



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 44

Managed discretionary account services

April 2003

Your comments

You are invited to comment on the proposals and issues for consideration in this paper, including the explanation sections. We will not treat your submission as confidential unless you specifically request that we treat the whole or part of your submission as confidential.

Comments are due by 22 May 2003 and should be sent to:

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You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.

What this policy proposal is about

1 This policy proposal paper outlines our preliminary views on how we propose to regulate managed discretionary account (“MDA”) services provided to retail clients under the *Corporations Act 2001* (“Corporations Act”). It covers the approach we propose to take in applying the licensing, managed investment, disclosure and conduct provisions to MDA services.

2 Our proposals cover:

- (a) what we consider to be an MDA service (**Section A**);
- (b) what conditional relief from the Corporations Act we are considering for MDA services (**Section B**); and
- (c) when the new policy will apply (**Section C**).

3 We have also included two Schedules. The Schedules set out details that we do not consider essential to the understanding of the proposals but which may interest some readers:

- (a) **Schedule 1** compares MDA services with investor directed portfolio services (“IDPS”) and managed investment schemes structured as unit trusts; and
- (b) **Schedule 2** outlines our understanding of why a client might use an MDA service.

4 This paper forms part of ASIC’s review of policy on the regulation of MDA services. The review is considering, among other things, the adequacy and appropriateness of the current arrangements for regulating MDA services in light of changes to the Corporations Act arising from the *Managed Investments Act 1998* and the *Financial Services Reform Act 2001*, and other industry developments.

Note: For references to the ASIC review: See Policy Statement 136 *Managed investments: Discretionary powers and closely related schemes* at [PS 136.34], Policy Statement 169 *Disclosure: Discretionary powers and transition* at [PS 169.37], and Information Releases [IR 02/11] *ASIC undertakes review relating to managed discretionary accounts* (28 June 2002) and [IR 02/19] *Sydney Futures Exchange associate participant class order relief* (27 September 2002).

5 Our proposals do not apply to other types of managed investment schemes such as IDPS, nor do they apply to MDA services offered to only wholesale clients as defined in s761G.

Note 1: For policy on IDPS and IDPS-like services, see Policy Statement 148 *Investor directed portfolio services* [PS 148] and Policy Statement 149 *Nominee and custody services* [PS 149].

Note 2: We are asking for public comment on whether any relief from the Corporations Act is required for an MDA service provided to a wholesale client: see policy proposal paragraph [B25] and [B25Q1] and [B25Q2].

6 The purpose of our proposals is to promote discussion about how MDA services should be regulated. They are only an indication of the way we are thinking at this stage and should not be seen as final ASIC policy. We encourage you to put forward:

- (a) your views in response to the specific questions in this paper;
and
- (b) any additional views you may have about regulation of MDA services.

Important note: The proposals and explanations in this paper do not constitute legal advice. Persons who intend to offer MDA services should seek their own legal advice. This paper is based on the legislation and regulations as at 11 April 2003. We do not anticipate any changes to the legislation or regulations that will affect our proposals. However, if there are relevant changes to the legislation or regulations before we publish our final policy, we will take those into account in finalising this policy.

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Policy proposals

In this paper, there are three groups of policy proposals for MDA services. For each group, we set out the proposals and identify issues we would like you to comment on. When necessary, we have also included some explanations of our proposals.

Special note: There may be other issues that you consider important. We are keen to hear from you on these issues and our general approach, as well as your answers to our specific questions.

A What is an MDA service?

Policy proposal	Your feedback
<p>A1 For the purposes of our proposals, an MDA service is a business arrangement that involves all the following features:</p> <ul style="list-style-type: none"> (a) a person (“the client”) makes contributions of money or money’s worth (“client contributions”) by giving to another person (“the operator”) either: <ul style="list-style-type: none"> (i) money or other assets; or (ii) access to and control of the client’s money or other assets (eg through a power of attorney or a signatory arrangement relating to a bank account of the client); (b) the client gives to the operator the discretion to acquire or dispose of financial products on behalf of the client using the client contributions or other assets derived directly or indirectly from the client contributions (“portfolio assets”) (which discretion is not merely confined to the time or price at which the acquisition or disposal of portfolio assets could be made); (c) the operator undertakes to: <ul style="list-style-type: none"> (i) manage the client’s portfolio as a discrete portfolio belonging to the client; (ii) provide reports to the client relating to the client’s portfolio; and (iii) follow the client’s instructions on the transfer and realisation of the client’s portfolio assets and the payment of relevant proceeds. The payments may be subject to any 	<p>A1Q1 Are there means other than those specified in subparagraph (a) by which a client could make contributions to the operator of an MDA service? If so, what are they and why should they be included?</p> <p>A1Q2 Do you think there are practical difficulties in applying our proposals to arrangements that involve the client giving only “access and control” of the client’s funds (see subparagraph (a)(i)), instead of custody (see subparagraph (a)(ii))? If so, how should those difficulties be addressed to promote regulation of services using such arrangements to produce similar outcomes as set out in our proposals?</p> <p>A1Q3 Is it sufficient to rely on the “business test” to exclude private arrangements under which trading activities are conducted on behalf of a family member from regulation as MDA services? If not, how should such private arrangements be effectively excluded from regulation as MDA services?</p> <p>Note: For details about how we see the</p>

Policy proposal

prior contrary arrangements the operator may put into place to ensure the repayment of moneys owed by the client; and

- (d)** the client is a retail client as defined in s761G.

