



**ASIC**

Australian Securities & Investments Commission

CONSULTATION PAPER 200

# Managed discretionary accounts: Update to RG 179

March 2013

## About this paper

This consultation paper sets out our proposed changes to our regulatory approach to managed discretionary accounts (MDAs), as contained in Regulatory Guide 179 *Managed discretionary account services* (RG 179) and Class Order [CO 04/194] *Managed discretionary accounts*.

We seek feedback on our proposals from MDA operators, investor-directed portfolio service (IDPS) operators, Australian financial services (AFS) licensees that provide financial product advice, stockbrokers, industry associations, MDA service providers, consumer and investor representatives, and other interested parties.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Document history

This paper was issued on 8 March 2013 and is based on the Corporations Act as at the date of issue.

### Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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## The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our guidance on MDAs. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section I, 'Regulatory and financial impact'.

### Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 19 April 2013 to:

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### What will happen next?

<b>Stage 1</b>	8 March 2013	ASIC consultation paper released
<b>Stage 2</b>	19 April 2013	Comments due on the consultation paper
	During 2013	Drafting of class order(s) and updated regulatory guide
<b>Stage 3</b>	End of 2013	Class order(s) and regulatory guide released

## A Background to the proposals

### Key points

ASIC has recently conducted a review of the operation of our guidance and relief for managed discretionary accounts (MDAs) provided to retail clients.

There has been increasing interest in MDAs from industry participants, including interest generated as a result of the implementation of the Government's Future of Financial Advice (FOFA) reforms. Our guidance and relief has not been substantially reviewed since it was implemented in 2004.

As a result of our review, we identified some areas where we think our guidance and relief should be modified. This consultation paper sets out our proposed amendments to Regulatory Guide 179 *Managed discretionary account services* (RG 179) and the accompanying class order relief in Class Order [CO 04/194] *Managed discretionary accounts*.

Our proposals are designed to resolve some ambiguities in the current requirements, to ensure that our regulatory requirements for MDAs are consistent with those that apply to comparable financial products, and to promote confident and informed consumers and investors.

### ASIC's current approach to MDAs

- 1 Managed discretionary accounts (MDAs) are arrangements that involve a person (an MDA operator) managing a portfolio of assets for a client on an individual basis. There are a wide variety of arrangements that can constitute an MDA.
- 2 There are some features, however, that are common to most MDA arrangements. These features are:
  - (a) the client gives the MDA operator the authority to make and implement investment decisions on their behalf, without the MDA operator seeking approval from the client for each decision. This discretion must be exercised in accordance with an agreed investment program;
  - (b) the MDA is personalised (to a greater or lesser degree) for each client. In some MDAs, the MDA operator makes investment decisions tailored specifically to the circumstances of each individual client. In other MDAs, the MDA operator may apply the same investment decisions to the accounts of multiple clients who have similar investment programs (e.g. through a 'model portfolio' arrangement)—however, there may be some specific 'rules' applied to the MDA accounts of individual clients for tax planning or other purposes; and

Note: For example, one client may request that securities in their account are sold on a 'first-in, first-out' basis, whereas another client may request that they are sold on a 'last-in, first-out' basis. Other rules may stipulate that, for a certain client, one specific investment should always be substituted with another specific investment.

- (c) the client holds a direct legal or beneficial interest in the underlying assets within the MDA. This is distinct from some other managed investments where the underlying assets are held by a trust fund or company, and the client has a direct interest in that trust fund or company rather than the assets themselves.
- 3 Our view is that providing an MDA to a retail or wholesale client is likely to involve providing a financial product (or products) and/or one or more financial services (including financial product advice where an MDA is provided to a retail client). As such, MDA operators need to hold an Australian financial services (AFS) licence.
- 4 We have implemented a tailored regulatory approach to MDAs based on AFS licence conditions and class order relief from some of the provisions of the *Corporations Act 2001* (Corporations Act) that apply to managed investment schemes for MDA operators who provide MDAs to retail clients. We adopted this regulatory approach because the particular characteristics of MDAs mean that a tailored regulatory approach would better meet the requirements of MDA operators and investors.
- 5 Under our current regulatory requirements, to offer an MDA to retail clients, an operator must either:
- (a) establish and register a managed investment scheme and offer the MDA through that scheme; or
  - (b) obtain an AFS licence authorisation permitting it to offer MDAs to retail clients in accordance with the relief granted in Class Order [CO 04/194] *Managed discretionary accounts*.
- 6 [CO 04/194] gives the MDA operator conditional relief from having to register a managed investment scheme and prepare a Product Disclosure Statement (PDS). In addition, the class order gives conditional relief for the MDA operator from complying with the securities disclosure and related provisions, contained in Ch 6D of the Corporations Act, for securities held within an MDA.
- 7 MDA operators who provide MDAs to retail clients in reliance on [CO 04/194] must meet the conditions of that relief. The main elements of these conditions are that:
- (a) the MDA operator must issue an enhanced Financial Services Guide (FSG) containing information about the features, operation and risks of the MDAs it offers;
  - (b) the MDA operator must enter into a contract with each client to whom it provides an MDA, specifying the nature and scope of the discretion given to the MDA operator and imposing specific conduct requirements on the MDA operator;

- (c) the MDA contract must also contain an investment program, prepared for the client by the MDA operator or an external MDA adviser;
- (d) the MDA operator or an external MDA adviser must provide personal financial product advice to the client which includes the basis on which the MDA operator or external MDA adviser considers the MDA contract to be suitable for the client;
- (e) the ongoing suitability of the MDA contract for the client must be reviewed at least once every 13 months, either by the MDA operator or an external MDA adviser. This review involves the provision of personal financial product advice;
- (f) the MDA operator must not permit a client's assets to be pooled with other assets to enable an investment to be made or made on more favourable terms;
- (g) the MDA operator must maintain professional indemnity and fraud insurance at the level specified in [CO 04/194];
- (h) the MDA operator must have documented compliance measures to ensure that it operates the MDA in accordance with [CO 04/194], the Corporations Act and the Corporations Regulations 2001 (Corporations Regulations). Each year a registered company auditor must review the MDA operator's activities and documented policies and provide a statement about whether the documented measures meet the conditions of [CO 04/194] and whether the MDA operator has complied with the documented measures during that year;
- (i) the MDA operator must report to clients on a quarterly basis the particulars of all transactions on the MDA, the MDA portfolio value, and all revenue and expenses, including fees and charges, or provide substantially continuous electronic access to this information;
- (j) the MDA operator must also report all transactions annually to the client, including the nature and purpose of each transaction, and provide a report from a registered company auditor stating the auditor's opinion about whether the periodic statements have been reconciled and have not been materially misstated, and whether internal controls and other procedures of the MDA operator, and any other relevant person, were suitably designed and operated effectively; and
- (k) the MDA operator must notify ASIC if any of the class order conditions have been breached.

Note: In this consultation paper, unless otherwise specified, references to 'client' mean 'retail client' as defined in s761G of the Corporations Act and Div 2 of Pt 7.1 of Ch 7 of the Corporations Regulations.

8 [CO 04/194] also contains some tailored requirements for MDA operators that use external custodians or dealers.

- 9 Regulatory Guide 179 *Managed discretionary account services* (RG 179) provides our guidance on how MDAs for retail clients may be operated in accordance with [CO 04/194].

## Recent industry developments

- 10 We were prompted to commence a review of the MDA sector and our regulation of MDAs in light of the recent and future anticipated growth in the number of MDA offerings. We also thought that a review was necessary to address:
- (a) the development that has occurred in the industry since our original [CO 04/194] and RG 179 were released in 2004;
  - (b) two temporary no-action positions which were adopted when the class order was first released and have not been formalised into our guidance; and
  - (c) the similarities between our guidance on platforms (investor-directed portfolio services (IDPSs) and IDPS-like schemes) and our guidance on MDAs, which mean that a contemporaneous review of our guidance and relief would be sensible.

Note: We released Consultation Paper 176 *Review of ASIC policy on platforms: Update to RG 148* (CP 176) on 13 March 2012, which contained our proposed changes to our guidance and relief for platforms. We are currently finalising our revised guidance and class order relief for platforms.

- 11 Our records indicate that, in August 2012, 193 AFS licensees had licence authorisations permitting them to operate an MDA or give advice on MDAs. Approximately 25% of these AFS licensees had only obtained their MDA authorisations since 1 January 2011, indicating the significant growth in this sector in recent years. These figures do not include AFS licensees that offer MDAs by relying on our no-action positions.
- 12 In particular, we have seen an increase in the number of MDAs that are structured as separately managed accounts—also known as model portfolios. MDA operators that offer these accounts devise a series of model investment portfolios, each with its own investment strategy and mandate. Similar investment decisions apply to all clients whose investment program aligns with that model portfolio. This type of MDA service can facilitate greater economies of scale. In the United States, these types of account are the dominant type of discretionary account.
- 13 Other industry developments that have come to our attention include:
- (a) an increasing number of MDA services that use extensive outsourcing arrangements to deliver an MDA, including outsourcing administration, reporting or investment management functions;



- (b) greater integration between MDAs and platforms, with many MDA operators electing to administer and operate their client accounts on a platform;
- (c) the development of MDA business models that target certain market segments, such as self-managed superannuation fund (SMSF) trustees;
- (d) the development of MDA offerings through registered managed investment schemes; and
- (e) a greater variety of investments being included within some MDAs, including unlisted and illiquid investments and over-the-counter (OTC) derivatives.

## Our review of the MDA sector

- 14 Over the course of 2011–12, we have reviewed the growth and development of the MDA sector, and the operation of our guidance and relief, including whether our guidance and relief facilitated competition and innovation within the MDA sector, whether it was consistent with our guidance and requirements for comparable financial products, and whether it contained sufficient mechanisms to promote confident and informed consumers and investors.
- 15 We have conducted research on industry developments and reviewed the various MDAs currently on offer. We have also consulted representative associations and industry participants representing several different business models and sought their views on the operation and effectiveness of our current guidance and relief.
- 16 We also consulted the US Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) in the United States, the Financial Services Authority (FSA) in the United Kingdom, and the Ontario Securities Commission in Canada to gain an understanding of the regulation of MDAs in these jurisdictions, and any emerging issues or risks identified by these regulatory bodies.
- 17 Our review found that, while most stakeholders considered that our regulatory framework was appropriate, there were several areas where further clarification of our guidance would be helpful to assist MDA operators to understand and comply with our requirements. We also identified some areas where our relief could benefit from clarification or revision to better address industry developments.
- 18 In particular, we found that:
- (a) there was likely to be an increase in MDA offerings in coming years as many AFS licensees that provide financial product advice consider how

to adapt and refocus their businesses to comply with the Future of Financial Advice (FOFA) reforms;

- (b) there was a need to ensure that MDA operators have the necessary resources and expertise to operate an MDA effectively and compliantly;
- (c) some aspects of our guidance and relief could be explained more clearly to assist current and potential MDA operators, and to help AFS licensees avoid unauthorised provision of an MDA;
- (d) the two no-action positions taken by ASIC when our guidance was first released should be reviewed and, if appropriate, integrated into [CO 04/194] and RG 179;
- (e) several different MDA business models have emerged, including MDAs that focus on particular products (e.g. OTC derivatives) or target particular investor segments (e.g. SMSFs);
- (f) there were concerns that some MDA investors do not sufficiently understand the operation and risks of some MDAs; and
- (g) in instances where MDA operators failed to meet our regulatory requirements, poor management of conflicts of interest was a common theme.

- 19 As a result, we have identified several areas where we think our current relief should be modified and our guidance could be strengthened to promote confident and informed consumers and investors, and to ensure that our requirements for MDA operators are clearly understood, appropriate given the nature of the products or services they are offering, and consistent with the requirements we impose on other financial products and services.

## Overview of our proposals

- 20 This consultation paper focuses primarily on the provision of MDAs to retail clients, in reliance on [CO 04/194], except where we have expressly indicated otherwise.
- 21 Our review found that the basic framework and approach of our guidance and relief for MDAs continue to work effectively and do not require substantial revision.
- 22 We propose to retain most elements of our current guidance and relief for the provision of MDAs to retail clients, including our definition of an MDA, as well as our AFS licensing requirements, conduct requirements for MDA operators, MDA contract and investment program conditions, client reporting requirements and the MDA annual review condition.
- 23 We have, however, identified some areas where our guidance and conditions of relief need revision to resolve ambiguities, to ensure that our guidance and

relief on MDAs are consistent with other relevant ASIC guidance and relief, and to promote confident and informed consumers and investors.

24

In particular, we propose to:

- (a) revoke the two outstanding no-action letters, incorporate a modified version of the relief offered under those letters into [CO 04/194], and provide guidance on our modified relief in RG 179;
- (b) require MDA operators to meet enhanced financial requirements, similar to those that have applied to responsible entities since 1 November 2012;
- (c) require MDA operators that provide custodial and depository services and external MDA custodians to meet enhanced financial requirements, equivalent to those proposed in Consultation Paper 194 *Financial requirements for custodial or depository service providers* (CP 194);
- (d) prohibit MDA operators from investing any of the retail client's portfolio assets in products or arrangements where recourse is not limited (e.g. contracts for difference);
- (e) require specific upfront disclosure about how the client may terminate their MDA contract;
- (f) require specific upfront disclosure about the operation of outsourcing arrangements, where the MDA operator outsources significant functions of the MDA; and
- (g) update our guidance to reflect the changes in the law that have been implemented as part of the FOFA reforms.

25

We have also identified some areas where we propose to provide new or enhanced guidance for MDA operators. These matters are outlined in Sections D–F.

## B Resolving the two outstanding no-action positions

### Key points

We propose to revoke our two temporary no-action letters, which were adopted when RG 179 and [CO 04/194] were first issued, and to incorporate within our guidance and relief our final position on the issues they address.

We do not think it is desirable or appropriate to continue, in its current form, the relief given by the no-action positions.

We propose to continue to give relief from our licensing requirements for AFS licensees that undertake discretionary trading in financial products on behalf of their family members—however, we propose to limit the scope of the definition of ‘family’ for the purposes of this relief, and also to require AFS licensees who use this relief to comply with certain requirements relating to disclosure, compensation arrangements, dispute resolution, and monitoring and supervision.

We propose to revoke the regulated platform no-action letter and instead require AFS licensees who currently rely on this no-action position to comply with our licensing requirements for MDA operators and the conditions of [CO 04/194], with some modifications, as outlined in this section. We propose to provide a two-year transition period to give licensees time to apply for the necessary AFS licence authorisations or to wind up their MDA activities.

- 26 When RG 179 and [CO 04/194] were first issued, there was some uncertainty about how our guidance applied to certain MDA arrangements.
- 27 To provide some comfort to industry, we issued two no-action letters, indicating that we would not take action for failure to comply with our guidance or AFS licence conditions in certain circumstances. It was intended that these no-action positions would be temporary while we liaised further with industry participants to determine whether any modifications to our regulatory approach were needed.
- 28 We consider that these no-action letters are not a desirable or transparent way to implement our guidance and relief for MDAs.

### Circumstances covered by the no-action letters

- 29 Following the release of [CO 04/194] and RG 179, the Investment and Financial Services Association (IFSA) (now the Financial Services Council (FSC)) and the Securities and Derivatives Industry Association (SDIA) (now

the Stockbrokers Association of Australia (SAA)) made separate submissions to ASIC, seeking limited relief from the requirements of [CO 04/194] and RG 179 on behalf of their members.

### **Family accounts**

30 The then SDIA sought relief from all the requirements of our guidance and relief for AFS licensees whose representatives undertake discretionary trading in financial products on behalf of their family members.

31 On 8 December 2004, we issued a no-action letter to the SDIA (the ‘family accounts no-action letter’), stating that, until ASIC advises otherwise:

ASIC does not intend to take enforcement action for failure to comply with the provisions from which relief is given under the MDA policy or have appropriate licence authorisations against a licensee. This applies only where the non-compliance is merely because the licensee’s representatives provide discretionary trading services to their immediate family members.

32 This letter stated that the temporary no-action position was taken because of some confusion among certain SDIA members about whether our guidance applied to family accounts.

33 The letter noted that ASIC’s position, as stated in Note 1 to RG 179.17, was that, if a representative of an AFS licensee undertakes discretionary trading on behalf of a family member, that trading would generally be part of the financial services business conducted by the representative’s principal (i.e. the licensee). As a result, these accounts would be considered MDAs and subject to the requirements in our guidance and class order, including licensing requirements.

34 We proposed, however, to seek further submissions from the SDIA on this matter and issued the no-action letter as an interim measure, while noting that, ‘this does not imply that ASIC’s policy is likely to change’.

### **Regulated platforms**

35 IFSA, as it was then known, sought relief from substantial elements of our guidance for situations where a financial adviser holds a limited power of attorney, enabling them to transfer funds on behalf of a client and on a discretionary basis between investments offered through a regulated platform (e.g. IDPSs, IDPS-like schemes, superannuation wraps and master trusts) but not enabling the financial adviser to contribute or withdraw funds to or from the regulated platform.

36 On 5 November 2004, we issued a no-action letter to IFSA (the ‘regulated platforms no-action letter’), addressing the situation of MDA operators who hold a limited power of attorney that is valid only within a regulated platform, and is limited to authorising the MDA operator to transfer funds between investments offered through the regulated platform, but not to

contribute or withdraw funds. The letter stated that, until ASIC advises otherwise:

ASIC will take no action against MDA operators holding limited powers of attorney for any failure to:

- (a) hold a financial services licence covering the provision of the MDA service (under Part 7.6 of the Act);
- (b) register the MDA service as a managed investment scheme (under section 601ED of the Corporations Act);
- (c) give a product disclosure statement for the financial product which is the MDA service (under Part 7.9 of the Act); or
- (d) give a product disclosure statement for a financial product acquired by a client or a prospectus for securities offered to the client, as part of the MDA service (under Chapter 6D or Part 7.9 of the Act).

