to questions have an amber indicator to an attribute in the TMD, then their application will proceed but they will receive a warning email that directs them to review the TMD to ensure that they are part of the target market for the Fund.

A. That the target market potentially includes investors with a risk and return profile of "Medium" and includes investors with a risk and return profile of "High".

Holon believes that it would be reasonable to conclude that, if the product were to be sold to a retail client in the target market as described in the TMD, being a retail client with risk and return profiles of "Medium or High", that investment in the product would likely be consistent with the likely objectives, financial situation and needs of the retail client. Holon's rationale is outlined below.

A.1 Fund in Isolation vs. Fund as part of a Portfolio

At Point 16 of the Statement of Concern, ASIC notes that Holon has defined the risk profiles on page 6 of the TMD. The risk profile definitions adopted by Holon originated from the Financial Services Council (FSC) TMD Template and Guidance Note. These definitions, as ASIC notes at Point 27, are based on the Standard Risk Measure Guidance Paper for Trustees.

ASIC is considering the volatility and risk profile of the fund in isolation not as part of an overall diversified investment strategy.

At Point 20 of the Statement of Concerns ASIC notes the historical performance of Ethereum and that it has been subject to extreme volatility and has the potential for severe negative returns. They note specifically:

a) Since April 2016 to date (i.e. just over a 6-year investment horizon), Ethereum has experienced four periods where annual returns have been negative.
b) Additionally, during these periods of negative returns, Ethereum's price declines have been very deep, with the largest decline being 90% between January 2018 and January 2019.

Based on the analysis above, the conclusion reached at Point 22 is that:

> *Given these historical returns and risk characteristics of Ethereum, an investment in the Fund is incompatible with an investor who has a "Medium" risk and return profile (being an investor who seeks to minimise potential losses and has the ability to bear up to 4 negative returns over a 20 year period) and a "High" risk and return profile (being an investor who has the ability to bear up to 6 negative returns over a 20 year period).*

And at **Point 23** in the statement of Concerns:

> *Therefore, ASIC considers the Fund's investments in Ethereum are such that it would not be appropriate for investors with either a risk and return profile of "Medium" or High" to invest in the Fund.*

The analysis above treats the fund in isolation as to whether it is a suitable investment for an investor with a Medium or High Risk profile, not in the context of a broader portfolio.

At **Point 5** of the Statement of Concerns, ASIC notes:

Under the heading "Investment Products and Diversification", the TMD provides further information about the application of the TMD to an investment in the Fund:

> *A consumer (or class of consumer) may intend to hold a product as part of a diversified portfolio (typically with an intended product use of satellite/small allocation or core component). In such circumstances, the product should be assessed against the consumer's attributes for the relevant portion of the portfolio, rather than the consumer's portfolio as a whole. For example, a consumer may seek to construct a conservative portfolio with a satellite/small allocation to growth assets. In this case, it may be likely that a product with a High or Very High risk/return profile is consistent with the consumer's objectives for that allocation notwithstanding that the risk/return profile of the consumer as a whole is Low or Medium. In making this assessment, distributors should consider all features of a product (including its key attributes).*

Given that the TMD published by Holon has considered the Fund as a part of an overall portfolio and that the Fund volatility and drawdown comprises a small (satellite) and long term investment, the view was reached by Holon that as part of an overall diversified portfolio an allocation to the Fund is consistent with the likely objectives, financial situation and needs of a retail client with a Medium or High Risk Profile. This approach is in line with the FSC's TMD Template and section 1. (Portfolio View) in its "DDO guidance on distribution of managed funds"[1] where the FSC states:

> *Question: How should a Target Market Determination (TMD) be considered where a managed fund is being held as part of an investment portfolio? For instance, if a customer wishes to have a portfolio that is overall low risk/return portfolio, then does that mean all the products in the portfolio should be low risk – and products that are not low risk are outside target market? And similar for other portfolio characteristics such as high risk/return, income distribution, investment timeframe, liquidity?*
>
> *Answer: The TMD should be considered against the intended use of the relevant component of the investment portfolio and not against the customer's desired characteristics of the whole portfolio.*
>
> *Therefore, a high risk/return product can legitimately be a component of a portfolio that is overall low risk/return. If a fund meets the customer's requirements for the relevant portion of the client's portfolio, then the distributor could legitimately classify the customer as being in the target market for that component of the portfolio.*
>
> *As part of portfolio construction, distributors, including financial advisers, can legitimately determine different parts of a customer's portfolio should have different characteristics, such as a portfolio could have part allocated to low risk/return products, another part to medium risk/return and the remainder to high risk/return products. Similarly, some parts of a portfolio may have higher desired liquidity than other parts, and some may have more capital growth, longer investment timeframe and so on. In each case, investment products should be assessed against the relevant component of the overall portfolio.*