Note 1: The operator includes an agent of the operator. For the definition of the term “operator”, see under “Key terms”.

Note 2: An operator of an MDA service will not be able to pool one client’s portfolio assets with that of another client’s for investment purposes. For more details, see paragraphs 11–13 of the Explanation in this section.

Note 3: For a discussion of the legal classification of an MDA service, see paragraphs 15 –16 of the Explanation in this section.

Note 4: For MDA services provided to wholesale clients: See policy proposal paragraph [B25].

Your feedback

licensing requirements under the Corporations Act applying to trading under powers of attorney and the application of the business test: See paragraph 8 of the Explanation in this section.

Explanation

How have we defined an MDA service?

1 For the purposes of developing our proposals and clarifying when the proposed relief will apply, we have formulated a definition of the service we are calling an MDA service. We have done this by reference to the features of such a service and have been deliberately broad: see policy proposal paragraph [A1] and paragraphs 4–13 of the Explanation in this section.

2 Generally, when we refer to an MDA service for the purposes of these proposals, we are referring to an arrangement such as a trading account through which a person (“the client”) gives another person (“the operator”) authority to effect transactions using the client’s portfolio assets on a discretionary basis (ie without prior reference to or approval of the client for each transaction) and where the client is a retail client as defined in s761G. In some cases, clients may provide broad parameters within which investments should or should not be made. In other instances, the client and operator may agree on a more detailed investment program or strategy. To facilitate such trading, the operator is given the custody of, or access to and control of, the client’s portfolio assets. If the custody is given to the operator, the client’s funds and assets are generally held in trust for and on behalf of the client.

Note: The operator may be, but is not always, a market participant.

3 Defining the concept of an MDA service by reference to its features in this way is particularly important because different terminology is used when referring to such a service and there is some inconsistency in the terminology used. Some services that are referred to as, for example, “separately managed accounts”, “individually managed accounts”, “investment advisory programs” and “managed discretionary portfolio services” may be MDA services. Before now, ASIC has also used different terminology when referring to these services. For example, we have used the term “MDA services” in our class order relief given to participants and ex-associate participants of SFE for discretionary accounts they operate: see Class Orders [CO 01/1598], [CO 02/186] and [CO 02/1022]. On the other hand, we have used the term “discretionary portfolio accounts” (“DPAs”) in the pro-forma licence conditions we impose on persons operating discretionary accounts for securities as defined under the Corporations Act before the commencement of the FSR Act (“old Corporations Act”). These are a type of MDA service: see Pro Forma 209 *Australian Financial Services Licence conditions* [PF 209] conditions 37–41.

What are the typical features of an MDA service?

4 For the purpose of our proposals, we have defined an MDA service as an arrangement between the client and the operator under which:

- (a) the client makes certain contributions (see subparagraph (a) of policy proposal paragraph [A1] and paragraphs 5–8 of the Explanation in this section);
- (b) the operator is given certain instructions and trading discretions (see subparagraph (b) of policy proposal paragraph [A1] and paragraph 9 of the Explanation in this section); and
- (c) the operator undertakes to manage the client’s portfolio assets in a certain manner (see subparagraph (c) of policy proposal paragraph [A1] and paragraphs 10–13 of the Explanation in this section).

Note: By way of additional background to what is an MDA service, we have set out:

- (a) a comparison of MDA services with IDPS, and also MDA services with unit trusts: see Schedule 1; and
- (b) our understanding of why a client might use an MDA service, including the potential benefits of using such a service: see Schedule 2.

Client contributions

5 A client could make contributions in two ways:

- (a) by giving the operator funds and/or other assets that could be readily converted to funds for investment purposes; or
- (b) by giving the operator access to and control of such funds and assets.

6 In the first case, the client will transfer to the operator or a person appointed by the operator (“the custodian”) the legal title to funds and assets. In the second case, while the client would continue to hold the legal title to the funds and assets in the client portfolio, the operator would be given access to or control over such assets to carry out transactional functions (eg trading activities). The means by which such access or control could be given include, for example:

- (a) a power of attorney given by the client to the operator; or
- (b) other authorisation forms such as signatory arrangements allowing the operator access to a bank account held in the client’s name.