37 The letter outlined, however, that these MDA operators were still required to comply with nearly all of the conditions in [CO 04/194] relating to the FSG for the MDA, the MDA contract, the investment program, the investment program review and the rights relating to the portfolio assets, as if the class order applied to the person holding the power of attorney as an MDA operator.

38 We proposed to consider whether further relief going beyond [CO 04/194] was warranted for situations where a financial adviser holds a limited power of attorney, enabling it to transfer funds between investments offered through a regulated platform. The letter noted, however, that the temporary no-action position should not be taken as an indication that ASIC was inclined to exempt these financial advisers from the AFS licence requirements for MDA operators.

## Family accounts not to be regulated as MDAs

### Proposal

**B1** We propose to revoke the family accounts no-action letter and modify [CO 04/194] to continue to exempt AFS licensees from the requirement to obtain 'MDA operator' and 'MDA advice' authorisations on their AFS licence if the only MDA accounts they operate are MDA accounts for their family members or the family members of their representatives.

#### *Your feedback*

B1Q1 Do you agree with the proposal to continue to exempt AFS licensees from the requirement to obtain MDA operator and MDA advice authorisations on their AFS licence if the only MDA accounts they operate are MDA accounts for their family members or the family members of their representatives? Why or why not?

- B1Q2 Should this proposal be limited to certain types of MDA arrangements or certain types of MDA operators (e.g. MDA operators that are market participants)? If so, please outline the limitations you would recommend and why.
- B1Q3 Will these proposals result in any costs for your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.
- B1Q4 If we were to require AFS licensees to obtain MDA operator and MDA advice authorisations on their AFS licence, even if the only MDA accounts they operate are MDA accounts for their family members or the family members of their representatives, would this result in any costs for your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.

### Proposal

- B2** For the purposes of this relief, we propose to explicitly define 'family' as 'the spouse and/or children (as defined in s995-1 of the *Income Tax Assessment Act 1997*) of an AFS licensee or its representatives'.

#### *Your feedback*

- B2Q1 Do you agree with our definition of 'family'? If you think 'family' should be defined using an alternative definition, please supply that definition and outline why it is preferred.

### Proposal

- B3** We propose that AFS licensees that operate family accounts on behalf of retail clients and rely on our licensing relief will be required to comply with specific conditions, including those listed in Table 1.

#### *Your feedback*

- B3Q1 Do you agree with our proposal that AFS licensees that operate family accounts and rely on our licensing relief will need to maintain adequate professional indemnity (PI) and fraud cover, as required by condition 1.27 in [CO 04/194] and by Regulatory Guide 126 *Compensation and insurance arrangements for AFS licensees* (RG 126), and which covers the provision of family accounts by the licensee or its representatives? If not, please outline why this PI and fraud cover is unnecessary.
- B3Q2 Do AFS licensees who are currently providing family accounts in reliance on our no-action letter already hold PI and fraud cover which covers the actions of their representatives in operating family accounts? If so, how simple or difficult was this cover to obtain?
- B3Q3 Will the proposed PI and fraud cover impose additional costs on your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.

- B3Q4 Do you think the proposed PI and fraud cover will provide compensation arrangements that sufficiently reduce the risk that compensation claims to retail clients cannot be met because of the lack of available financial resources? If you do not think the proposed cover is appropriate, please explain why and identify what cover or other arrangements you think would be more appropriate.
- B3Q5 Do you agree with our proposal that AFS licensees that operate family accounts and rely on our licensing relief will need to maintain adequate monitoring and supervision policies and processes for family accounts? If not, please explain why not.
- B3Q6 Will the proposed monitoring and supervision arrangements impose additional costs on your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.
- B3Q7 Will the proposed monitoring and supervision arrangements provide appropriate safeguards for family members by reducing the risk of inappropriate or unauthorised transactions, and by increasing the likelihood that such transactions will be detected? If you do not think these safeguards are appropriate, please suggest alternative options.
- B3Q8 Do you agree with our proposal that family account holders should have access to internal dispute resolution (IDR) and external dispute resolution (EDR) arrangements that cover the operation of the family accounts? If not, please explain why not.
- B3Q9 What benefits and disadvantages do you think will result from the implementation of this proposal? Please provide details.
- B3Q10 Do the current IDR and EDR arrangements of licensees whose representatives operate family accounts provide coverage for disputes relating to the operation of these family accounts (including disputes relating to advice, operation and dealing)? Please provide details.
- B3Q11 If these disputes are not covered under current arrangements, should the responsibility to provide access to IDR and EDR arrangements rest with the licensee? Please explain why or why not.
- B3Q12 Should the responsibility to pay any compensation arising out of claims settled through IDR or EDR rest with the licensee? Please explain why or why not.
- B3Q13 Will the proposed IDR and EDR arrangements impose additional costs on your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.



- B3Q14 For AFS licensees who are only licensed to provide financial services to wholesale clients, will the proposed IDR and EDR requirements be feasible for your business?
- B3Q15 Are there alternative mechanisms that would more effectively deliver access to dispute resolution systems and compensation for family account holders? Please identify these mechanisms and explain why they would be more effective.
- B3Q16 Do you agree with our proposal that AFS licensees that operate family accounts and rely on our licensing relief should obtain written acknowledgement by the family member covering the matters outlined in Table 1? If not, please outline your reasons.
- B3Q17 Do you think this written acknowledgement should cover any other matters? If so, please identify these and explain why.
- B3Q18 Do you agree with our proposal that, if the AFS licensee is notified that the spouse has become separated from the licensee or its representative, the discretionary authority will cease to have effect, unless, subsequent to the separation, the relevant spouse gives their consent for the discretionary authority to commence or continue? If not, please outline what other requirements, if any, should be in place to manage family accounts in the event of a relationship breakdown.

**Table 1: Proposed conditions of relief for AFS licensees that operate family accounts**

Type of condition	How to comply with the condition
PI and fraud cover	The licensee maintains adequate professional indemnity (PI) and fraud cover, as required by condition 1.27 in [CO 04/194] and Regulatory Guide 126 <i>Compensation and insurance arrangements for AFS licensees</i> (RG 126), and which covers the provision of family accounts by the licensee or its representatives.
Monitoring and supervision	The licensee maintains adequate monitoring and supervision policies and processes to ensure the scope of the discretion given is being adhered to <i>and to detect transactions that are beyond the scope of this discretion.</i>
Dispute resolution systems	The licensee provides family account holders with access to a dispute resolution system that covers the operation of family account MDAs, including: <ul style="list-style-type: none"> <li>• internal dispute resolution (IDR) procedures that comply with the standards and requirements made or approved by ASIC; and</li> <li>• membership of one or more ASIC-approved external dispute resolution (EDR) schemes that covers—or together cover—complaints made by retail clients in relation to the operation of the family accounts (other than complaints that may be dealt with by the Superannuation Complaints Tribunal (SCT)).</li> </ul>

Type of condition	How to comply with the condition
Written acknowledgement by family member	<p>The licensee obtains written acknowledgement by the family member, if the family member has legal capacity, that:</p> <ul style="list-style-type: none"> <li>• the AFS licensee or its representative is authorised by the family member to deal on the account;</li> <li>• confirmations of the transaction will be sent to an address nominated by the family member; and</li> <li>• where relevant, the account of the family member will be considered to be a staff account subject to the surveillance usually applied to staff proprietary investment decisions and reviewed in accordance with the firm's staff proprietary investment and trading procedures.</li> </ul>
Separation of spouse from licensee or representative	<p>If the licensee is notified that a spouse has become separated (within the meaning of the <i>Family Law Act 1975</i>) from the licensee or its representative, the discretionary authority will cease to have effect, unless, subsequent to the separation, the relevant spouse gives their consent for the discretionary authority to commence or continue. If a spouse becomes divorced from the licensee or its representative, the licensee will no longer be able to operate a family account MDA for that person under our licensing relief.</p>

## Rationale

- 39 Incorporating our regulatory position on family account MDAs into [CO 04/194] and RG 179 improves transparency and provides greater comfort and certainty to industry, while also assisting investors to make confident and informed decisions. Our no-action letter was issued as an interim measure, and it is therefore appropriate that it is reconsidered as part of our current review.
- 40 We have reviewed our original position on family accounts and consider our position, as stated in Note 1 to RG 179.17, remains correct—that is, if a representative of an AFS licensee undertakes discretionary trading on behalf of a family member, that trading would generally be part of the financial services business conducted by the representative's principal (i.e. the licensee).
- 41 We note, however, the similarities between the activities undertaken by AFS licensees and their representatives who manage family accounts, and the activities undertaken by individuals who manage their family members' financial affairs using their own resources and in a private capacity. The latter activity would not be deemed to be carrying on a financial services business. Given the similarities in these activities, our proposed relief seeks to afford consistent treatment to AFS licensees by exempting them from the requirement to obtain MDA operator and MDA advice authorisations on their AFS licence and from complying with all the conditions of [CO 04/194] if the only MDA accounts they operate are MDA accounts for their family members or the family members of their representatives.

- 42 Given that the family member must give discretionary authority to the AFS licensee or its representative (if they have the legal capacity to do so), the high level of trust that exists within most family relationships, the professional expertise of the representative, and the alignment of interests that commonly occurs between family members, we consider that imposing our full MDA licence requirements would be of limited value for family accounts.
- 43 The more extensive the scope of family members for whom the AFS licensee and/or its representatives can offer family accounts, the greater the risk, however, that the interests of the family member and the AFS licensee or its representatives are not aligned. Because of this risk, we propose to limit the definition of ‘family’ for the purposes of our relief to ‘the spouse and/or children (as defined by s995-1 of the *Income Tax Assessment Act 1997*) of an AFS licensee or its representatives’.
- 44 While we have proposed to exempt AFS licensees from the requirement to obtain MDA operator and MDA advice authorisations on their AFS licence for the purpose of operating family accounts, we consider it is important that licensees comply with specific conditions relating to adequate compensation arrangements, monitoring and supervision, dispute resolution and obtaining a written acknowledgement from the family member (where they have legal capacity to sign such an acknowledgement).
- 45 We recognise that these conditions will impose additional costs on AFS licensees that currently offer family accounts—however, we think that the benefits for family account holders justify these costs. If we implement our proposals, licensees may elect to rely on our additional relief for family accounts, or to comply with our general regulatory requirements for MDAs, as contained in [CO 04/194] and RG 179. Alternatively, licensees may choose to cease offering MDA accounts for family members and, instead, operate family accounts under instruction—in which case these accounts would cease to be MDAs.

## Switches on regulated platforms to be regulated as MDAs

### Proposal

- B4** We propose to revoke the regulated platforms no-action letter and modify our guidance to specify that:
- (a) where AFS licensees or their representatives give instructions at their discretion to regulated platform providers, including instructions to switch between investment options, these arrangements will be regulated as MDAs; and
  - (b) AFS licensees that wish to undertake this activity will need to obtain the relevant AFS licence authorisations.

*Your feedback*

- B4Q1 Do you agree with our proposal to require AFS licensees offering MDAs through a regulated platform to obtain the relevant AFS licence authorisations? If not, please explain why you think this licensing relief should continue, given the similarity between MDAs operated through regulated platforms and other MDAs.
- B4Q2 Will this proposal impose costs on your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.

**Proposal**

- B5** We propose to provide a two-year transition period from the time that our revised regulatory guidance and class order are issued to allow AFS licensees and their representatives who are currently relying on the no-action position time to obtain the relevant AFS licence authorisations or to wind up their MDA business.

*Your feedback*

- B5Q1 Will this transition period assist AFS licensees and their representatives who are currently relying on the no-action position to adjust to the proposed changes to our guidance and relief? Please explain if you think a shorter or longer transition period is needed and why.

**Proposal**

- B6** We propose that, where all of an MDA operator's MDA investments are contained on a regulated platform, the MDA operator must comply with the same operation, disclosure and conduct requirements that apply to other MDA operators, except for the following:
- (a) the MDA operator does not have to issue transactional reports for clients if the transactions have been, or will be, reported to the client or MDA operator by the regulated platform operator, as long as the MDA operator ensures that:
    - (i) the reports generated by the regulated platform are passed on to clients if they are sent via an address of the MDA operator; and
    - (ii) as soon as reasonably practicable following the reports being provided by the regulated platform operator, the MDA operator reviews the transaction details in the report and reports any exceptions or anomalies to clients; and
  - (b) the MDA operator does not need to provide its MDA clients with an annual statement from a registered company auditor providing their opinion whether transactional reports have, or have not, been materially misstated.

*Your feedback*

- B6Q1 Do you agree with our proposal to exempt MDA operators from issuing transactional reports and an audit opinion on those reports to clients when all investments of the MDA are held through a regulated platform and the regulated platform provider reports transactions to clients? If not, why not?
- B6Q2 Do you agree with our proposal that AFS licensees offering MDAs through a regulated platform must comply with our MDA guidance and relief in all other respects? If not, please identify any further modifications or concessions that you think are warranted, and explain why.
- B6Q3 Are any additional modifications to our conditions of relief needed to address the situation where only some of the assets of a client's MDA are invested through a regulated platform? If so, please outline how you think these modifications should operate.

**Proposal**

- B7** For the purposes of proposals B4–B6, we propose to define a 'regulated platform' as 'an IDPS, IDPS-like scheme or superannuation entity'.

*Your feedback*

- B7Q1 Do you agree with our proposal to explicitly define 'regulated platform' in this way? If not, please suggest an alternative definition.

**Rationale**

- 46 Incorporating our regulatory position on regulated platform MDAs into [CO 04/194] and RG 179 improves transparency, provides greater comfort and certainty to industry, and facilitates informed and confident decision-making by consumers and investors. Our no-action letter was issued as an interim measure, and it is therefore appropriate that it is reconsidered as part of our current review, and our final position incorporated into our main guidance and relief.
- 47 In our discussions with MDA operators, as part of our regulatory review, several operators raised concerns that the regulated platforms no-action letter created an alternative, less onerous regulatory regime for some MDA operators in comparison to others. Although the existing no-action approach does not permit the discretionary withdrawal of funds from the platform, we do not think there is a strong argument for maintaining the current regulatory distinction between different types of MDAs, depending on whether or not they are offered through a regulated platform.

- 48 Platforms have undergone significant change and development since the no-action letter was issued. Many platforms now have a very wide range of investments available through the platform, including many direct investments. This broader range of investment options increases the similarities between many MDA arrangements operated in reliance on the no-action position and other MDA arrangements operated under [CO 04/194] and RG 179.
- 49 While some MDA operators use the no-action letter in a limited way to undertake portfolio rebalancing between managed investments, we understand that other operators have interpreted the boundaries of the no-action position quite expansively, and consider that trading in equities or other assets and setting up and operating ‘model portfolios’ for clients can be done within the bounds of the relief. We think that these latter activities are very similar to those undertaken by MDA operators that do not use the no-action letter and must comply with our general guidance on MDAs. We therefore think that it is appropriate and simpler to apply similar regulatory requirements.
- 50 We think that our proposals facilitate the concurrent provision of MDAs and regulated platforms. Our proposals balance ASIC’s aim to avoid imposing duplicate requirements on MDA operators with the need to ensure that investors who invest in an MDA operated on a regulated platform are afforded adequate protections, given the significant level of control that the client gives to the MDA operator.
- 51 Our proposed transition period will give AFS licensees and their representatives who are currently relying on the no-action position a reasonable period of time in which to obtain the relevant AFS licence authorisations or to wind up their MDA business. When assessing applications to add MDA licence authorisations during the transition period, we will take into consideration the experience gained by a licensee under the no-action position for regulated platforms, to the extent that it is equivalent to the MDA business proposed to be undertaken by that licensee. Applicants will still need to meet the minimum experience requirements set out in Regulatory Guide 105 *Licensing: Organisational competence* (RG 105).

## C Updating financial requirements for MDA operators

### Key points

We have recently reviewed the financial requirements for responsible entities of managed investment schemes (including IDPS-like schemes) and IDPS operators. We have also recently consulted on revised financial requirements for AFS licensees that operate custodial or depository services, and the requirements that apply to scheme property holding arrangements for registered managed investment schemes (registered schemes).

We propose to increase the financial requirements for MDA operators to ensure that these correspond with the requirements that have applied to responsible entities of managed investment schemes since 1 November 2012 and with our proposed financial requirements for platform operators. We also propose to apply to MDA operators the same financial requirements as proposed to apply to responsible entities having regard to scheme property holding arrangements.

It is important that MDA operators maintain adequate financial resources to operate their MDAs effectively and compliantly. We think that increased financial requirements will assist in achieving this objective, and will also ensure that our regulatory requirements for MDA operators are similar to the requirements for comparable investment arrangements, including registered schemes (including IDPS-like schemes) and IDPSs.

## Proposed new financial requirements

### Proposal

- c1 We propose that MDA operators should be subject to updated financial requirements that are similar to the financial requirements that have applied to responsible entities of managed investment schemes since 1 November 2012 and that we have proposed to apply to platform operators, as outlined in Regulatory Guide 166 *Licensing: Financial requirements* (RG 166) (revised version forthcoming). We also propose to apply to MDA operators the same financial requirements as proposed to apply to responsible entities having regard to scheme property holding arrangements. In particular, we propose that MDA operators should meet:
- (a) the standard solvency and positive net assets requirement that applies to all AFS licensees;
  - (b) a tailored cash needs requirement similar to the requirement that applies to responsible entities;

- (c) a tailored audit requirement similar to the requirement that applies to responsible entities; and
- (d) a net tangible assets (NTA) requirement similar to that which is proposed to apply to responsible entities.

See Table 2 for more details of the proposed financial requirements.