[1] https://fsc.org.au/web-page-resources/2514-fsc-ddo-guidance-for-distribution-of-managed-funds

A.2 Returns - Fund in Isolation

The rolling one, three and five year returns calculated daily are important to consider in the context of whether an investment in the Fund is suited to investors in particular risk / return profiles. Investors who do not fall within the target market are knocked out of the application process, that is, they cannot proceed with their application. In light of defining the target market in this way, Holon believes that the performance over a longer term is relevant.

Holon has undertaken analysis looking at the daily rolling one, three and five year returns for Ethereum between 7th August 2015 and 10th October 2022[2]. The rolling return observations are looking at an investment on each day that the asset has been in existence and then seeing what the return would be for the one, three and five year periods. Given that an investor can enter or exit the investment at any stage, Holon believes this to be the most consistent method to consider performance to best consider the customer outcome.

Table 1: Rolling 1, 3 and 5 year returns for Ethereum

ETH	5 year	3 year	1 year
Observations	795	1,526	2,256
Average	180%	148%	854%
Median	204%	140%	121%
Max	320%	677%	14168%
Min	22%	-16%	-91%
# +ve	795	1,467	1,530
#-ve	0	59	726
% #-ve	0%	4%	32%

As can be seen in the table above, for a one year period, there have been 2,256 observations of daily rolling one year returns for Ethereum. Of those observations, there have been 1,530 positive returns, representing 68% of observations and 32% negative rolling one year returns. The median rolling one year return was 121% and the largest draw down was 91%.

It is then relevant to consider the risk / return profile over a more protracted period which is more reflective of the minimum recommended investment horizon. For the three year rolling return data, which is a period less than the recommended minimum investment horizon, the table above shows that of 1,526 observations, only 4% were negative. The rolling three year return had a median of 140% and the largest draw down was 16%.

Then if the period is extended to the minimum suggested investment period for a consumer, Holon notes from the table above that there have been no periods of negative returns. Of the 759 observations, the minimum return has been 22%, that is, no negative return periods.

ASIC concludes at Point 22 of the Statement of Concern that given the historical returns used by ASIC in Point 20:

[2] Data source - Messari.io

…an investment in the Fund is incompatible with an investor who has a "Medium" risk and return profile (being an investor who seeks to minimise potential losses and has the ability to bear up to 4 negative returns over a 20 year period) and a "High" risk and return profile (being an investor who has the ability to bear up to 6 negative returns over a 20 year period).

If we are to base the appropriateness of historical data as opposed to the method outlined in the AFSA paper "Standard Risk Measure Guidance Paper for Trustees" as ASIC has done in their analysis, since inception of Ethereum, 32% of observations of rolling one year returns have been negative, if that is to be considered over a 20 year period, 6.4 observations would be negative. This analysis is on the basis of the fund on a standalone basis.

A.3 Returns - Fund as part of a Portfolio

When considered in the context of a diversified investment portfolio, which is how it is defined in page 2 of the TMD, the results support the inclusion of the Fund for investors with a "Medium" and "High" risk / return profile even more conclusively. As a proxy to a portfolio that an investor in the "Medium" Risk and Return profile might hold, Holon has adopted the Australian Super Conservative Balanced Investment option[3]. To understand the impact that a 5% allocation to Ethereum would have had since its inception, Holon has undertaken an analysis of the rolling one, three and five year returns of the Australian Super Conservative Balanced Investment option with the inclusion of 5% invested in Ethereum.

Table 2 – Rolling 1, 3 and 5 year returns for Australian Super Conservative Balanced Investment option with the inclusion of 5% invested in Ethereum

	Ethereum	5 year	3 year	1 year
Start	7 Aug 15	7 Aug 20	7 Aug 18	7 Aug 16
End	10 Oct 22			
Days	2,621			