*Your feedback*

- C1Q1 Do you agree with our proposal that MDA operators should be subject to similar financial requirements to those that apply to the responsible entities of managed investment schemes? If not, why not?
- C1Q2 Do you agree that this proposal is appropriate, given the level of risk carried by MDA operators? Why or why not?
- C1Q3 Are there any practical problems with the implementation of this proposal? If so, please give details.
- C1Q4 Are there any circumstances in which the proposed financial requirements should not apply? Please specify.

**Table 2: Proposed financial requirements for MDA operators**

Financial requirements that you must meet	How to meet this requirement
Standard solvency and positive net assets requirement	See RG 166.34–RG 166.36 in Section B of RG 166 (version issued in November 2012).  Note: These requirements apply to all AFS licensees.
Tailored cash needs requirement	<p><b>Projection</b></p> <p><b>1</b> Prepare a projection of your cash flows over at least the next 12 months based on your reasonable estimate of what is likely to happen over this term.</p> <p>Note: You can take into account, for example, the following factors in preparing your projection <i>if</i> you reasonably believe they are likely to be available: assets you hold at the time the projection starts that can be used to pay your liabilities; and inflows you may receive, including income from your business, amounts that you may borrow (e.g. under an overdraft), and amounts that you may receive from an eligible provider under an eligible undertaking.</p> <p><b>2</b> Document your calculations and assumptions on which the projection is based, and describe in writing why they are the appropriate assumptions.</p> <p>Note: We expect that a <i>description</i> in writing of your calculations and assumptions will vary according to the nature, scale and complexity of your business.</p> <p><b>3</b> Update your projection of cash flows when:</p> <ul style="list-style-type: none"> <li>(a) those cash flows cease to cover the next 12 months;</li> <li>(b) there is a material change; or</li> <li>(c) you have reason to suspect that an updated projection would show that you were not meeting items 5 or 6 below.</li> </ul> <p>Note: A 'material change' is a change for which it would be reasonable for you to plan by updating your cash flow projection.</p>



Financial requirements that you must meet	How to meet this requirement
Tailored cash needs requirement— <i>continued</i>	<p><b>4</b> Have your cash flow projection approved by the board of directors, or other governing body if applicable, at least quarterly as satisfying the requirements in this cash needs requirement.</p> <p><b>Financial resources</b></p> <p><b>5</b> Show, based on your projection of cash flows, that you will have access as needed to enough financial resources to meet your liabilities over the projected term of at least the next 12 months, including any additional liabilities you project will be incurred during that term.</p> <p><b>6</b> Demonstrate, based on the projection of your cash flows, that you will hold at all times during the period to which the projection relates, in cash or cash equivalents, an amount equal to or greater than the current amount you are required to hold in cash or cash equivalents. For MDA operators, cash or cash equivalents means:</p> <ul style="list-style-type: none"> <li>(a) cash on hand, demand deposits and money deposited with an Australian authorised deposit-taking institution (ADI) that is available for immediate withdrawal;</li> <li>(b) short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value;</li> <li>(c) the value of any eligible undertaking provided by an eligible provider; and</li> <li>(d) a commitment to provide cash from an eligible provider that can be drawn down within five business days and has a maturity of at least six months.</li> </ul>
Tailored audit requirement	<p>Your audit report must include statements by a registered company auditor addressed to you and ASIC that, for the relevant period:</p> <ul style="list-style-type: none"> <li>(a) in the auditor's opinion, you: <ul style="list-style-type: none"> <li>(i) complied with the NTA requirements (see below) and any other financial requirements applying to you;</li> <li>(ii) had, at all times, cash flow projections (covering at least the following 12 months) that purported to, and on their face appeared to, demonstrate your solvency; and</li> <li>(iii) correctly calculated the cash flow projections based on the assumptions you based them on; and</li> </ul> </li> <li>(b) following an examination of the documents you relied on to create your cash flow projections, the auditor has no reason to believe that: <ul style="list-style-type: none"> <li>(i) you did not satisfy s912A(1)(h) of the Corporations Act for managing the risk of having insufficient funds to meet the NTA requirements (see below) and any other financial requirements applying to you;</li> <li>(ii) you failed to prepare cash flow projections as required, failed to have these projections approved by your board or governing body, or failed to document the calculations used in creating the cash flow projections and explain why they are appropriate; and</li> <li>(iii) the assumptions you used to create the cash flow projections were inappropriate.</li> </ul> </li> </ul>

Financial requirements that you must meet	How to meet this requirement
Tailored audit requirement— <i>continued</i>	Note: We refer to the auditor statements in paragraph (a) as ‘positive assurance’ and the statements in paragraph (b) as ‘negative assurance’. We expect that when giving negative assurance for the purposes of paragraph (b), the auditor will take into consideration any information from the audit for positive assurance.
Net tangible assets (NTA) requirement	<p>MDA operators that do not provide custodial and depository services must hold at all times minimum NTA of the greater of:</p> <ul style="list-style-type: none"> <li>(a) \$150,000;</li> <li>(b) 0.5% of the average value of all of the client’s portfolio assets of the MDAs you operate up to \$5 million NTA; or</li> <li>(c) 10% of your average MDA operator revenue with no maximum NTA.</li> </ul> <p>MDA operators that provide custodial and depository services must hold at all times minimum NTA of the greater of:</p> <ul style="list-style-type: none"> <li>(a) \$10 million;</li> <li>(b) 10% of your average MDA operator revenue with no maximum NTA.</li> </ul> <p>Note: See proposals C3–C4 for further information about the proposed financial requirements for external MDA custodians and MDA operators that provide custodial and depository services.</p>
Other requirements	Depending on the financial products and services you offer, you must meet any other requirements set out in RG 166 that apply to you.

## Proposal

- c2** For the purposes of proposal C1, we propose to define ‘client’s portfolio assets’ as ‘financial products and other property that are the client’s contributions or that are derived directly or indirectly from the client’s contributions’ (this is the same definition that is currently used in [CO 04/194]). We also propose to define ‘average MDA operator revenue’ as:
- (a) in the first financial year in which the licensee is first authorised to operate an MDA, the licensee’s reasonable forecast of its revenue from the date it was first authorised for the remainder of the first financial year pro-rated to a 12-month period;
  - (b) in the next financial year after the first financial year in which the licensee was first authorised to operate an MDA, the average of the aggregate of the licensee’s:
    - (i) actual revenue for the second financial year to date, plus reasonable forecast of its revenue for the remainder of the second financial year; and
    - (ii) revenue in the first financial year from the calculation date pro-rated to a 12-month period;
  - (c) in its second financial year after the first financial year in which the licensee was first authorised to operate an MDA, the average of:

- (i) the aggregate of the licensee's revenue for the financial year to date and reasonable forecast of its revenue for the remainder of the financial year;
  - (ii) the licensee's revenue for its previous financial year; and
  - (iii) the revenue in the first financial year in which the licensee was first authorised to operate an MDA from the date of that authorisation pro-rated to a 12-month period; and
- (d) for all subsequent financial years, the average of:
- (i) the aggregate of the licensee's revenue for the current financial year to date and reasonable forecast of its revenue for the remainder of the current financial year;
  - (ii) the licensee's revenue for the last preceding financial year; and
  - (iii) the licensee's revenue for the second preceding financial year.

In determining average MDA operator revenue, an MDA operator should include the revenue of persons performing the functions relating to an MDA for which the MDA operator is responsible (e.g. functions outsourced to other entities).

#### *Your feedback*

C2Q1 Do you agree with our proposed definition of 'client's portfolio assets'? If you think that 'client's portfolio assets' should be defined using an alternative definition, please supply that definition and outline why it is preferred.

C2Q2 Do you agree with our proposed definition of 'average MDA operator revenue'? If you think that 'average MDA operator revenue' should be defined using an alternative definition, please supply that definition and outline why it is preferred.

## **Rationale**

- 52 It is important that MDA operators maintain adequate financial resources to operate their MDAs effectively and compliantly. We consider that it is appropriate for AFS licensees that are managing investors' money, and making discretionary investment decisions on behalf of investors, to have sufficient equity within their businesses.
- 53 While increased financial requirements will not prevent MDA operator failure, they will facilitate the orderly transfer or winding-up of the MDA business, if that becomes necessary.
- 54 While the functions of an MDA operator and a responsible entity differ in some respects, in many key aspects they are similar. Both are typically primarily responsible for managing investments and making discretionary investment decisions on behalf of investors. In addition, some MDA operators elect to structure their MDA offering as a registered scheme. These

operators are already subject to the higher financial requirements that apply to responsible entities. For these reasons, it is desirable that MDAs and registered schemes are subject to similar financial requirements.

- 55 Enhanced capital requirements will ensure that MDA operators are adequately resourced and committed to their MDA business, and also increase the incentives for the operator to strive to operate the MDA effectively and compliantly.
- 56 In our consultation with current MDA operators, most operators also identified small, inadequately resourced and inexperienced operators as one of the greatest risks within the MDA sector. Our proposal seeks to address this concern.
- 57 If the MDA operator is a responsible entity, average responsible entity revenue, as defined in Class Order [CO 11/1140] *Financial requirements for responsible entities*, is included in MDA operator revenue. We will adopt a similar approach to MDA operators that are also IDPS operators. MDA operators who are also responsible entities or IDPS operators can utilise the same capital to meet their multiple financial resources requirements; however, they must ensure that this capital is sufficient to meet the requirements of each obligation.

## Ensuring consistency with financial requirements for providers of custodial and depository services

### Proposal

- c3 We propose that external MDA custodians must meet the same requirements as those we propose to apply under CP 194 to providers of custodial or depository services that are not incidental providers. This includes the requirement to hold net tangible assets (NTA) of \$10 million, or 10% of average revenue, whichever is higher. In determining average revenue, an MDA operator should include the revenue of persons performing the functions relating to an MDA for which the MDA operator is responsible (e.g. functions outsourced to other entities).

#### Your feedback

- C3Q1 Do you agree with our proposal that external MDA custodians must meet the same requirements as those we proposed to apply under CP 194 to providers of custodial or depository services? If you disagree, please explain why.

## Proposal

- c4** We propose that MDA operators responsible for holding client portfolio assets must meet the same requirements as those we proposed to apply under CP 194 to responsible entities that hold scheme property. This includes the requirement to hold NTA of \$10 million, or 10% of average revenue, whichever is higher, unless the MDA operator arranges for the client portfolio assets to be held by a person licensed to provide a custodial or depository service that is not an incidental provider or a body regulated by the Australian Prudential Regulation Authority (APRA).

We propose to exclude MDA operators who are responsible for holding client portfolio assets from the definition of 'incidental custodial or depository services' as defined in CP 194. This means these MDA operators would not be able to fulfil their NTA obligations by meeting the reduced minimum NTA requirements for incidental providers of custodial and depository services. In determining average revenue, an MDA operator should include the revenue of persons performing the functions relating to an MDA for which the MDA operator is responsible (e.g. functions outsourced to other entities).

### *Your feedback*

- C4Q1 Do you agree with our proposal that MDA operators responsible for holding client portfolio assets must meet the same requirements as those we proposed to apply under CP 194 to responsible entities that hold scheme property unless the MDA operator arranges for the client portfolio assets to be held by a person licensed to provide a custodial or depository service? If you disagree, please explain why.

## Rationale

- 58 Our proposal means that MDA operators who hold client portfolio assets would be excluded from the definition of incidental custodial and depository services, and would therefore need to meet the financial requirements proposed for custodians. Details of these requirements are set out in CP 194.
- 59 This corresponds with the approach we have proposed to adopt for responsible entities who hold scheme property and IDPS operators, as outlined in CP 194. We consider that retail investors in managed investment schemes place significant reliance on arrangements made by responsible entities, IDPS operators and MDA operators for safe custody of their assets, and so our proposal is designed to ensure that MDA operators who hold client portfolio assets have robust and well resourced custodial arrangements.

## D Improving disclosure for MDA investors

### Key points

Our MDA disclosure requirements are designed to be flexible enough to accommodate the wide variety of MDAs that are regulated by us.

Disclosure plays an important role in encouraging confident and informed consumer and investor decision making in relation to financial products and services.

We think it would be beneficial for MDA operators and investors if our guidance contained more detailed disclosure requirements in relation to:

- the investment strategy and program;
- fees charged within the MDA;
- outsourcing arrangements (where these are employed); and
- how the MDA contract may be terminated.

### The investment program, MDA contract and advice about the MDA

#### Proposal

- D1 We propose to refine our conditions relating to the MDA contract, investment program and financial advice to make it clear that:
- (a) the investment program that forms part of the MDA contract must contain an investment strategy;
  - (b) the invest strategy must contain sufficient detail to permit an opinion to formed on the suitability of the investment program for a particular client;
  - (c) the investment program forms part of the MDA contract;
  - (d) the MDA operator or an external MDA adviser must provide personal advice about the MDA contract, *including the investment program*, on an annual basis. This personal advice must meet the conduct and disclosure obligations under Pt 7.7 and Pt 7.7A of the Corporations Act that apply to personal advice (including the obligation for the AFS licensee or its authorised representative to prepare and provide a Statement of Advice (SOA) or record of advice, and the obligation for the advice provider to act in the best interests of the client, provide appropriate advice, warn the client where advice is based on inaccurate or incomplete information, and prioritise the interests of the client), and must contain advice about whether the MDA contract for that client, *including the investment program*, continues to be suitable in light of the client's personal objectives, needs and relevant personal circumstances.

*Your feedback*

- D1Q1 Do you agree with our proposal to introduce an explicit requirement for the investment program to contain an investment strategy? If not, why not?
- D1Q2 Do you agree with our proposed clarification that personal advice about the MDA must state that the MDA contract *including the investment program* is appropriate to the client's financial situation, needs and objectives? If not, please explain why.
- D1Q3 Are there any other aspects of our investment program, MDA contract or SOA requirements that need clarification or refinement? If so, please provide details.

**Rationale**

- 60 We think there is some ambiguity in our current guidance about the content of the investment program and the interaction between the investment program, the MDA contract and financial advice about the MDA. We propose to clarify the requirements in [CO 04/194] to resolve these ambiguities.
- 61 We also propose to explicitly require that the investment program must contain the proposed investment strategy for the MDA. We know that, in practice, MDA operators and advisers generally include specific statements or information about the investment strategy within the investment program. Our proposal seeks to formalise this practice by making it explicitly required under our instrument of relief.

**Fee disclosure****Proposal**

- D2 We propose to clarify that the FSG and MDA contract must contain information about the fees and costs of the MDA in a manner that is consistent with Sch 10 of the Corporations Regulations.

*Your feedback*

- D2Q1 Do you agree with this proposal? If not, why not?
- D2Q2 Do you think that this proposal will assist investors to more easily compare different MDAs, or an MDA and an alternative investment?
- D2Q3 Do you think that this proposal will assist investors to make better, more informed decisions about whether to invest in an MDA? Please explain your views.

## Rationale

- 62 This proposal seeks to promote confident and informed consumer and investor decision making by assisting clients to more readily ascertain the fees and costs involved in a particular MDA, and to compare these with the fees and costs associated with other MDAs and other managed investments.
- 63 Our proposal makes explicit requirements about fee disclosure that are already implicit in our requirements for the content of the FSG. We think it is important that fee information is also included within the MDA contract, because this sets out the terms that govern the relationship between the MDA operator and the client.
- 64 For details of our proposed guidance in relation to ongoing fee arrangements and fee disclosure statements, please see proposal F5.

## Outsourcing arrangements

### Proposal

- D3 We propose to require the FSG for the MDA to provide a description of the operation of outsourcing arrangements that apply to the MDA, where relevant. This description should cover:
- (a) the entities involved and the functions they perform; and
  - (b) how outsourced arrangements will be monitored.

#### *Your feedback*

D3Q1 Do you agree with this proposal? Please explain your response.

## Rationale

- 65 Several MDA business models use extensive outsourcing arrangements to deliver the MDA. To assist retail investors in making informed decisions about whether or not to invest in an MDA, we propose to require a brief description of the operation of outsourcing arrangements that apply to the MDA in the upfront disclosure in the FSG.
- 66 We recognise that many MDA operators outsource functions that relate to their AFS licence or their operation of MDAs, including administrative or operational functions. While MDA operators may engage external providers to perform functions on their behalf, they remain responsible for the discharge of those functions and for meeting the obligations under their AFS licence, the Corporations Act and under [CO 04/194].



## Terminating the MDA

### Proposal

- D4** We propose to require both the FSG and the MDA contract to contain information about how the client may terminate the MDA contract including:
- (a) how the instruction to terminate must be communicated;
  - (b) how long it will take for the termination to take effect; and
  - (c) how the MDA assets will be disposed of, or transferred to the client, if those assets are not held directly by the client.

#### *Your feedback*

- D4Q1** Do you agree with this proposal to require explicit upfront disclosure of how the client may terminate the MDA contract, and the processes for ceasing the MDA arrangement? Please provide details.
- D4Q2** Will this proposal assist retail clients to better understand the operation of their MDA contract, how they can terminate that contract and the impact of any termination? If not please explain why.
- D4Q3** Are there any other conduct or disclosure requirements that should be imposed on MDA operators to ensure that retail investors are able to terminate the MDA if they so choose?

### Proposal

- D5** We propose to require that the length of time required by an MDA operator for the termination to take effect must be no longer than is reasonably necessary.

#### *Your feedback*

- D5Q1** Do you agree with our proposal to require that the length of time required by an MDA operator for the termination to take effect must be no longer than is reasonably necessary? If not, please explain why.

### Proposal

- D6** We propose to require MDA operators to:
- (a) formulate a policy outlining the steps they will take to terminate an MDA contract when under the terms of the MDA contract it is to be terminated or when the MDA contract no longer meets our conditions of relief (for example, if an the annual review of the investment program is not completed within the required timeframe); and
  - (b) disclose the details of this policy to investors in the FSG.

*Your feedback*

- D6Q1 Do you agree with our proposal to require MDA operators to formulate a policy outlining the steps they will take if a client opts out of receiving ongoing advice? If not please provide details
- D6Q2 Do you agree with our proposal to require disclosure of this policy in the FSG? If not, please explain why.

**Rationale**

- 67 To run their MDAs effectively and efficiently, MDA operators should have policies and procedures in place to ensure the orderly exit of clients from MDA contracts, including in situations where that exit may occur as a result of a client opting out of an ongoing fee arrangement, where permitted, under s962K of the Corporations Act.
- 68 Disclosing these policies to the investor upfront will ensure that investors know what they must do if they wish to terminate the MDA, and what will happen to their assets if these are held by the MDA operator or a custodian.
- 69 We also propose to provide specific guidance about how some of the FOFA provisions apply to the operation of MDAs: see proposals F3–F6.

## E Other modifications to our guidance and relief

### Key points

As a result of our review of the operation of our current guidance and relief, we identified some areas where updating and clarifying our requirements was necessary to assist MDA operators and MDA clients, or to promote consistency.

Some MDA operators make discretionary investments in products or arrangements that could incur losses that are greater than the amount invested in the product or arrangement, and would therefore require additional client contributions to cover the loss. We are seeking feedback on three alternative proposals, which seek to ensure that MDA investors are adequately informed about the specific risks involved when their MDA operator has discretion to invest in products or investment strategies with non-limited recourse.

We propose to formally incorporate into our relief additional relief for licensed trustee companies who provide traditional trustee company services who have MDA clients that become not of sound mind. This proposal extends limited relief to all licensed trustee companies who provide traditional trustee company services, whereas previously we had only offered similar relief on an application basis.

We also propose changes to our guidance and conditions of relief to harmonise the MDA breach reporting requirements with the requirements in the Corporations Act, and to clarify that [CO 04/194] only applies to the provision of MDAs to retail clients.

### Investing in arrangements where recourse is not limited

- 70 In our consultation with industry during 2012, several providers identified MDAs containing higher-risk investment products as a potential area of greater risk within the MDA sector.
- 71 Some MDA providers have discretion to invest in and trade in contracts for difference and other leveraged OTC derivatives on behalf of their MDA clients. It is possible that the discretionary trading undertaken by MDA operators in these products may result in losses that exceed the total client investment in the MDA, and therefore require additional client contributions to cover the loss. We think that MDAs that contain these types of investments are significantly more risky than other MDAs.
- 72 Depending on the size of the investment and the degree of leverage involved, an investor can suffer significant losses in a short period of time, and may end up with losses that exceed the value of the investment in their portfolio, requiring an additional contribution of funds. Because the operator can make

discretionary decisions on behalf of an investor, the investor may not be immediately aware of the positions held or of any losses, margin calls or other adverse events.

- 73 MDA investors are not given the PDSs for the underlying products and so may not appreciate the risks involved when their MDA operator invests in highly leveraged products. The MDA operator or adviser is required to outline the key risks of the MDA in the FSG and the investment program.
- 74 We are seeking feedback on three alternative proposals which seek to ensure that MDA investors are adequately informed about the specific risks involved when their MDA operator has discretion to invest in products or investment strategies with non-limited recourse.

### Proposal

**E1** We propose to modify our conditions of relief under one of the three options listed below:

- (a) in situations where an MDA operator may invest an MDA client's portfolio assets in non-limited recourse arrangements, the MDA operator is required to include a specific risk warning in the MDA operator's FSG and in each client's investment program, which outlines the additional risks to the client as a result of their MDA investing in non-limited recourse arrangements. The MDA operator will also be required to disclose in the investment program the degree of leverage that may be employed, the types of products used and the MDA operator's policies in relation to communicating and meeting margin calls and closing positions at a loss;
- (b) in situations where an MDA operator may invest an MDA client's portfolio assets in non-limited recourse arrangements, the MDA operator is required to seek express consent from the MDA client on each occasion when the MDA operator is proposing to invest in such a product or arrangement, and not to invest in any such product or arrangement where express consent has not been obtained; or
- (c) MDA operators are prohibited from investing retail client's portfolio assets within an MDA in non-limited recourse arrangements.

#### *Your feedback*

E1Q1 Do you agree with our proposal to modify our conditions of relief to impose specific conditions when a client's MDA operator has discretion to invest in products or investment strategies with non-limited recourse? If not, why not?

E1Q2 Do you think option (a), (b) or (c) would be most effective in addressing the additional risks faced by retail clients when an MDA operator has discretion to invest in products or investment strategies with non-limited recourse? Please outline your reasons for preferring that option.

- E1Q3 Do you think option (a), (b) or (c) would be most effective in promoting confident and informed consumer and investor decision making and investment in MDAs?
- E1Q4 If you prefer option (a), do you think the wording of the risk warning should be standardised or should MDA operators be able to tailor the warning to suit their particular MDA offering?
- E1Q5 Do you think any other measures need to be taken to address the risks faced by retail clients when higher-risk investments are included within an MDA? If so, what measures would be the most effective?
- E1Q6 Do you think there are any other classes of investment products or strategies that should be subject to the same conditions outlined in this proposal? Please identify which investments or strategies, and why.
- E1Q7 Will any of the three options impose costs on your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing

## Proposal

- E2** For the purpose of all three options outlined in proposal E1, we propose to define a ‘non-limited recourse product or arrangement’ as ‘an obligation imposed on a person under an agreement to pay an amount to another person in the event of the occurrence or non-occurrence of something, where the rights of the other person are not limited to any property that the first person has paid or set aside as security for the payment, including property to be transferred by the other person to the first person on completion of the obligation under the agreement’.

### *Your feedback*

- E2Q1 Do you agree with our proposed definition of a ‘non-limited recourse product or arrangement’? If you think an alternative definition should be used, please supply that definition and outline why it is preferred.
- E2Q2 Should the definition specifically exclude certain types or classes of non-limited recourse products or arrangements that involve lower risks for investors? If so, which investments should be excluded?

## Rationale

75

Our current class order relief does not impose any limitations on what financial products can be included within an MDA (aside from prohibitions on investments in unregistered schemes). We have adopted this approach to ensure that MDA operators have the flexibility to structure their MDA offering to best suit the needs of their particular clients.

76 MDA operators, or an external MDA adviser, are required to formulate an investment program which sets the investment strategy for the MDA. Some investment programs specifically mention the products or class of products that will be included in the MDA for that client, whereas other investment programs provide less specific information on this point. MDA investors delegate significant control and authority to the MDA operator. We think it is appropriate to limit operators' ability to use their discretion to invest in products that could generate additional liabilities for the client.

## MDA clients that become *non compos mentis* or of unsound mind

### Proposal

- E3 We propose to modify the conditions of our relief so that, when a licensed trustee company who provides traditional trustee company services which include acting as an attorney under an enduring power of attorney (EPA):
- (a) is acting as an attorney for an MDA client under an EPA;
  - (b) is providing an MDA service to the client under [CO 04/194]; and
  - (c) the client subsequently loses legal capacity as a result of becoming of unsound mind,

we will modify the MDA reporting requirements so that the trustee company who is the MDA operator would be required to maintain and prepare the ongoing disclosure documentation required by [CO 04/194] and retain a copy for seven years and:

- (a) give the documentation to the next of kin of the client; or
- (b) where there is no next of kin, or it is not appropriate or practicable to give the documentation to the next of kin, the documentation may be provided to a guardian, administrator or manager of the client.

### Your feedback

- E3Q1 Do you agree with our proposal to formally incorporate the above relief for trustee companies who are licensed to provide traditional trustee company services and who hold EPAs for MDA clients who subsequently lose capacity? If not please explain why.
- E3Q2 Do you think our proposal to give MDA operators who are licensed to provide traditional trustee company services alternative options for the delivery of MDA documentation is appropriate in these circumstances? If not, please explain why.
- E3Q3 Are there any alternative options that should be made available to MDA operators who are licensed to provide traditional trustee company services? If so, please outline what other options should be available and why?

- E3Q4 Are there any other alternative requirements or modifications that should be imposed on MDA operators who are licensed to provide traditional trustee company services when a client loses legal capacity because they are of unsound mind? If so, please outline what other requirements or modifications should apply and why?
- E3Q5 Aside from MDA operators who are licensed to provide traditional trustee company services, do other MDA operators ever act under enduring powers of attorney for some or all of their MDA clients and how common is this? Please provide details.
- E3Q6 Should the proposed reporting arrangements also apply to MDA operators who are not licensed to provide traditional trustee company services, provided that they are also acting under an enduring power of attorney? If so, please outline who this should apply to and why. If not, please outline why not.
- E3Q7 Will implementing this proposal impose additional costs for these MDA operators? Please give details of any initial and/or ongoing costs that would result.
- E3Q8 Should ASIC address any other issues in our terms of relief in relation to MDA clients that lose legal capacity due to unsoundness of mind? Particular issues include: when ASIC should address relief for arrangements that have effect only on loss of capacity; when it is appropriate to provide information to the next of kin or guardians; nomination of alternative recipients in advance of incapacity; the obligations that should apply if a client resumes legal capacity; and whether the same provisions should apply to MDAs involving trusts rather than powers of attorney. Please outline why or why not these issues should be addressed.

## Rationale

- 77 The designation *non compos mentis* or ‘of unsound mind’ refers to a situation where a person is not competent to make decisions or enter into legal arrangements on their own behalf.
- 78 This proposal is designed to assist MDA operators who are licensed trustee company who provide traditional trustee company services and who have clients who become, temporarily or permanently, *non compos mentis* while they have an MDA account. It does not cover situations where a client has already lost their mental capacity before they commence investing in the MDA, nor does it intend to incorporate traditional trustee services into our regulatory framework for MDAs.
- 79 When a client becomes *non compos mentis*, we still think it is appropriate that reports are prepared on their investments, and that the ongoing

suitability of the MDA for the client is assessed annually. Our proposal is designed to ease the practical difficulty that MDA operators who are licensed trustee company who provide traditional trustee company services may face when trying to determine who this documentation must be supplied to in these circumstances.

## Breaches of the conditions of relief

### Proposal

- E4 We propose to modify the conditions of our relief to change the breach reporting timeframe from five business days to 10 business days.

#### *Your feedback*

- E4Q1 Do you agree with our proposal to increase breach reporting times to correspond with the breach reporting requirements in s912D(1B)? If not, why not?

### Proposal

- E5 We propose to provide guidance that, when an MDA operator breaches our conditions of relief, we will consider the nature, scope and effect of any breach to determine a proportionate regulatory response, which may include exclusion from relief.

#### *Your feedback*

- E5Q1 Do you agree with our proposed guidance concerning breaches of our conditions of relief? If not, why not?

### Rationale

- 80 This revised breach reporting timeframe ensures consistency between [CO 04/194] and the timeframes that apply to breach reporting under the Corporations Act. Our proposed guidance is consistent with the guidance we have proposed for platforms. In adopting this proposed approach, we will apply the considerations set out in Regulatory Guide 98 *Licensing: Administrative action against financial service providers* (RG 98) when exercising our administrative powers.

## Providing MDAs to wholesale clients

### Proposal

- E6 We propose to modify the conditions of our relief to make it explicit that the requirements of our class order only apply to an MDA operator when it is providing an MDA to a retail client, or to a custodian in a



custodial arrangement under s1012IA that has been given instruction by a retail client.

*Your feedback*

E6Q1 Do you agree with this proposal? If not, why not?

## **Rationale**

- 81 This proposal formalises our longstanding approach to the application of our guidance and class order requirements to wholesale MDA operators. We expect that this proposal would merely formalise the practices that ASIC and most industry participants have been observing to date.

## F Updated regulatory guidance

### Key points

We propose to revise and clarify our current guidance to make it more useful for current and future MDA operators. These revisions will address common questions about our guidance that have been raised by industry participants.

We propose to provide additional guidance on the obligations of MDA operators to adequately manage conflicts of interest.

We also propose to provide specific guidance on the application of some key aspects of the FOFA reforms to MDA operators and advisers, covering:

- the best interests duty and related obligations;
- fee disclosure statements; and
- the opt-in requirement.

## Clarification of our guidance

### Proposal

- F1 We propose to revise RG 179 and to provide revised regulatory guidance on the scope and application of our MDA class order relief—in particular, to:
- (a) make it clearer what arrangements are captured by our guidance on MDAs, including by using examples;
  - (b) clarify in our guidance that, for an arrangement to meet the definition of an MDA, the client and the MDA operator *intend* that the MDA operator will use client contributions of the client to generate a financial return or other benefit (this aligns with the current class order);
  - (c) clarify that we consider MDAs to be financial products, which also involve the provision of several financial services;
  - (d) provide guidance on what AFS licence authorisations are required for:
    - (i) MDA operators providing MDAs to retail clients only;
    - (ii) MDA operators who provide MDAs to wholesale clients only;
    - (iii) MDA operators who provide MDAs to wholesale and retail clients;
    - (iv) external MDA advisers; and
    - (v) external MDA custodians; and

- (e) clarify that, as well as meeting the PI and fraud insurance requirements in [CO 04/194], MDA operators must also meet the requirements imposed on all AFS licensees in RG 126.

#### Your feedback

- F1Q1 Do you agree with our proposals to provide revised regulatory guidance on the scope and application of our MDA relief and guidance? If not, please explain why.
- F1Q2 Are there any other topics which relate to the scope and application of our MDA relief and guidance where revised guidance is needed? Please provide details.
- F1Q3 Do you agree with our proposals to provide revised regulatory guidance on what licence authorisations are required for different MDA activities? If not, please explain why.

## Rationale

- 82 During our review of the MDA sector during 2012, several stakeholders identified areas where further clarification of our guidance would be helpful to assist MDA operators to understand and comply with our requirements.
- 83 We consider that these clarifications to RG 179 will make our guidance more useful to current and potential MDA operators, custodians and advisers.

## Conflicts of interest

### Proposal

- F2 We propose to provide more detailed regulatory guidance about our expectations for MDA operators in relation to managing conflicts of interest. This guidance will cover:
- the requirement for MDA operators who rely on [CO 04/194] to act in the best interests of the client in providing the MDA services to the client ([CO 04/194], condition 1.12(c));
  - the requirement for MDA operators who rely on [CO 04/194] to prioritise the client's interests ahead of their own, if there is a conflict between the interests of the client and their own interests ([CO 04/194], condition 1.12); and
  - specific guidance for all MDA operators in relation to the general obligation to manage conflicts of interest set out in s912A(1)(aa).

This guidance is intended to supplement the guidance provided for all AFS licensees in Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181): see the draft regulatory guidance in paragraphs 104–124 in the appendix to this paper.

Note: The guidance in this proposal will not address the best interests duty and related obligations that apply to the provision of personal advice to retail clients. See proposal F4 for our proposed guidance that specifically addresses the best interests duty and related obligations for MDA operators and external MDA advisers.

#### *Your feedback*

- F2Q1 Do MDA operators need ASIC guidance to assist them to comply with their obligations under [CO 04/194] and under s912A(1)(aa) in relation to conflicts of interest management?
- F2Q2 Do you agree with our proposed approach to guidance on conflicts of interest management by MDA operators?
- F2Q3 Are there any other topics relevant to conflicts of interest management by MDA operators that our guidance should cover? If so, please identify the topics where further guidance is needed.
- F2Q4 Where an MDA operator has a material conflict of interest in relation to a specific transaction, should they be required to obtain the express consent of the client before undertaking that transaction? Please explain why or why not this should be an explicit requirement.

## **Rationale**

- 84 An MDA operator can be subject to several material conflicts of interest in the course of operating an MDA. Most enforcement matters that ASIC has investigated in relation to MDAs (aside from matters relating to unauthorised provision of MDAs) involve inadequate management of conflicts of interest by MDA operators and advisers. Poor conflicts management was also identified as a key current and emerging risk by the MDA operators that we consulted during 2012.
- 85 [CO 04/194] imposes strong conduct requirements on MDA operators. These requirements complement the FOFA obligations which require that an advice provider should not act to further their interests, or those of any of their related parties, ahead of the client's interests when giving the client personal advice about an MDA (or any other financial product).
- 86 Despite these requirements, some MDA operators do not prioritise their clients' interests. Further, disclosure of potential or actual conflicts of interest to MDA clients is often poor because conflicts may not be known at the time when the MDA is established, and so they cannot be effectively disclosed. Because the operator can make transactions without reference to the client, the client may not be made aware of the conflict at all.
- 87 To address these concerns, we have proposed to provide more detailed regulatory guidance about the management of conflicts of interest for MDA operators. We are also seeking feedback on whether MDA operators should

be explicitly required to seek the consent of their client before engaging in any transaction where they have a material conflict of interest.

## FOFA reforms and MDAs

### Proposal

- F3** We propose to provide additional guidance in RG 179 to complement the guidance ASIC is providing on the legislative changes arising out of the FOFA reforms, addressing the specific circumstances of MDAs and MDA operators in relation to:
- (a) the best interests duty and related obligations;
  - (b) fee disclosure statements; and
  - (c) the opt-in requirement.

#### *Your feedback*

**F3Q1** Do you agree with our proposals to provide MDA-specific regulatory guidance on the FOFA reforms? If not, please explain why.

**F3Q2** Are there any other aspects of the FOFA reforms where specific guidance from ASIC is needed on applying these provisions to advice about or the operation of MDAs? Please identify which aspects, if any, and why additional MDA-specific guidance is needed.