AUSTCB w ETH	5 year w ETH	5 year AustCB	Difference	3 year w ETH	3 year AustCB	Difference	1 year w ETH	1 year AustCB	Difference
Observations	795	795		1,526	1,526		2,256	2,256	
Average	11.8%	7.1%	4.7%	10.6%	7.0%	3.6%	12.8%	7.1%	5.7%
Median	12.9%	7.5%	5.4%	11.5%	7.3%	4.2%	12.7%	7.6%	5.0%
Max	15%	8%	6.6%	19%	10%	9.3%	41%	19%	21.8%
Min	6%	5%	0.7%	4%	3%	0.8%	-11%	-5%	5.4%
# +ve	795	795		1,526	1,526		1,872	2,102	
#-ve	0	0		0	0		384	154	
% #-ve	0%	0%	0.0%	0%	0%	0.0%	17%	7%	10.2%

The table above shows that the number of negative periods increased for a "Medium" risk investor by 10% over a one year horizon to 17% which represents 3.4 negative performance

[3] Data Source - Super Returns Performance | Charts & Tables | AustralianSuper

years over a 20 year period. This finding is consistent with the definition of a "Medium" risk investor on page 6 of the TMD. A "Medium" risk investor is defined as follows.

> *"Medium: The consumer is moderate or medium risk in nature, seeks to minimise potential losses (e.g. has the ability to bear up to 4 negative returns over a 20 year period (SRM 3 to 5)) and comfortable with a moderate target return profile. Consumer typically prefers a balance of growth assets such as shares, property and alternative assets and defensive assets such as cash and fixed income."*

As we extend the time series of rolling returns, the probability of a negative return year diminishes for the Fund on a standalone basis and even further when added to a broadly diversified portfolio of assets. The longer term performance is more relevant as it better aligns with the minimum recommended investment horizon as defined in the TMD as 5 years.

As a proxy to a portfolio that an investor in the "High" Risk and Return profile might hold, Holon has adopted the Australian Super Balanced Investment option. To understand the impact that a 5% allocation to Ethereum would have had since its inception, Holon has undertaken an analysis of the rolling one, three and five year returns of the Australian Super Balanced Investment option with the inclusion of 5% invested in Ethereum.

Table 3 – Rolling 1, 3 and 5 year returns for Australian Super Balanced Investment option with the inclusion of 5% invested in Ethereum

	Ethereum	5 year	3 year	1 year
Start	7 Aug 15	7 Aug 20	7 Aug 18	7 Aug 16
End	10 Oct 22			
Days	2,621			

AUSTB w ETH	5 year w ETH	5 year AustB	Difference	3 year w ETH	3 year AustB	Difference	1 year w ETH	1 year AustB	Difference
Observations	795	795		1,526	1,526		2,256	2,256	
Average	14.5%	10.1%	4.3%	12.9%	9.7%	3.2%	15.8%	10.2%	5.6%
Median	15.5%	10.4%	5.1%	14.2%	10.1%	4.1%	15.4%	10.0%	5.4%
Max	18%	13%	5.6%	23%	15%	7.4%	49%	34%	14.7%
Min	8%	7%	0.3%	4%	3%	1.2%	-12%	-9%	3.1%
# +ve	795	795		1,526	1,526		1,859	2,030	
#-ve	0	0		0	0		397	226	
% #-ve	0%	0%	0.0%	0%	0%	0.0%	18%	10%	7.6%

The table above shows that the number of negative periods increased for a "High" risk investor by 7.6% over a one year horizon to 18% which represents 3.6 negative performance years over a 20 year period. This finding is consistent with the definition of a "High" risk investor on page 6 of the TMD. A "High" risk investor is defined as follows.

> *"High: The consumer is higher risk in nature and can accept potential losses (e.g. has the ability to bear up to 6 negative returns over a 20 year period (SRM 6)) in order to target a higher target return profile. Consumer typically prefers predominantly growth*

assets such as shares, property and alternative assets with only a smaller or moderate holding in defensive assets such as cash and fixed income."

Dataset	Percentage -ve return	Number in 20 years
ETH rolling 1 year	32%	6.4
ETH rolling 3 year return	4%	0.8
ETH rolling 5 year return	0%	0
"Medium" risk + 5% ETH (rolling 1 year)	17%	3.4
"Medium" risk + 5% ETH (rolling 3 year)	0%	0
"Medium" risk + 5% ETH (rolling 5 year)	0%	0
"High" risk + 5% ETH (rolling 1 year)	18%	3.6
"High" risk + 5% ETH (rolling 3 year)	0%	0
"High" risk + 5% ETH (rolling 5 year)	0%	0

Based on the analysis outlined above Holon believes that it would be reasonable to conclude that, if the product were to be sold to a retail client in the target market as described in the TMD, being a retail client with risk and return profiles of "Medium or High", that investment in the product would likely be consistent with the likely objectives, financial situation and needs of the retail client.