## Best interests duty and related obligations

### Proposal

- F4** We propose to provide guidance consistent with our updated Regulatory Guide 175 *Licensing: Financial product advisers—Conduct and disclosure* (RG 175) about the interaction of the new best interests duty and related obligations (which apply to all AFS licensees and their representatives that provide personal advice to clients) and the conditions of relief in [CO 04/194] concerning the provision of financial advice to MDA clients: see the draft regulatory guidance in paragraphs 125–128 in the appendix to this paper.

#### *Your feedback*

**F4Q1** Do MDA operators need specific ASIC guidance to assist them to comply with their obligations under the best interests duty and related obligations?

**F4Q2** Do you agree with our proposed guidance on the best interests duty and related obligations as they specifically apply to MDAs operated under [CO 04/194] and RG 179? If not, please provide details.

## Fee disclosure statements

### Proposal

- F5 We propose to provide guidance consistent with Regulatory Guide 245 *Fee disclosure statements* (RG 245) about the interaction of the requirements to give annual fee disclosure statements to retail clients and the conditions of relief in [CO 04/194] requiring annual financial advice: see the draft regulatory guidance in paragraphs 129–134 in the appendix to this paper.

#### *Your feedback*

- F5Q1 Do you agree with our proposals to provide MDA-specific regulatory guidance on the requirement to give annual fee disclosure statements? If not, please explain why.
- F5Q2 Would our proposed guidance on the requirement to give annual fee disclosure statements assist MDA operators to comply with the new requirements that will be introduced as a result of the FOFA reforms? If not, please explain why.
- F5Q3 Do you agree with our proposed guidance on the requirement to give annual fee disclosure statements as they apply to MDAs operated under [CO 04/194] and RG 179? If not, please provide details.

## Opt-in requirement

### Proposal

- F6 We propose to provide guidance about the interaction of the new opt-in requirement requiring fee recipients to send renewal notices and the conditions of relief in [CO 04/194] which require annual financial advice to be provided by the MDA operator or an external MDA adviser to a retail client who invests in an MDA: see the draft regulatory guidance in paragraphs 135–139 in the appendix to this paper.

#### *Your feedback*

- F6Q1 Do you agree with our proposals to provide MDA-specific regulatory guidance on the interaction of the opt-in requirement and the conditions of relief in [CO 04/194]? If not, please explain why.
- F6Q2 Would our proposed guidance on the opt-in requirement and the conditions of relief in [CO 04/194] assist MDA operators to comply with the new requirements that will be introduced as a result of the FOFA reforms? If not, please explain why.
- F6Q3 Do you agree with our proposed guidance on the opt-in requirement and the conditions of relief in [CO 04/194]? If not, please provide details.

## Rationale

- 88 We think that incorporating this additional guidance into RG 179 will better assist current and potential MDA operators to comply with our existing requirements, as well as the new requirements that have been introduced as a result of the FOFA reforms.

## ASX Guidance Note 29

### Proposal

- F7 We propose to withdraw ASX Guidance Note 29, which contains guidance about MDAs for market participants, and incorporate that guidance in the updated RG 179, subject to any modifications arising out of our proposed changes to our guidance or relief.

#### *Your feedback*

- F7Q1 Do you agree with our proposal to withdraw ASX Guidance Note 29 and to incorporate the guidance contained in the guidance note in the updated RG 179? If not, please explain why.

## Rationale

- 89 ASIC is responsible for the supervision of operators of financial markets and clearing and settlement facilities, and of market participants, and for the supervision of real-time trading on Australia's domestic licensed markets. Incorporating the guidance previously provided by ASX to market participants that are MDA operators into our general guidance for MDA operators will ensure that all guidance relevant to MDAs is contained in the revised RG 179.

## G Guidance and relief that we propose to retain

### Key points

We propose to retain key elements of our current regulatory approach to MDAs, including all aspects of our current regulatory approach that have not been addressed elsewhere by the proposals in this consultation paper.

Our review indicated that the basic principles and framework that underpin our regulatory approach to MDAs is appropriate. We therefore do not intend to alter the primary foundations of our regulatory approach.

### Continuing guidance and relief

#### Proposal

- G1** We propose to retain key elements of our current approach to MDAs, including:
- (a) our current definition of an MDA;
  - (b) the enhanced FSG conditions for MDA operators, except where these are modified by the proposals discussed in this paper;
  - (c) the MDA contract conditions, except where these are modified by the proposals discussed in this paper;
  - (d) the requirement for an investment program to be formulated and reviewed on an annual basis, through personal advice, except where the current conditions are modified by the proposals in this paper;
  - (e) the asset holding conditions that currently apply to MDA operators;
  - (f) the conditions attached to the rights relating to portfolio assets that currently apply to MDA operators;
  - (g) the prohibition on an MDA operator investing client assets in most unregistered schemes;
  - (h) the PI and fraud insurance conditions that currently apply to MDA operators (as contained in [CO 04/194] and RG 126);
  - (i) the requirement to report all transactions to clients on a quarterly basis, or provide substantially continuous electronic access to this information, and report all transactions on an annual basis—except for the proposed modification for MDAs offered through a regulated platform;
  - (j) the requirement for MDA operators to obtain an audit report on whether the MDA operator:
    - (i) had appropriate documented measures in place to ensure its compliance with the requirements of the Corporations Act and the class order; and



- (ii) had appropriate internal controls and procedures to ensure that transaction reports were not materially misstated;
- (k) the specific conditions that apply to MDA operators and custodians when an external custodian is used; and
- (l) the specific conditions that apply to MDA operators and dealers when dealers are contracted by the MDA operator.

*Your feedback*

G1Q1 Do you agree with our proposal for continuing guidance and conditions of relief in the areas outlined above? If not, which guidance and/or conditions of relief do you think need to be reviewed and why?

G1Q2 Are there any contradictions or inconsistencies that arise out of retaining these elements of our guidance and conditions of relief while implementing some or all of the proposals contained elsewhere in this consultation paper? If so, please give details.

### Proposal

- G2** We do not propose any changes to the regulatory requirements that apply to MDAs that are registered schemes.

*Your feedback*

G2Q1 Do you agree with our proposal not to make any changes to the regulatory requirements that apply to MDAs that are registered schemes? If not, please outline what changes are required and why.

### Proposal

- G3** We propose to continue to give relief from the requirements that:
- (a) an MDA must be operated as a registered scheme;
  - (b) disclosure must be provided, as required by Pt 7.9 of the Corporations Act, in relation to a financial product that is:
    - (i) a right to MDA services operated by the MDA operator; or
    - (ii) held by a client because a legal or equitable interest in the financial product is held on behalf of the client as part of an MDA; and
  - (c) disclosure must be provided, as required by Ch 6D of the Corporations Act, for an offer to a client of securities to be held as part of an MDA.

*Your feedback*

G3Q1 Do you agree with our proposal for continuing relief in the areas outlined above? If not, why not?

G3Q2 Are there any contradictions or inconsistencies that arise out of retaining these elements of our relief while implementing some or all of the proposals contained elsewhere in this consultation paper? If so, please give details.

### **Rationale**

- 90 We propose to retain key aspects of our current regulatory approach to MDAs, including all aspects of our current regulatory framework not otherwise addressed in this consultation paper.
- 91 We think that most elements of the underlying framework of our guidance work well and are not in need of revision or modification. We therefore propose to continue to incorporate them in our revised guidance on MDAs.

## H Implementation and transition period

### Key points

We propose that new MDA operators comply with our revised regulatory guidance and conditions of relief in the amended class order from the date on which that guidance and class order are released.

We appreciate that, in response to any revised requirements, established MDA operators may need to recapitalise, restructure and/or determine how to meet any changed requirements in our guidance and class order. We therefore propose giving these operators staged transition periods to meet any revised requirements.

### New operators

#### Proposal

H1 We propose that new MDA operators comply with any revised regulatory guidance and conditions of relief in the amended class order(s) from the date on which the guidance and class order(s) are released.

#### *Your feedback*

H1Q1 Do you agree with this proposal? If not, why not?

H1Q2 Is the proposal for new MDA operators to start complying with the new requirements when they are released reasonable? If not, why not?

#### Rationale

92 We consider that our proposals are important to ensure the integrity of the MDA sector and promote investor confidence in MDAs. This is particularly true, given the increasing number of new MDA operators entering the sector following recent regulatory reforms.

93 Accordingly, we believe that our proposed requirements should apply to new MDA operators from the date on which our revised regulatory guidance and class order(s) are released in 2013.

### Established operators

#### Proposal

H2 We propose to provide existing MDA operators with staged transition periods to comply with any revised regulatory guidance and conditions of relief in the amended class order. Specifically, we propose that:

- (a) established AFS licensees currently offering family accounts under our no-action letter comply with our proposal to require family accounts to be operated in accordance with certain conditions from 1 July 2014;
- (b) established AFS licensees currently offering MDAs under our regulated platforms no-action letter comply with our proposal to regulate these MDAs similarly to other MDAs within two years from the time our revised regulatory guidance and class order are issued (see proposal B5);
- (c) established MDA operators, including those currently offering MDAs in reliance on either of the two no-action positions, comply with the revised financial resource requirements from 1 July 2014; and
- (d) all established MDA operators comply with any other revised requirements and regulatory guidance from 1 July 2014.

*Your feedback*

H2Q1 Do you agree with the proposed timeframe and transitional arrangements? If not, please indicate what timeframes you think are more appropriate.

## Rationale

- 94 We consider that our proposals are important to ensure the ongoing integrity of the MDA sector, to ensure that current and potential MDA operators have the appropriate competency and resources to offer MDA services, and to promote confident and informed consumer and investor participation.
- 95 We appreciate that established MDA operators may need to recapitalise to meet the proposed revised financial requirements, including the requirements relating to custodial and depository services, where relevant.
- 96 We also appreciate that MDA operators that are currently relying on either of the two no-action positions may need to reconsider whether they wish to continue to operate MDAs and, if so, to ensure that their businesses are appropriately resourced and structured, develop the necessary policies and procedures, and if necessary obtain the required AFS licence authorisations to continue to offer MDA services.
- 97 We therefore think it is appropriate to provide a staged transition for existing MDA operators.
- 98 Established MDA operators will also be able to comply with any revised regulatory requirements before the expiry of the proposed transition periods if they wish to do so.

## I Regulatory and financial impact

99 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:

- (a) resolving ambiguities within our current guidance on MDAs, ensuring that our regulatory requirements for MDAs are consistent with those that apply to comparable financial products, and strengthening mechanisms to promote confident and informed consumers and investors; and
- (b) promoting efficiency and fostering competition and innovation within the MDA sector, enabling existing MDA operators to continue to expand and develop their businesses, and facilitating the entry of new, competent and appropriately resourced MDA operators.

100 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:

- (a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;
- (b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and
- (c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

101 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

102 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:

- (a) the likely compliance costs;
- (b) the likely effect on competition; and
- (c) other impacts, costs and benefits.

See 'The consultation process', p. 4.

## Appendix: Draft guidance for proposals in Section F

- 103 This appendix includes our draft guidance for the proposals in Section F relating to:
- (a) the conflicts management obligations of MDA operators; and
  - (b) the FOFA reforms—the best interests duty and related obligations, fee disclosure statements, and the opt-in requirement.

### Conflicts management obligations of MDA operators

- 104 All AFS licensees, including MDA operators, are obliged to have adequate arrangements for the management of conflicts of interest that may arise in relation to the provision of financial services by the licensee, or their representatives (the ‘conflicts management obligation’): s912A(1)(aa).
- 105 In Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181), we have provided guidance on how AFS licensees can comply with this obligation.
- 106 In addition to the conflicts management obligation which applies to all licensees, MDA operators who operate MDAs in reliance on [CO 04/194] are subject to additional obligations to ensure that each MDA contract obliges the MDA operator to:
- ... act in the best interests of the client in providing the MDA services to the client and, if there is a conflict between the interests of the client and its own interests in providing the MDA services to the client, give priority to the client’s interests ([CO 04/194], condition 1.12(c)).
- 107 Our class order imposes this additional, more specific obligation on MDA operators because they have discretionary authority to make and implement investment decisions on behalf of their clients. The obligations in condition 1.12 of [CO 04/194] ensure consistency between the obligations imposed on MDA operators and those imposed on responsible entities of registered schemes under s601FC.

Note: From 1 July 2013, advisers providing personal advice to retail clients will be subject to a duty to act in the client’s best interests in relation to the personal advice. The obligation in [CO 04/194] is a separate and additional obligation. Operating an MDA encompasses a broader range of financial services than the provision of personal advice, and so the duty under [CO 04/194] applies across all activities undertaken in operating the MDA.

## Common conflicts of interest

108 The operation of an MDA will often give rise to conflicts of interest that need to be managed by MDA operators. Some common conflicts of interest that may arise in the provision of an MDA include:

- (a) MDA operators who derive revenue from transaction fees (e.g. brokerage) from transactions within the MDA may have a conflict between their interest in generating revenue by increasing the number and/or size of transactions that they undertake for clients, and the client's interest in avoiding unnecessary transaction fees;
- (b) MDA operators who issue other financial products may have a conflict between their interest in generating additional revenue from those other financial products, and their client's interests in being invested in the most appropriate investments given their relevant circumstances;
- (c) MDA operators who have interests in other investments or companies (e.g. as an investor or officer) may have conflict between their interests as an investor or officer of those investments or companies and their client's interests in being invested in the most appropriate investments given their relevant circumstances; and
- (d) MDA operators who underwrite or act as lead manager for capital raisings may have conflict between their interest in the success of those capital raisings and their client's interests in being invested in the most appropriate investments given their relevant circumstances.

Note 1: This list contains examples only and is not an exhaustive list of all conflicts of interest that may arise in the course of operating an MDA.

Note 2: From 1 July 2013, AFS licensees, including MDA operators, must comply with provisions in the Corporations Act relating to conflicted remuneration and other prohibited remuneration. MDA operators also need to consider their obligations under these provisions and ensure that they comply with all relevant obligations, including prohibitions on giving and accepting conflicted remuneration. See Regulatory Guide 246 *Conflicted remuneration* (RG 246) for further guidance on these obligations.

## Managing conflicts of interest as an MDA operator

109 To fulfil their conflicts management obligation, and the specific requirements in relation to conflicts under [CO 04/194], MDA operators must, on an ongoing basis, have adequate conflicts management arrangements in place that ensure that they and their representatives:

- (a) identify actual or potential conflicts of interest;
- (b) evaluate and assess those conflicts; and
- (c) act in the best interests of each MDA client and, where there is a conflict, prioritise each MDA client's interests over their own interests.

- 110 RG 181 identifies three mechanisms that AFS licensees would generally use to manage conflicts of interest. These mechanisms are:
- (a) avoiding conflicts of interest;
  - (b) controlling conflicts of interest; and
  - (c) disclosing conflicts of interest.

### **Avoiding conflicts of interest**

- 111 Some conflicts of interest would have such a serious or significant potential impact on an MDA client or an MDA operator that the only adequate mechanism for the MDA operator to manage that conflict would be to avoid it. Given MDA operators have a specific obligation under [CO 04/194] to give priority to clients' interests in any situation of conflict, it is likely that they may need to manage certain conflicts of interest by avoidance.
- 112 MDA operators are responsible for identifying and avoiding such conflicts. MDA operators need to ensure that they have effective conflicts identification and evaluation arrangements in place to enable them to do this.
- 113 Mechanisms MDA operators may use to avoid conflicts of interest include:
- (a) declining to enter into an MDA contract in certain circumstances;
  - (b) declining to enter into other arrangements or business activities which give rise to a serious conflict of interest in relation to their MDA operator responsibilities; or
  - (c) utilising remuneration and fee charging models which negate certain conflicts of interest.

### **Example**

#### **Scenario**

XY Invest is a small, boutique financial planning business which offers MDAs to retail clients. The principals of XY Invest also undertake trading in shares and derivatives on their own behalf.

Grant seeks personal advice from one of the principals of XY Invest about setting up an MDA account with them. He has some existing shareholdings that he would like to be incorporated into an MDA account, and he would like XY Invest to also exercise discretionary authority over those holdings as part of the MDA.

One of Grant's holdings is a stock that the principal of XY Invest short sells from time to time.



### Commentary

The interests of the principal of XY Invest in short selling the relevant stock are not aligned with the interests of Grant as an existing stockholder. This conflict of interest means that if XY Invest were to manage an MDA on Grant's behalf, a significant and serious conflict of interest arises.

In order to fulfil their obligations under s912A(1)(aa) and [CO 04/194], we would consider that XY Invest needs to avoid this conflict of interest. For example, XY Invest may offer the MDA to Grant but decline to hold discretionary authority over those shares or undertake not to engage in short selling of those shares on their own behalf while they hold that discretionary authority over Grant's holding.

### Controlling conflicts of interest

114 Some conflicts of interest that may arise with MDAs can be adequately managed by the MDA operator implementing internal controls to ensure that they and their representatives act in the client's best interests and, where there is a conflict, that they prioritise the client's interests over their own.

115 MDA operators may utilise some or all of the following measures to control conflicts of interest that arise in their provision of MDAs:

- (a) the use of an independent investment committee to make or review investment decisions;
- (b) the requirement for all investment decisions to be approved by a compliance officer before being implemented;
- (c) requirements for conflicted transactions to be flagged and subject to an additional level of approval or oversight;
- (d) monitoring and supervision systems which create alerts if certain parameters are breached (e.g. relating to trading frequency), and processes for a review of those alerts;
- (e) robust information barriers which insulate representatives who provide advice or make discretionary investment decisions from the information or circumstances that give rise to a particular conflict; and
- (f) suspending their discretionary authority in certain circumstances and instead seeking the express consent or instruction from the client before undertaking certain transactions, where such an approach would result in an outcome that is in the client's best interests.

Note: This is not an exhaustive list.

116 If the MDA operator elects to seek the express consent or instruction from the client before undertaking certain transactions, we would expect them to notify the client of this modification to their MDA contract and of the nature of the material conflict. Acting under instruction from the client does not

negate the MDA operator's obligations to act in the client's best interest and to prioritise the client's interests over their own.