Holon has enhanced the "Consumer's Risk (ability to bear loss) and Return profile" section in the TMD (as attached) to further demonstrate when a "Medium" or "High" risk and return profile is appropriate.

B. The Fund is not suitable for an investor with a 'Very High' risk and return profile as defined by the TMD

In addition to the analysis undertaken in Part A above, where the risk and return associated with Ethereum in isolation was considered, Holon analyses the impact of a 5% exposure to Ethereum for a "Very High" risk and return investor as is consistent with the manner in which an investment in the Fund is considered in the TMD.

As a proxy to a portfolio that an investor in the "Very High" Risk and Return profile might hold, Holon has adopted that Australian Super High Growth Investment option. To understand the impact that a 5% allocation to Ethereum would have had since its inception, Holon has undertaken an analysis of the rolling one, three and five year returns of the Australian Super High Growth Investment option with the inclusion of 5% invested in Ethereum.

The table below shows the difference between the Australian Super High Growth investment [4]option and the Australian Super High Growth investment option with the inclusion of a 5% allocation to Ethereum. The percentage of one year observations that were negative was 12%, representing an increase of just 3.6%. If extrapolated over a 20 year period, this would suggest that an investor might experience a negative return slightly over every two years.

The difference in the lowest return for a one year period was 0.2%.

[4] Data Source - Super Returns Performance | Charts & Tables | AustralianSuper

If the minimum suggested investment horizon for the fund is considered, being 5 years, then there are no negative return observations, and the median return of the observations has increased by 3.8%.

Table 4 – Rolling 1, 3 and 5 year returns for Australian Super High Growth Investment option with the inclusion of 5% invested in Ethereum

	Ethereum	5 year	3 year	1 year					
Start	7 Aug 15	7 Aug 20	7 Aug 18	7 Aug 16					
End	10 Oct 22								
Days	2,621								
AUSTHGwETH	5 year w ETH	5 year AustHG	Difference	3 year w ETH	3 year AustHG	Difference	1 year w ETH	1 year AustHG	Difference
Observations	795	795		1,526	1,526		2,256	2,256	
Average	13.7%	9.2%	4.5%	12.3%	8.8%	3.4%	14.9%	9.2%	5.7%
Median	14.8%	9.5%	5.3%	13.3%	9.2%	4.1%	14.6%	9.4%	5.2%
Max	17%	11%	5.8%	22%	13%	8.7%	45%	27%	18.0%
Min	7%	7%	0.6%	5%	4%	0.8%	-11%	-7%	4.5%
# +ve	795	795		1,526	1,526		1,864	2,053	
#-ve	0	0		0	0		392	203	
% #-ve	0%	0%	0.0%	0%	0%	0.0%	17%	9%	8.4%

The table above shows that the number of negative periods increased for a "Very High" risk investor by 8.4% over a one year horizon to 17% which represents 3.4 negative performance years over a 20 year period. This finding is consistent with the definition of a "Very High" risk investor on page 6 of the TMD. A "Very High" risk investor is defined as follows.

> *"Very high: The consumer has a more aggressive or very high risk appetite, seeks to maximise returns and can accept higher potential losses (e.g. has the ability to bear 6 or more negative returns over a 20 year period (SRM 7) and possibly other risk factors such as leverage). Consumer typically prefers growth assets such as shares, property, alternative assets and cryptocurrency."*

Based on the analysis outlined above Holon believes that it would be reasonable to conclude that, if the product were to be sold to a retail client in the target market as described in the TMD, being a retail client with risk and return profile "Very High", that investment in the product would likely be consistent with the likely objectives, financial situation and needs of the retail client.

C. Retail clients that intend to use the product as a Satellite / Small Allocation (<25% of their investible assets)" in their investment portfolio

In preparing the TMD of the Fund, Holon adopted the TMD template from the Financial Services Council on the understanding that the aim was to have standardisation across the industry.

In a video published to the FSC website titled “FSC Engage – April 2022: A message from CEO Blake Briggs” Mr Briggs said

> “*To lessen the compliance burden and the cost that will be borne by customers and the industry, the Financial Services Council is urging consistent adoption of standards across the industry the FSC has developed templates for target market determinations…:*
>
> *Given the complexity that arises from potentially hundreds of inconsistent approaches, the template and data standards we have developed will assist companies to write TMDs for the products that they issue and facilitate the necessary flow of data between financial advisers, platforms and product issuers.*
>
> *“The FSC also thanks ASIC for the supportive role they’re taking to help the industry comply with the regime. ASIC is also providing helpful guidance particularly as the FSC consults with them on the design and content of our template TMDs to support broad based standardisation of DDO compliance.”*[5]

In selecting the appropriate portfolio weighting for what should be deemed to be a Satellite allocation for an investor in a portfolio, Holon was informed by the FSC template which was understood to be an accepted industry standard as to what constituted an appropriate allocation for a Satellite exposure.

Holon does not believe that investors should allocate up to 25% of their investible assets in the Fund.

Holon has amended the definition of a Satellite / Small Allocation in the TMD to be less than or equal to 5% of their investible assets as opposed to the FSC standard definition of less than 25% of their investible assets*. *(We note that diverging from the FSC TMD Template will potentially impact the flow of data between financial advisers, platforms and product issuers).

D. Retail clients that intend to use the product as a Solution / Standalone Allocation (75-100% of their investible assets)” of their investment portfolio are in the target market.

At point 39 of the Statement of Concerns ASIC notes that;

> *“The TMD states on page 3 under the heading “Product description including key attributes’ with respect to the “Consumer’s intended product use (% of Investable Assets)” that: “Investors should use the Fund as a Solution/Standalone allocation”.*

At Point 40 ASIC notes that:

> *…this is inconsistent with the red “TMD indicator” that is given to the “Solution/Standalone (75-100%)” in respect of the “Consumer’s intended product use (% of Investable Assets)”.*

[5] https://www.fsc.org.au/resources/target-market-determination-templates

Holon agrees with ASIC's Point 43 that is would not be reasonable to conclude that, if the product were issued or sold to a retail client in the target market, being an investor who looks to allocate 75% to 100% of their investment portfolio in the Fund, would be likely to be consistent with the likely investment objectives, financial situation and needs of the retail client.

This was an editing error, and it was never Holon's intention to include retail investors that intend to use the Fund as a "Solution / Standalone Allocation (75%-100% of their investible assets)" of their investment portfolio within the target market.

This assertion is supported by the fact that Holon has implemented a knockout question as part of the application process that specifically excludes an investor who indicates that they intend to use the Fund for an allocation of between 75-100% of their portfolio. That is, the investment cannot proceed because of the investor being knocked out of the application process.

Holon has made the appropriate amendment to ensure that the TMD is consistent in the disclosure that a retail investor is not part of the target market for the Fund if they intend to use the Fund as a "Solution / Standalone allocation (75%-100% of their investible assets)."

Conclusion – Reasons why the Delegate should not make Final Orders

That the target market potentially includes investors with a risk and return profile of "Medium" and includes investors with a risk and return profile of "High".

Based on the analysis provided in this submission, Holon maintains that it is reasonable to conclude that, if the product were to be sold to a retail client in the target market described in the TMD (being a retail client with a "Medium" or "High" Risk and Return Profile), that investment in the product would likely be consistent with the likely objectives, financial situation and needs of the retail client and is therefore not is breach of s994B(8)(b) of the Corporations Act.

Holon has enhanced the "Consumer's Risk (ability to bear loss) and Return profile" section in the TMD (as attached) to further demonstrate when a "Medium" or "High" risk and return profile is appropriate.

The Fund is not suitable for an investor with a 'Very High' risk and return profile as defined by the TMD

Based on the analysis provided in this submission, Holon maintains that it is reasonable to conclude that, if the product were to be sold to a retail client in the target market described in the TMD (being a retail client with a "Very High" Risk and Return Profile), that investment in the product would likely be consistent with the likely objectives, financial situation and needs of the retail client and is therefore not is breach of s994B(8)(b).

Retail clients that intend to use the product as a Satellite / Small Allocation (<25% of their investible assets)" in their investment portfolio

Holon has amended the definition of a Satellite / Small Allocation in the TMD to be less than 5% of their investible assets as opposed to the FSC standard definition of less than 25% of their investible assets, but note that diverging from the FSC TMD Template will potentially impact the flow of data between financial advisers, platforms and product issuers.

Retail clients that intend to use the product as a Solution / Standalone Allocation (75-100% of their investible assets)" of their investment portfolio are in the target market.

Holon has amended the TMD to be consistent in the disclosure that a retail investor is not part of the target market for the Fund if they intend to use the Fund as a "Solution / Standalone allocation (75%-100% of their investible assets)."