### **Disclosing conflicts of interest**

117 Where an MDA operator has a material conflict of interest, we would expect them to disclose this to their affected MDA clients in a meaningful and timely way.

118 Material conflicts of interest that are known (or should reasonably be expected to be known) before the MDA commences should be clearly identified in the MDA operator's FSG and in the MDA contract and/or SOA provided to the client. RG 181.49–RG 181.56 provides further guidance on what information we expect AFS licensees to provide to clients when disclosing conflicts.

119 Some material conflicts of interest may not be envisaged when initial advice is provided to the client and the MDA contract is entered into. Other conflicts may only be able to be described in a very generic way. MDA operators need to consider how they will disclose these sorts of conflicts of interest to their clients. Potential options for disclosure include:

- (a) writing to clients before undertaken specific transactions to advise them of a conflict related to a specific transaction;
- (b) writing to clients if changes in business activities or operations result in material conflicts that may affect many transactions; or
- (c) suspending their discretionary authority in certain circumstances and instead seeking the express consent or instruction from the client before undertaking certain transactions.

120 It would be difficult to provide meaningful and timely disclosure of material conflicts if the disclosure is only made after a transaction has occurred (e.g. by flagging conflicted transactions on quarterly or annual report). Disclosure after the transaction has already taken place means that the client may not have the opportunity to consider how the conflict may affect the service being provided to them before the service is actually provided.

121 In RG 181, we note that disclosure on its own will often not be sufficient to manage a conflict of interest: see RG 181.49. Rather, in many cases, disclosure is best used to supplement the avoidance or control of a conflict, by providing the client with a means to assess the product they are being offered in light of the AFS licensee's own interests and to decide on the extent (if any) to which they will utilise the product or service being offered: see RG 181.51. In light of MDA operators' specific duty under [CO 04/194] to give priority to clients' interests in any situation of conflict, in most cases, it is unlikely that disclosure will be sufficient on its own to meet this duty,

and should be used in addition to managing the conflict by other means (i.e. avoidance or control).

### Documentation and compliance audit requirements

122 We expect that arrangements adopted by an MDA operator to avoid, control or disclose conflicts of interest are documented, and that compliance with those measures is also documented on an ongoing basis.

123 MDA operators acting under [CO 04/194] are specifically required to have and maintain adequate documented measures to ensure compliance with their obligations under [CO 04/194], condition 1.28(a), including the conflicts of interest obligations in condition 1.12(c).

Note: For more general guidance on documentation and record keeping in relation to conflicts of interest, see RG 181.44–RG 181.48.

124 They are also required to obtain and lodge with ASIC on an annual basis a statement from a registered company auditor as to whether:

- (a) the MDA operator has complied with their documented measures during the preceding financial year; and
- (b) the documented measures met the conditions of class order (see [CO 04/194], condition 1.28(b)).

## FOFA reforms

### Best interests duty and related obligations

125 Part 7.7 and Div 2 of Pt 7.7A of the *Corporations Act 2001* (Corporations Act) require persons who provide financial product advice to retail clients to comply with certain conduct and disclosure obligations. These obligations are designed to ensure that retail clients receive reliable advice about financial products.

126 Division 2 of Pt 7.7A imposes four key obligations on persons who provide personal advice to clients, including MDA operators who provide personal advice and external MDA advisers. These obligations are:

- (a) the best interests duty (s961B);
- (b) the appropriate advice requirement (s961G);
- (c) the obligation to warn the client if advice is based on incomplete or inaccurate information (s961H); and
- (d) the obligation to prioritise the client's interest (s961L).

- 127 We have provided guidance to all advice providers about these obligations in the updated Regulatory Guide 175 *Licensing: Financial product advisers—Conduct and disclosure* (RG 175) released in December 2012.
- 128 For AFS licensees who are MDA operators and who also provide personal advice, the obligations in s961B, 961G, 961H and 961J mean that when providing personal financial advice to a retail client they may need to consider issues such as:
- (a) ensuring that, when giving advice to invest in a particular MDA, rather than in another MDA or in another type of investment (including direct investments), that the adviser prioritises the client's interest over their own interest as an MDA operator or an associate of an MDA operator;
  - (b) when recommending a particular MDA investment strategy and program for a client, that the adviser prioritises the client's interest over their own interest as an MDA operator or an associate of an MDA operator; and
  - (c) when undertaking an annual review of the investment program for a client and making a recommendation about its ongoing suitability for the client, that the adviser prioritises the client's interest over their own interest as an MDA operator or an associate of an MDA operator.

### **Fee disclosure statements**

- 129 We would consider that most fee arrangements for MDAs would be 'ongoing fee arrangements' for the purposes of the fee disclosure statement (FDS) obligations in Div 3 of Pt 7.7A of the Corporations Act. Fee recipients must give retail clients an FDS, which discloses information about the previous 12 months of their ongoing fee arrangements. For detailed guidance on the FDS obligations, see Regulatory Guide 245 *Fee disclosure statements* (RG 245).
- 130 The legislation prescribes that product fees charged by the issuer of financial products (see s962A(5) of the Corporations Act and reg 7.7A.10 of the Corporations Regulations) do not form part of the ongoing fee arrangement and therefore do not need to be disclosed in the fee disclosure statements. It is noted that ASIC treats an MDA as if the MDA is a financial product in itself.
- 131 Where the product fees charged by product issuers, in relation to products acquired through the MDA, and the fees for running the MDA itself (e.g. investment management, administration, account keeping fees, transaction fees) are bundled together with other fees, such as advice fees, the MDA operator needs to determine to what extent the fees are product fees and disclose all other fees.

- 132 To the extent that the MDA operator cannot identify the breakdown of fees, good practice would be to disclose the whole amount of the fees. Given that an annual review is an integral component of an MDA, we would be concerned if an MDA operator did not identify any fees that were charged for providing financial advice.
- 133 If the MDA operator desired, the annual fee disclosure statement could be provided at the same time as the annual investment program review SOA or record of advice. The MDA operator would need to ensure that both the SOA or record of advice requirements and the ongoing fee disclosure statement requirements are met. In doing so, the MDA operator should be careful to adhere to the general obligations in the Corporations Act and the *Australian Securities and Investments Commission Act 2001* (ASIC Act)—in particular, with the provisions that deal with misleading or deceptive conduct and false or misleading representations.
- 134 Therefore, the prescribed information for the fee disclosure statement (see s962H(2)) should not be blended into another document such as an SOA, and the prescribed information should remain separate and clear to ensure that retail clients are able to ascertain whether the service they are receiving is commensurate to the ongoing fees they are paying.

### **Opt-in requirement**

- 135 Under s962K of the Corporations Act, an AFS licensee, or its representative, who enters into an ongoing fee arrangement with a client must give their client a written renewal notice every two years which requires the client to ‘opt in’ to renew that fee arrangement. The adviser in these circumstances is referred to as the ‘fee recipient’. If the client does not respond to the renewal notice, or opts out, then the fee arrangement terminates.
- 136 MDA operators who provide personal financial advice to retail clients and external MDA advisers must comply with these requirements where they enter into an ongoing fee arrangement, unless they are bound by a code of conduct approved by ASIC under s1101A: see Regulatory Guide 183 *Approval of financial services sector codes of conduct* (RG 183) for further information about ASIC’s code approval powers.
- 137 If an MDA client does not respond to a renewal notice, or opts out, then the fee arrangement terminates. The termination of the fee arrangement will generally mean that the MDA operator or adviser will cease providing personal financial advice (including the annual investment program review) to the MDA client.
- 138 An MDA client may also explicitly direct that their MDA operator or external MDA adviser cease providing personal financial advice, either in response to the renewal notice or at any time.

- 139           Where a client is not given an annual investment program review, as required, their MDA account will need to be terminated (not necessarily meaning their holdings have to be sold or transferred, but stopping any further discretionary trading or management by the MDA operator). This is because annual financial advice about the ongoing suitability of the MDA is part of the conditions of relief under [CO 04/194].

## Key terms

Term	Meaning in this document
advice	Financial product advice
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services  Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act  Note: This is a definition contained in s761A.
ASIC	Australian Securities and Investments Commission
best interests duty	The duty to act in the best interests of the client when giving personal advice to a client as set out in s961B(1) of the Corporations Act
best interests duty and related obligations	The obligations in Div 2 of Pt 7.7A of the Corporations Act
child	Without limiting who is a child of an individual, each of the following is the child of an individual: <ul style="list-style-type: none"> <li>the individual's adopted child, stepchild or exnuptial child;</li> <li>a child of the individual's spouse; or</li> <li>someone who is a child of the individual within the meaning of the <i>Family Law Act 1975</i></li> </ul> Note: This is a definition contained in s995-1 of the <i>Income Tax Assessment Act 1997</i> .
client	A retail client, unless otherwise specified
[CO 04/194] (for example)	An ASIC class order (in this example numbered CO 04/194)
conflicted remuneration provisions	The provisions on conflicted remuneration and other banned remuneration in Divs 4 and 5 of Pt 7.7A of the Corporations Act
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
CP 189 (for example)	An ASIC consultation paper (in this example numbered 189)

Term	Meaning in this document
custodial and depository service	<p>A service that is provided by a person (the provider) to another person (the client), under an arrangement between the provider and the client, or between the provider and another person with whom the client has an arrangement (whether or not there are also other parties to any such arrangement), whereby a financial product, or a beneficial interest in a financial product, is held by the provider in trust for, or on behalf of, the client or another person nominated by the client</p> <p>Note: This is a definition contained in s766E of the Corporations Act.</p>
EDR	External dispute resolution
EPA	Enduring power of attorney
external MDA adviser	<p>An AFS licensee authorised to provide financial product advice to retail clients who directly contracts with a retail client to prepare or review an investment program where:</p> <ul style="list-style-type: none"> <li>• the investment program is, or is intended to be, included in an MDA contract; and</li> <li>• the MDA contract is between that client and another person, who is an MDA operator</li> </ul>
external MDA custodian	An AFS licensee who directly contracts with a retail client to provide custody services relating to an MDA operated by an MDA operator
family	The spouse and/or children (as defined in s995-1 of the <i>Income Tax Assessment Act 1997</i> ) of an AFS licensee or its representatives
family accounts	MDA accounts operated by AFS licensees for their family members or the family members of their representatives
family accounts no-action letter	A no-action letter issued by ASIC to the then SIDA on 8 December 2004 concerning discretionary trading services provided by representatives of AFS licensees to their immediate family members
FDS	Fee disclosure statement—a document required by s962G of the Corporations Act to be given in accordance with Div 3 of Pt 7.7A
fee recipient	<p>A fee recipient is:</p> <ul style="list-style-type: none"> <li>• the AFS licensee or its representative who enters into an ongoing fee arrangement with a client; or</li> <li>• if the rights of the person who entered into the ongoing fee arrangement have been assigned, the person who currently holds those rights</li> </ul> <p>Note: See s962C of the Corporations Act for the exact definition.</p>
financial adviser	An AFS licensee or its representative who provides personal advice



Term	Meaning in this document
FOFA	Future of Financial Advice
FSG	Financial Services Guide—a document required by s941A or 941B of the Corporations Act to be given in accordance with Div 2 of Pt 7.7  Note: This is a definition contained in s761A.
IDPS	Investor-directed portfolio service
IDPS-like scheme	Investor directed portfolio services-like managed investment scheme, as defined in [CO 02/296]
IDR	Internal dispute resolution
investment program	A document that forms part of the MDA contract and which contains information about the nature and scope of the discretions that the MDA operator will be authorised and required to exercise, any significant risks associated with the MDA contract, the basis on which the MDA contract is considered to be suitable for the client and warnings about the importance of any limitations relating to the MDA contract that the client must consider before signing the MDA contract
investment strategy	The investment objective and other parameters that guide the investment decision making of the MDA operator
leveraged investments	Investments that employ borrowed capital or other mechanisms to amplify returns
managed discretionary account	An arrangement that involves a person (an MDA operator) managing a portfolio of assets for a client on an individual basis, and where the client gives the MDA operator the authority to make and implement investment decisions on their behalf, without the MDA operator seeking approval from the client for each decision
managed investment scheme	Arrangement where: <ul style="list-style-type: none"> <li>• people are brought together to contribute money to acquire an interest in the scheme ('interests' in a scheme are a type of 'financial product' and are regulated by the Corporations Act);</li> <li>• money is pooled together with contributions from other investors (often many hundreds or thousands of investors) or used in a common enterprise; and</li> <li>• a 'responsible entity' operates the scheme. Investors do not have day-to-day control over the operation of the scheme</li> </ul>
MDA	Managed discretionary account
MDA contract	A contract under which an MDA operator provides an MDA to a retail client
MDA operator	A person who operates one or more MDAs

Term	Meaning in this document
no-action letter	<p>A letter expressing ASIC's regulatory intention about how we will exercise our powers. The purpose of a no-action letter is to provide an indication of the future regulatory action that we will, or will not, take.</p> <p>A no-action letter will state that we do not intend to take regulatory action in relation to particular conduct on the basis of our understanding of the facts of the particular case at the particular time that an application for a no-action letter is made</p>
<i>non compos mentis</i>	Of unsound mind—refers to a situation where a person is not competent to make decisions or enter into legal arrangements on their own behalf
non-limited recourse product or arrangement	An obligation imposed on a person under an agreement to pay an amount to another person in the event of the occurrence or non-occurrence of something, where the rights of the other person are not limited to any property that the first person has paid or set aside as security for the payment, including property to be transferred by the other person to the first person on completion of the obligation under the agreement
NTA	Net tangible assets
ongoing fee arrangement	<p>An arrangement where an AFS licensee or its representative:</p> <ul style="list-style-type: none"> <li>• gives personal advice to a person as a retail client; and</li> <li>• that person enters into an arrangement with the licensee, or a representative of the licensee; and</li> <li>• under the terms of the arrangement, a fee (however described or structured) is to be paid during a period of more than 12 months</li> </ul> <p>Note: See s962A of the Corporations Act for the exact definition.</p>
OTC	Over the counter
PDS	Product Disclosure Statement
PI	Professional indemnity
platform	<p>IDPS and IDPS-like schemes</p> <p>Note: In this consultation paper, this term extends to superannuation master trusts or other superannuation funds, SMSFs or MDAs, but does not extend to nominee and custody services, as defined in Regulatory Guide 149 <i>Nominee and custody services</i> (RG 149)</p>
Pt 7.7A (for example)	A part of the Corporations Act (in this example numbered 7.7A)
registered managed investment scheme	A managed investment scheme registered under s601EB of the Corporations Act

Term	Meaning in this document
registered scheme	A registered managed investment scheme
regulated platform	An IDPS, IDPS-like scheme or a superannuation entity
regulated platforms no-action letter	A no-action letter issued by ASIC to the then IFSA on 5 November 2004 addressing the situation of MDA operators who hold a limited power of attorney that is valid only within a regulated platform, and is limited to authorising the MDA operator to transfer funds between investments offered through the regulated platform, but not to contribute or withdraw funds
representative	An authorised representative or an employee representative of an AFS licensee
retail client	A retail client as defined in s761G of the Corporations Act and Div 2 of Pt 7.1 of Ch 7 of the Corporations Regulations
RG 126 (for example)	An ASIC regulatory guide (in this example numbered 126)
s912D (for example)	A section of the Corporations Act (in this example numbered 912D), unless otherwise specified
SMSF	Self-managed superannuation fund
SOA	Statement of Advice—A document that must be given to a client for the provision of personal advice under Subdivs C and D of Div 3 of Pt 7.7 of the Corporations Act  Note: See s761A for the exact definition.
spouse	The spouse of an individual includes: <ul style="list-style-type: none"> <li>• another individual (whether of the same sex or a different sex) with whom the individual is in a relationship that is registered under a state or territory law prescribed for the purposes of s2E of the <i>Acts Interpretation Act 1901</i> as a kind of relationship prescribed for the purposes of that section; and</li> <li>• another individual who, although not legally married to the individual, lives with the individual on a genuine domestic basis in a relationship as a couple</li> </ul> Note: This is a definition contained in s995-1 of the <i>Income Tax Assessment Act 1997</i> .
trustee company	Has the same meaning as in s601RAB of the Corporations Act
wholesale client	A wholesale client as defined in s761G of the Corporations Act and Div 2 of Pt 7.1 of Ch 7 of the Corporations Regulations

## List of proposals and questions

Proposal	Your feedback
<p>B1 We propose to revoke the family accounts no-action letter and modify [CO 04/194] to continue to exempt AFS licensees from the requirement to obtain 'MDA operator' and 'MDA advice' authorisations on their AFS licence if the only MDA accounts they operate are MDA accounts for their family members or the family members of their representatives.</p>	<p>B1Q1 Do you agree with the proposal to continue to exempt AFS licensees from the requirement to obtain MDA operator and MDA advice authorisations on their AFS licence if the only MDA accounts they operate are MDA accounts for their family members or the family members of their representatives? Why or why not?</p> <p>B1Q2 Should this proposal be limited to certain types of MDA arrangements or certain types of MDA operators (e.g. MDA operators that are market participants)? If so, please outline the limitations you would recommend and why.</p> <p>B1Q3 Will these proposals result in any costs for your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.</p> <p>B1Q4 If we were to require AFS licensees to obtain MDA operator and MDA advice authorisations on their AFS licence, even if the only MDA accounts they operate are MDA accounts for their family members or the family members of their representatives, would this result in any costs for your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.</p>
<p>B2 For the purposes of this relief, we propose to explicitly define 'family' as 'the spouse and/or children (as defined in s995-1 of the <i>Income Tax Assessment Act 1997</i>) of an AFS licensee or its representatives'.</p>	<p>B2Q1 Do you agree with our definition of 'family'? If you think 'family' should be defined using an alternative definition, please supply that definition and outline why it is preferred.</p>
<p>B3 We propose that AFS licensees that operate family accounts on behalf of retail clients and rely on our licensing relief will be required to comply with specific conditions, including those listed in Table 1.</p>	<p>B3Q1 Do you agree with our proposal that AFS licensees that operate family accounts and rely on our licensing relief will need to maintain adequate professional indemnity (PI) and fraud cover, as required by condition 1.27 in [CO 04/194] and by Regulatory Guide 126 <i>Compensation and insurance arrangements for AFS licensees</i> (RG 126), and which covers the provision of family accounts by the licensee or its representatives? If not, please outline why this PI and fraud cover is unnecessary.</p> <p>B3Q2 Do AFS licensees who are currently providing family accounts in reliance on our no-action letter already hold PI and fraud cover which covers the actions of their representatives in operating family accounts? If so, how simple or difficult was this cover to obtain?</p> <p>B3Q3 Will the proposed PI and fraud cover impose additional costs on your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.</p> <p>B3Q4 Do you think the proposed PI and fraud cover will provide compensation arrangements that sufficiently reduce the risk</p>

Proposal	Your feedback
	<p>that compensation claims to retail clients cannot be met because of the lack of available financial resources? If you do not think the proposed cover is appropriate, please explain why and identify what cover or other arrangements you think would be more appropriate.</p>
B3Q5	<p>Do you agree with our proposal that AFS licensees that operate family accounts and rely on our licensing relief will need to maintain adequate monitoring and supervision policies and processes for family accounts? If not, please explain why not.</p>
B3Q6	<p>Will the proposed monitoring and supervision arrangements impose additional costs on your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.</p>
B3Q7	<p>Will the proposed monitoring and supervision arrangements provide appropriate safeguards for family members by reducing the risk of inappropriate or unauthorised transactions, and by increasing the likelihood that such transactions will be detected? If you do not think these safeguards are appropriate, please suggest alternative options.</p>
B3Q8	<p>Do you agree with our proposal that family account holders should have access to internal dispute resolution (IDR) and external dispute resolution (EDR) arrangements that cover the operation of the family accounts? If not, please explain why not.</p>
B3Q9	<p>What benefits and disadvantages do you think will result from the implementation of this proposal? Please provide details.</p>
B3Q10	<p>Do the current IDR and EDR arrangements of licensees whose representatives operate family accounts provide coverage for disputes relating to the operation of these family accounts (including disputes relating to advice, operation and dealing)? Please provide details.</p>
B3Q11	<p>If these disputes are not covered under current arrangements, should the responsibility to provide access to IDR and EDR arrangements rest with the licensee? Please explain why or why not.</p>
B3Q12	<p>Should the responsibility to pay any compensation arising out of claims settled through IDR or EDR rest with the licensee? Please explain why or why not.</p>
B3Q13	<p>Will the proposed IDR and EDR arrangements impose additional costs on your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.</p>
B3Q14	<p>For AFS licensees who are only licensed to provide financial services to wholesale clients, will the proposed IDR and EDR requirements be feasible for your business?</p>

Proposal	Your feedback
	<p>B3Q15 Are there alternative mechanisms that would more effectively deliver access to dispute resolution systems and compensation for family account holders? Please identify these mechanisms and explain why they would be more effective.</p> <p>B3Q16 Do you agree with our proposal that AFS licensees that operate family accounts and rely on our licensing relief should obtain written acknowledgement by the family member covering the matters outlined in Table 1? If not, please outline your reasons.</p> <p>B3Q17 Do you think this written acknowledgement should cover any other matters? If so, please identify these and explain why.</p> <p>B3Q18 Do you agree with our proposal that, if the AFS licensee is notified that the spouse has become separated from the licensee or its representative, the discretionary authority will cease to have effect, unless, subsequent to the separation, the relevant spouse gives their consent for the discretionary authority to commence or continue? If not, please outline what other requirements, if any, should be in place to manage family accounts in the event of a relationship breakdown.</p>
<p>B4 We propose to revoke the regulated platforms no-action letter and modify our guidance to specify that:</p> <p>(a) where AFS licensees or their representatives give instructions at their discretion to regulated platform providers, including instructions to switch between investment options, these arrangements will be regulated as MDAs; and</p> <p>(b) AFS licensees that wish to undertake this activity will need to obtain the relevant AFS licence authorisations.</p>	<p>B4Q1 Do you agree with our proposal to require AFS licensees offering MDAs through a regulated platform to obtain the relevant AFS licence authorisations? If not, please explain why you think this licensing relief should continue, given the similarity between MDAs operated through regulated platforms and other MDAs.</p> <p>B4Q2 Will this proposal impose costs on your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.</p>
<p>B5 We propose to provide a two-year transition period from the time that our revised regulatory guidance and class order are issued to allow AFS licensees and their representatives who are currently relying on the no-action position time to obtain the relevant AFS licence authorisations or to wind up their MDA business.</p>	<p>B5Q1 Will this transition period assist AFS licensees and their representatives who are currently relying on the no-action position to adjust to the proposed changes to our guidance and relief? Please explain if you think a shorter or longer transition period is needed and why.</p>

Proposal	Your feedback
<p>B6 We propose that, where all of an MDA operator's MDA investments are contained on a regulated platform, the MDA operator must comply with the same operation, disclosure and conduct requirements that apply to other MDA operators, except for the following:</p> <p>(a) the MDA operator does not have to issue transactional reports for clients if the transactions have been, or will be, reported to the client or MDA operator by the regulated platform operator, as long as the MDA operator ensures that:</p> <p>(i) the reports generated by the regulated platform are passed on to clients if they are sent via an address of the MDA operator; and</p> <p>(ii) as soon as reasonably practicable following the reports being provided by the regulated platform operator, the MDA operator reviews the transaction details in the report and reports any exceptions or anomalies to clients; and</p> <p>(b) the MDA operator does not need to provide its MDA clients with an annual statement from a registered company auditor providing their opinion whether transactional reports have, or have not, been materially misstated.</p>	<p>B6Q1 Do you agree with our proposal to exempt MDA operators from issuing transactional reports and an audit opinion on those reports to clients when all investments of the MDA are held through a regulated platform and the regulated platform provider reports transactions to clients? If not, why not?</p> <p>B6Q2 Do you agree with our proposal that AFS licensees offering MDAs through a regulated platform must comply with our MDA guidance and relief in all other respects? If not, please identify any further modifications or concessions that you think are warranted, and explain why.</p> <p>B6Q3 Are any additional modifications to our conditions of relief needed to address the situation where only some of the assets of a client's MDA are invested through a regulated platform? If so, please outline how you think these modifications should operate.</p>
<p>B7 For the purposes of proposals B4–B6, we propose to define a 'regulated platform' as 'an IDPS, IDPS-like scheme or superannuation entity'.</p>	<p>B7Q1 Do you agree with our proposal to explicitly define 'regulated platform' in this way? If not, please suggest an alternative definition.</p>

Proposal	Your feedback
<p>C1 We propose that MDA operators should be subject to updated financial requirements that are similar to the financial requirements that have applied to responsible entities of managed investment schemes since 1 November 2012 and that we have proposed to apply to platform operators, as outlined in Regulatory Guide 166 <i>Licensing: Financial requirements</i> (RG 166) (revised version forthcoming). We also propose to apply to MDA operators the same financial requirements as proposed to apply to responsible entities having regard to scheme property holding arrangements. In particular, we propose that MDA operators should meet:</p> <ul style="list-style-type: none"> <li>(a) the standard solvency and positive net assets requirement that applies to all AFS licensees;</li> <li>(b) a tailored cash needs requirement similar to the requirement that applies to responsible entities;</li> <li>(c) a tailored audit requirement similar to the requirement that applies to responsible entities; and</li> <li>(d) a net tangible assets (NTA) requirement similar to that which is proposed to apply to responsible entities.</li> </ul> <p>See Table 2 for more details of the proposed financial requirements.</p>	<p>C1Q1 Do you agree with our proposal that MDA operators should be subject to similar financial requirements to those that apply to the responsible entities of managed investment schemes? If not, why not?</p> <p>C1Q2 Do you agree that this proposal is appropriate, given the level of risk carried by MDA operators? Why or why not?</p> <p>C1Q3 Are there any practical problems with the implementation of this proposal? If so, please give details.</p> <p>C1Q4 Are there any circumstances in which the proposed financial requirements should not apply? Please specify.</p>
<p>C2 For the purposes of proposal C1, we propose to define 'client's portfolio assets' as 'financial products and other property that are the client's contributions or that are derived directly or indirectly from the client's contributions' (this is the same definition that is currently used in [CO 04/194]). We also propose to define 'average MDA operator revenue' as:</p> <ul style="list-style-type: none"> <li>(a) in the first financial year in which the licensee is first authorised to operate an MDA, the licensee's reasonable forecast of its revenue from the date it was first authorised for the remainder of the first financial year pro-rated to a 12-month period;</li> <li>(b) in the next financial year after the first</li> </ul>	<p>C2Q1 Do you agree with our proposed definition of 'client's portfolio assets'? If you think that 'client's portfolio assets' should be defined using an alternative definition, please supply that definition and outline why it is preferred.</p> <p>C2Q2 Do you agree with our proposed definition of 'average MDA operator revenue'? If you think that 'average MDA operator revenue' should be defined using an alternative definition, please supply that definition and outline why it is preferred.</p>



Proposal	Your feedback
<p>financial year in which the licensee was first authorised to operate an MDA, the average of the aggregate of the licensee's:</p> <ul style="list-style-type: none"> <li>(i) actual revenue for the second financial year to date, plus reasonable forecast of its revenue for the remainder of the second financial year; and</li> <li>(ii) revenue in the first financial year from the calculation date pro-rated to a 12-month period;</li> </ul> <p>(c) in its second financial year after the first financial year in which the licensee was first authorised to operate an MDA, the average of:</p> <ul style="list-style-type: none"> <li>(i) the aggregate of the licensee's revenue for the financial year to date and reasonable forecast of its revenue for the remainder of the financial year;</li> <li>(ii) the licensee's revenue for its previous financial year; and</li> <li>(iii) the revenue in the first financial year in which the licensee was first authorised to operate an MDA from the date of that authorisation pro-rated to a 12-month period; and</li> </ul> <p>(d) for all subsequent financial years, the average of:</p> <ul style="list-style-type: none"> <li>(i) the aggregate of the licensee's revenue for the current financial year to date and reasonable forecast of its revenue for the remainder of the current financial year;</li> <li>(ii) the licensee's revenue for the last preceding financial year; and</li> <li>(iii) the licensee's revenue for the second preceding financial year.</li> </ul> <p>In determining average MDA operator revenue, an MDA operator should include the revenue of persons performing the functions relating to an MDA for which the MDA operator is responsible (e.g. functions outsourced to other entities).</p>	

Proposal	Your feedback
<p>C3 We propose that external MDA custodians must meet the same requirements as those we propose to apply under CP 194 to providers of custodial or depository services that are not incidental providers. This includes the requirement to hold net tangible assets (NTA) of \$10 million, or 10% of average revenue, whichever is higher. In determining average revenue, an MDA operator should include the revenue of persons performing the functions relating to an MDA for which the MDA operator is responsible (e.g. functions outsourced to other entities).</p>	<p>C3Q1 Do you agree with our proposal that external MDA custodians must meet the same requirements as those we proposed to apply under CP 194 to providers of custodial or depository services? If you disagree, please explain why.</p>
<p>C4 We propose that MDA operators responsible for holding client portfolio assets must meet the same requirements as those we proposed to apply under CP 194 to responsible entities that hold scheme property. This includes the requirement to hold NTA of \$10 million, or 10% of average revenue, whichever is higher, unless the MDA operator arranges for the client portfolio assets to be held by a person licensed to provide a custodial or depository service that is not an incidental provider or a body regulated by the Australian Prudential Regulation Authority (APRA).</p> <p>We propose to exclude MDA operators who are responsible for holding client portfolio assets from the definition of 'incidental custodial or depository services' as defined in CP 194. This means these MDA operators would not be able to fulfil their NTA obligations by meeting the reduced minimum NTA requirements for incidental providers of custodial and depository services. In determining average revenue, an MDA operator should include the revenue of persons performing the functions relating to an MDA for which the MDA operator is responsible (e.g. functions outsourced to other entities).</p>	<p>C4Q1 Do you agree with our proposal that MDA operators responsible for holding client portfolio assets must meet the same requirements as those we proposed to apply under CP 194 to responsible entities that hold scheme property unless the MDA operator arranges for the client portfolio assets to be held by a person licensed to provide a custodial or depository service? If you disagree, please explain why.</p>

Proposal	Your feedback
<p>D1 We propose to refine our conditions relating to the MDA contract, investment program and financial advice to make it clear that:</p> <ul style="list-style-type: none"> <li>(a) the investment program that forms part of the MDA contract must contain an investment strategy;</li> <li>(b) the invest strategy must contain sufficient detail to permit an opinion to formed on the suitability of the investment program for a particular client;</li> <li>(c) the investment program forms part of the MDA contract;</li> <li>(d) the MDA operator or an external MDA adviser must provide personal advice about the MDA contract, including the investment program, on an annual basis. This personal advice must meet the conduct and disclosure obligations under Pt 7.7 and Pt 7.7A of the Corporations Act that apply to personal advice (including the obligation for the AFS licensee or its authorised representative to prepare and provide a Statement of Advice (SOA) or record of advice, and the obligation for the advice provider to act in the best interests of the client, provide appropriate advice, warn the client where advice is based on inaccurate or incomplete information, and prioritise the interests of the client), and must contain advice about whether the MDA contract for that client, including the investment program, continues to be suitable in light of the client's personal objectives, needs and relevant personal circumstances.</li> </ul>	<p>D1Q1 Do you agree with our proposal to introduce an explicit requirement for the investment program to contain an investment strategy? If not, why not?</p> <p>D1Q2 Do you agree with our proposed clarification that personal advice about the MDA must state that the MDA contract including the investment program is appropriate to the client's financial situation, needs and objectives? If not, please explain why.</p> <p>D1Q3 Are there any other aspects of our investment program, MDA contract or SOA requirements that need clarification or refinement? If so, please provide details.</p>
<p>D2 We propose to clarify that the FSG and MDA contract must contain information about the fees and costs of the MDA in a manner that is consistent with Sch 10 of the Corporations Regulations.</p>	<p>D2Q1 Do you agree with this proposal? If not, why not?</p> <p>D2Q2 Do you think that this proposal will assist investors to more easily compare different MDAs, or an MDA and an alternative investment?</p> <p>D2Q3 Do you think that this proposal will assist investors to make better, more informed decisions about whether to invest in an MDA? Please explain your views.</p>

Proposal	Your feedback
<p>D3 We propose to require the FSG for the MDA to provide a description of the operation of outsourcing arrangements that apply to the MDA, where relevant. This description should cover:</p> <ul style="list-style-type: none"> <li>(a) the entities involved and the functions they perform; and</li> <li>(b) how outsourced arrangements will be monitored.</li> </ul>	<p>D3Q1 Do you agree with this proposal? Please explain your response.</p>
<p>D4 We propose to require both the FSG and the MDA contract to contain information about how the client may terminate the MDA contract including:</p> <ul style="list-style-type: none"> <li>(a) how the instruction to terminate must be communicated;</li> <li>(b) how long it will take for the termination to take effect; and</li> <li>(c) how the MDA assets will be disposed of, or transferred to the client, if those assets are not held directly by the client.</li> </ul>	<p>D4Q1 Do you agree with this proposal to require explicit upfront disclosure of how the client may terminate the MDA contract, and the processes for ceasing the MDA arrangement? Please provide details.</p> <p>D4Q2 Will this proposal assist retail clients to better understand the operation of their MDA contract, how they can terminate that contract and the impact of any termination? If not please explain why.</p> <p>D4Q3 Are there any other conduct or disclosure requirements that should be imposed on MDA operators to ensure that retail investors are able to terminate the MDA if they so choose?</p>
<p>D5 We propose to require that the length of time required by an MDA operator for the termination to take effect must be no longer than is reasonably necessary.</p>	<p>D5Q1 Do you agree with our proposal to require that the length of time required by an MDA operator for the termination to take effect must be no longer than is reasonably necessary? If not, please explain why.</p>
<p>D6 We propose to require MDA operators to:</p> <ul style="list-style-type: none"> <li>(a) formulate a policy outlining the steps they will take to terminate an MDA contract when under the terms of the MDA contract it is to be terminated or when the MDA contract no longer meets our conditions of relief (for example, if an the annual review of the investment program is not completed within the required timeframe); and</li> <li>(b) disclose the details of this policy to investors in the FSG.</li> </ul>	<p>D6Q1 Do you agree with our proposal to require MDA operators to formulate a policy outlining the steps they will take if a client opts out of receiving ongoing advice? If not please provide details</p> <p>D6Q2 Do you agree with our proposal to require disclosure of this policy in the FSG? If not, please explain why.</p>

Proposal	Your feedback
<p>E1 We propose to modify our conditions of relief under one of the three options listed below:</p> <p>(a) in situations where an MDA operator may invest an MDA client's portfolio assets in non-limited recourse arrangements, the MDA operator is required to include a specific risk warning in the MDA operator's FSG and in each client's investment program, which outlines the additional risks to the client as a result of their MDA investing in non-limited recourse arrangements. The MDA operator will also be required to disclose in the investment program the degree of leverage that may be employed, the types of products used and the MDA operator's policies in relation to communicating and meeting margin calls and closing positions at a loss;</p> <p>(b) in situations where an MDA operator may invest an MDA client's portfolio assets in non-limited recourse arrangements, the MDA operator is required to seek express consent from the MDA client on each occasion when the MDA operator is proposing to invest in such a product or arrangement, and not to invest in any such product or arrangement where express consent has not been obtained; or</p> <p>(c) MDA operators are prohibited from investing retail client's portfolio assets within an MDA in non-limited recourse arrangements.</p>	<p>E1Q1 Do you agree with our proposal to modify our conditions of relief to impose specific conditions when a client's MDA operator has discretion to invest in products or investment strategies with non-limited recourse? If not, why not?</p> <p>E1Q2 Do you think option (a), (b) or (c) would be most effective in addressing the additional risks faced by retail clients when an MDA operator has discretion to invest in products or investment strategies with non-limited recourse? Please outline your reasons for preferring that option.</p> <p>E1Q3 Do you think option (a), (b) or (c) would be most effective in promoting confident and informed consumer and investor decision making and investment in MDAs?</p> <p>E1Q4 If you prefer option (a), do you think the wording of the risk warning should be standardised or should MDA operators be able to tailor the warning to suit their particular MDA offering?</p> <p>E1Q5 Do you think any other measures need to be taken to address the risks faced by retail clients when higher-risk investments are included within an MDA? If so, what measures would be the most effective?</p> <p>E1Q6 Do you think there are any other classes of investment products or strategies that should be subject to the same conditions outlined in this proposal? Please identify which investments or strategies, and why.</p> <p>E1Q7 Will any of the three options impose costs on your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing</p>

Proposal	Your feedback
<p>E2 For the purpose of all three options outlined in proposal E1, we propose to define a 'non-limited recourse product or arrangement' as 'an obligation imposed on a person under an agreement to pay an amount to another person in the event of the occurrence or non-occurrence of something, where the rights of the other person are not limited to any property that the first person has paid or set aside as security for the payment, including property to be transferred by the other person to the first person on completion of the obligation under the agreement'.</p>	<p>E2Q1 Do you agree with our proposed definition of a 'non-limited recourse product or arrangement'? If you think an alternative definition should be used, please supply that definition and outline why it is preferred.</p> <p>E2Q2 Should the definition specifically exclude certain types or classes of non-limited recourse products or arrangements that involve lower risks for investors? If so, which investments should be excluded?</p>
<p>E3 We propose to modify the conditions of our relief so that, when a licensed trustee company who provides traditional trustee company services which include acting as an attorney under an enduring power of attorney (EPA):</p> <ul style="list-style-type: none"> <li>(a) is acting as an attorney for an MDA client under an EPA;</li> <li>(b) is providing an MDA service to the client under [CO 04/194]; and</li> <li>(c) the client subsequently loses legal capacity as a result of becoming of unsound mind,</li> </ul> <p>we will modify the MDA reporting requirements so that the trustee company who is the MDA operator would be required to maintain and prepare the ongoing disclosure documentation required by [CO 04/194] and retain a copy for seven years and:</p> <ul style="list-style-type: none"> <li>(a) give the documentation to the next of kin of the client; or</li> <li>(b) where there is no next of kin, or it is not appropriate or practicable to give the documentation to the next of kin, the documentation may be provided to a guardian, administrator or manager of the client.</li> </ul>	<p>E3Q1 Do you agree with our proposal to formally incorporate the above relief for trustee companies who are licensed to provide traditional trustee company services and who hold EPAs for MDA clients who subsequently lose capacity? If not please explain why.</p> <p>E3Q2 Do you think our proposal to give MDA operators who are licensed to provide traditional trustee company services alternative options for the delivery of MDA documentation is appropriate in these circumstances? If not, please explain why.</p> <p>E3Q3 Are there any alternative options that should be made available to MDA operators who are licensed to provide traditional trustee company services? If so, please outline what other options should be available and why?</p> <p>E3Q4 Are there any other alternative requirements or modifications that should be imposed on MDA operators who are licensed to provide traditional trustee company services when a client loses legal capacity because they are of unsound mind? If so, please outline what other requirements or modifications should apply and why?</p> <p>E3Q5 Aside from MDA operators who are licensed to provide traditional trustee company services, do other MDA operators ever act under enduring powers of attorney for some or all of their MDA clients and how common is this? Please provide details.</p> <p>E3Q6 Should the proposed reporting arrangements also apply to MDA operators who are not licensed to provide traditional trustee company services, provided that they are also acting under an enduring power of attorney? If so, please outline who this should apply to and why. If not, please outline why not.</p> <p>E3Q7 Will implementing this proposal impose additional costs for these MDA operators? Please give details of any initial and/or ongoing costs that would result.</p>

Proposal	Your feedback
	<p>E3Q8 Should ASIC address any other issues in our terms of relief in relation to MDA clients that lose legal capacity due to unsoundness of mind? Particular issues include: when ASIC should address relief for arrangements that have effect only on loss of capacity; when it is appropriate to provide information to the next of kin or guardians; nomination of alternative recipients in advance of incapacity; the obligations that should apply if a client resumes legal capacity; and whether the same provisions should apply to MDAs involving trusts rather than powers of attorney. Please outline why or why not these issues should be addressed.</p>
<p>E4 We propose to modify the conditions of our relief to change the breach reporting timeframe from five business days to 10 business days.</p>	<p>E4Q1 Do you agree with our proposal to increase breach reporting times to correspond with the breach reporting requirements in s912D(1B)? If not, why not?</p>
<p>E5 We propose to provide guidance that, when an MDA operator breaches our conditions of relief, we will consider the nature, scope and effect of any breach to determine a proportionate regulatory response, which may include exclusion from relief.</p>	<p>E5Q1 Do you agree with our proposed guidance concerning breaches of our conditions of relief? If not, why not?</p>
<p>E6 We propose to modify the conditions of our relief to make it explicit that the requirements of our class order only apply to an MDA operator when it is providing an MDA to a retail client, or to a custodian in a custodial arrangement under s1012IA that has been given instruction by a retail client.</p>	<p>E6Q1 Do you agree with this proposal? If not, why not?</p>
<p>F1 We propose to revise RG 179 and to provide revised regulatory guidance on the scope and application of our MDA class order relief—in particular, to:</p> <ul style="list-style-type: none"> <li>(a) make it clearer what arrangements are captured by our guidance on MDAs, including by using examples;</li> <li>(b) clarify in our guidance that, for an arrangement to meet the definition of an MDA, the client and the MDA operator intend that the MDA operator will use client contributions of the client to generate a financial return or other benefit (this aligns with the current class order);</li> <li>(c) clarify that we consider MDAs to be financial products, which also involve the provision of several financial services;</li> </ul>	<p>F1Q1 Do you agree with our proposals to provide revised regulatory guidance on the scope and application of our MDA relief and guidance? If not, please explain why.</p> <p>F1Q2 Are there any other topics which relate to the scope and application of our MDA relief and guidance where revised guidance is needed? Please provide details.</p> <p>F1Q3 Do you agree with our proposals to provide revised regulatory guidance on what licence authorisations are required for different MDA activities? If not, please explain why.</p>

Proposal	Your feedback
<p>(d) provide guidance on what AFS licence authorisations are required for:</p> <ul style="list-style-type: none"> <li>(i) MDA operators providing MDAs to retail clients only;</li> <li>(ii) MDA operators who provide MDAs to wholesale clients only;</li> <li>(iii) MDA operators who provide MDAs to wholesale and retail clients;</li> <li>(iv) external MDA advisers; and</li> <li>(v) external MDA custodians; and</li> </ul> <p>(e) clarify that, as well as meeting the PI and fraud insurance requirements in [CO 04/194], MDA operators must also meet the requirements imposed on all AFS licensees in RG 126.</p>	
<p>F2 We propose to provide more detailed regulatory guidance about our expectations for MDA operators in relation to managing conflicts of interest. This guidance will cover:</p> <ul style="list-style-type: none"> <li>(a) the requirement for MDA operators who rely on [CO 04/194] to act in the best interests of the client in providing the MDA services to the client ([CO 04/194], condition 1.12(c));</li> <li>(b) the requirement for MDA operators who rely on [CO 04/194] to prioritise the client's interests ahead of their own, if there is a conflict between the interests of the client and their own interests ([CO 04/194], condition 1.12); and</li> <li>(c) specific guidance for all MDA operators in relation to the general obligation to manage conflicts of interest set out in s912A(1)(aa).</li> </ul> <p>This guidance is intended to supplement the guidance provided for all AFS licensees in Regulatory Guide 181 <i>Licensing: Managing conflicts of interest</i> (RG 181): see the draft regulatory guidance in paragraphs 104–124 in the appendix to this paper.</p>	<p>F2Q1 Do MDA operators need ASIC guidance to assist them to comply with their obligations under [CO 04/194] and under s912A(1)(aa) in relation to conflicts of interest management?</p> <p>F2Q2 Do you agree with our proposed approach to guidance on conflicts of interest management by MDA operators?</p> <p>F2Q3 Are there any other topics relevant to conflicts of interest management by MDA operators that our guidance should cover? If so, please identify the topics where further guidance is needed.</p> <p>F2Q4 Where an MDA operator has a material conflict of interest in relation to a specific transaction, should they be required to obtain the express consent of the client before undertaking that transaction? Please explain why or why not this should be an explicit requirement.</p> <p>Note: The guidance in this proposal will not address the best interests duty and related obligations that apply to the provision of personal advice to retail clients. See proposal F4 for our proposed guidance that specifically addresses the best interests duty and related obligations for MDA operators and external MDA advisers.</p>



Proposal	Your feedback
<p>F3 We propose to provide additional guidance in RG 179 to complement the guidance ASIC is providing on the legislative changes arising out of the FOFA reforms, addressing the specific circumstances of MDAs and MDA operators in relation to:</p> <p>(a) the best interests duty and related obligations;</p> <p>(b) fee disclosure statements; and</p> <p>(c) the opt-in requirement.</p>	<p>F3Q1 Do you agree with our proposals to provide MDA-specific regulatory guidance on the FOFA reforms? If not, please explain why.</p> <p>F3Q2 Are there any other aspects of the FOFA reforms where specific guidance from ASIC is needed on applying these provisions to advice about or the operation of MDAs? Please identify which aspects, if any, and why additional MDA-specific guidance is needed.</p>
<p>F4 We propose to provide guidance consistent with our updated Regulatory Guide 175 <i>Licensing: Financial product advisers—Conduct and disclosure</i> (RG 175) about the interaction of the new best interests duty and related obligations (which apply to all AFS licensees and their representatives that provide personal advice to clients) and the conditions of relief in [CO 04/194] concerning the provision of financial advice to MDA clients: see the draft regulatory guidance in paragraphs 125–128 in the appendix to this paper.</p>	<p>F4Q1 Do MDA operators need specific ASIC guidance to assist them to comply with their obligations under the best interests duty and related obligations?</p> <p>F4Q2 Do you agree with our proposed guidance on the best interests duty and related obligations as they specifically apply to MDAs operated under [CO 04/194] and RG 179? If not, please provide details.</p>
<p>F5 We propose to provide guidance consistent with Regulatory Guide 245 <i>Fee disclosure statements</i> (RG 245) about the interaction of the requirements to give annual fee disclosure statements to retail clients and the conditions of relief in [CO 04/194] requiring annual financial advice: see the draft regulatory guidance in paragraphs 129–134 in the appendix to this paper.</p>	<p>F5Q1 Do you agree with our proposals to provide MDA-specific regulatory guidance on the requirement to give annual fee disclosure statements? If not, please explain why.</p> <p>F5Q2 Would our proposed guidance on the requirement to give annual fee disclosure statements assist MDA operators to comply with the new requirements that will be introduced as a result of the FOFA reforms? If not, please explain why.</p> <p>F5Q3 Do you agree with our proposed guidance on the requirement to give annual fee disclosure statements as they apply to MDAs operated under [CO 04/194] and RG 179? If not, please provide details.</p>
<p>F6 We propose to provide guidance about the interaction of the new opt-in requirement requiring fee recipients to send renewal notices and the conditions of relief in [CO 04/194] which require annual financial advice to be provided by the MDA operator or an external MDA adviser to a retail client who invests in an MDA: see the draft regulatory guidance in paragraphs 135–139 in the appendix to this paper.</p>	<p>F6Q1 Do you agree with our proposals to provide MDA-specific regulatory guidance on the interaction of the opt-in requirement and the conditions of relief in [CO 04/194]? If not, please explain why.</p> <p>F6Q2 Would our proposed guidance on the opt-in requirement and the conditions of relief in [CO 04/194] assist MDA operators to comply with the new requirements that will be introduced as a result of the FOFA reforms? If not, please explain why.</p> <p>F6Q3 Do you agree with our proposed guidance on the opt-in requirement and the conditions of relief in [CO 04/194]? If not, please provide details.</p>

Proposal	Your feedback
<p>F7 We propose to withdraw ASX Guidance Note 29, which contains guidance about MDAs for market participants, and incorporate that guidance in the updated RG 179, subject to any modifications arising out of our proposed changes to our guidance or relief.</p>	<p>F7Q1 Do you agree with our proposal to withdraw ASX Guidance Note 29 and to incorporate the guidance contained in the guidance note in the updated RG 179? If not, please explain why.</p>
<p>G1 We propose to retain key elements of our current approach to MDAs, including:</p> <ul style="list-style-type: none"> <li>(a) our current definition of an MDA;</li> <li>(b) the enhanced FSG conditions for MDA operators, except where these are modified by the proposals discussed in this paper;</li> <li>(c) the MDA contract conditions, except where these are modified by the proposals discussed in this paper;</li> <li>(d) the requirement for an investment program to be formulated and reviewed on an annual basis, through personal advice, except where the current conditions are modified by the proposals in this paper;</li> <li>(e) the asset holding conditions that currently apply to MDA operators;</li> <li>(f) the conditions attached to the rights relating to portfolio assets that currently apply to MDA operators;</li> <li>(g) the prohibition on an MDA operator investing client assets in most unregistered schemes;</li> <li>(h) the PI and fraud insurance conditions that currently apply to MDA operators (as contained in [CO 04/194] and RG 126);</li> <li>(i) the requirement to report all transactions to clients on a quarterly basis, or provide substantially continuous electronic access to this information, and report all transactions on an annual basis—except for the proposed modification for MDAs offered through a regulated platform;</li> <li>(j) the requirement for MDA operators to obtain an audit report on whether the MDA operator:</li> </ul>	<p>G1Q1 Do you agree with our proposal for continuing guidance and conditions of relief in the areas outlined above? If not, which guidance and/or conditions of relief do you think need to be reviewed and why?</p> <p>G1Q2 Are there any contradictions or inconsistencies that arise out of retaining these elements of our guidance and conditions of relief while implementing some or all of the proposals contained elsewhere in this consultation paper? If so, please give details.</p>

Proposal	Your feedback
<ul style="list-style-type: none"> <li>(i) had appropriate documented measures in place to ensure its compliance with the requirements of the Corporations Act and the class order; and</li> <li>(ii) had appropriate internal controls and procedures to ensure that transaction reports were not materially misstated;</li> <li>(k) the specific conditions that apply to MDA operators and custodians when an external custodian is used; and</li> <li>(l) the specific conditions that apply to MDA operators and dealers when dealers are contracted by the MDA operator.</li> </ul>	
<p>G2 We do not propose any changes to the regulatory requirements that apply to MDAs that are registered schemes.</p>	<p>G2Q1 Do you agree with our proposal not to make any changes to the regulatory requirements that apply to MDAs that are registered schemes? If not, please outline what changes are required and why.</p>
<p>G3 We propose to continue to give relief from the requirements that:</p> <ul style="list-style-type: none"> <li>(a) an MDA must be operated as a registered scheme;</li> <li>(b) disclosure must be provided, as required by Pt 7.9 of the Corporations Act, in relation to a financial product that is: <ul style="list-style-type: none"> <li>(i) a right to MDA services operated by the MDA operator; or</li> <li>(ii) held by a client because a legal or equitable interest in the financial product is held on behalf of the client as part of an MDA; and</li> </ul> </li> <li>(c) disclosure must be provided, as required by Ch 6D of the Corporations Act, for an offer to a client of securities to be held as part of an MDA.</li> </ul>	<p>G3Q1 Do you agree with our proposal for continuing relief in the areas outlined above? If not, why not?</p> <p>G3Q2 Are there any contradictions or inconsistencies that arise out of retaining these elements of our relief while implementing some or all of the proposals contained elsewhere in this consultation paper? If so, please give details.</p>

Proposal	Your feedback
<p>H1 We propose that new MDA operators comply with any revised regulatory guidance and conditions of relief in the amended class order(s) from the date on which the guidance and class order(s) are released.</p>	<p>H1Q1 Do you agree with this proposal? If not, why not?</p> <p>H1Q2 Is the proposal for new MDA operators to start complying with the new requirements when they are released reasonable? If not, why not?</p>
<p>H2 We propose to provide existing MDA operators with staged transition periods to comply with any revised regulatory guidance and conditions of relief in the amended class order. Specifically, we propose that:</p> <ul style="list-style-type: none"> <li>(a) established AFS licensees currently offering family accounts under our no-action letter comply with our proposal to require family accounts to be operated in accordance with certain conditions from 1 July 2014;</li> <li>(b) established AFS licensees currently offering MDAs under our regulated platforms no-action letter comply with our proposal to regulate these MDAs similarly to other MDAs within two years from the time our revised regulatory guidance and class order are issued (see proposal B5);</li> <li>(c) established MDA operators, including those currently offering MDAs in reliance on either of the two no-action positions, comply with the revised financial resource requirements from 1 July 2014; and</li> <li>(d) all established MDA operators comply with any other revised requirements and regulatory guidance from 1 July 2014.</li> </ul>	<p>H2Q1 Do you agree with the proposed timeframe and transitional arrangements? If not, please indicate what timeframes you think are more appropriate.</p>