7 When a client gives to an operator access to and control of the client’s funds and/or other assets, in effect the operator has the power to

convert or dispose of such funds or assets in the same way as if the operator held the legal title. Therefore, we consider that such arrangements are sufficient to satisfy the requirement that the client makes contributions for the purposes of operating an MDA service, as the client does not have day-to-day control over those assets.

8 However, where the arrangements under which a person carries out investment activities as agent of another person are private arrangements (eg private arrangements using a power of attorney given by a family member), these arrangements may not be covered by our proposals. This is because such a person may generally not be carrying out those activities in such a manner to be considered as conducting a business (that is, engaging in such conduct with system, repetition and continuity) to attract the licensing requirements under the Corporations Act.

Trading discretions

9 In an MDA service, the operator makes trading decisions using its discretion. For this purpose, the client gives to the operator an authority to acquire and dispose of financial products using the client contributions, and also to balance investments in the client portfolio on an ongoing basis. Such an authority may allow the operator to exercise its discretion under either:

- (a) a detailed program that identifies particular financial products or classes of financial products in which the client contributions will be invested; or
- (b) a broad investment mandate that contains only an identified strategy or an objective.

Note: For more details about the investment program, see paragraphs 20–28 of the Explanation in Section B.

If the discretion given to the operator is confined to merely the time or price at which transactions could be effected, we do not consider such an arrangement to be covered by our proposals. Such an arrangement may not be a financial product, but in some circumstances, it may be an IDPS.

Note: For our policy on IDPS, see Policy Statement 148 *Investor directed portfolio services* [PS 148].

Client portfolio management

10 As part of an MDA service, the operator typically undertakes to:

- (a) manage the assets in each client's portfolio as a discrete portfolio;
- (b) provide reports to the client relating to the client's portfolio; and
- (c) follow the client's instructions relating to:
 - (i) the transfer and liquidation of assets in the client's portfolio; and
 - (ii) payment of proceeds from the realisation of assets, subject to any prior contrary arrangements the operator may put into place to ensure the repayment of moneys owed by the client.

11 Assets in the client's portfolio could generally be managed as a discrete portfolio for that client through an MDA service in one of two ways:

- (a) the legal title to the assets could be held by the operator (or a custodian) and the client would have a beneficial interest in those assets. This would generally involve an actual or notional allocation of those assets as belonging to the particular client; or
- (b) the legal title to the assets could be held by the client. In this case, the management of the client's assets as a discrete portfolio would need to be given effect to through an authorisation arrangement, such as a power of attorney or a signatory arrangement.

12 In both cases, the operator will not be able to pool one client's portfolio assets with those of any other client's portfolio assets for investment purposes (ie to access wholesale investments). This is because we believe that such pooling would be inconsistent with the requirement to manage the client's assets as a discrete portfolio belonging to that client. However, this would not generally prevent an MDA operator from being able to carry out some transactional and other functions relating to client portfolios on a collective basis (such as placing bulk orders, netting of transactions or research relating to financial products in which portfolio assets are to be invested).

13 Although the client delegates to the operator the effective investment selection function relating to the client's portfolio, the client may retain the discretion to direct the operator as to the timing of the transfer or realisation of assets in the client's portfolio, and also as to how the

proceeds from the realisation of assets should be used. However, the operator may expressly reserve rights to recover amounts due from the client out of the assets in the client's portfolio (such as under margin lending arrangements or brokerage or other fees payable by the client). In such cases, we will still consider those arrangements to be an MDA service for the purposes of our policy proposals.

What about MDA services offered to wholesale clients?

14 We propose not to apply our proposals to MDA services offered to wholesale clients as defined in s761G(4). This is because the managed investment and financial product disclosure provisions in Chapter 5C and Part 7.9 of the Corporations Act do not apply to MDA services provided to wholesale clients. However, the licensing requirements in Part 7.6 and the conduct requirements in Part 7.8 (excluding the prohibitions against hawking: s992A and 992AA) do apply to an MDA service provided to a wholesale client. Therefore, we are asking your feedback on:

- (a) whether any relief from the applicable provisions is required for an MDA service provided to a wholesale client; and
- (b) some conditions of relief proposed under this paper where MDA services are offered by an operator to both retail and wholesale clients.

See policy proposal paragraph [B25] and [B25Q1] and [B25Q2].

What is the legal classification of an MDA service?

15 In developing our proposals, we have considered whether an MDA service:

- (a) is a managed investment scheme;
- (b) is a financial product;
- (c) involves the provision of financial product advice; and
- (d) involves the operation of a custodial and depository service.

16 Our view is that an MDA service:

- (a) is likely to constitute a managed investment scheme:
 - (i) between the operator and each client to whom an MDA service is provided, on the basis that there is a common enterprise between the client and the operator; and

- (ii) between the operator and all the clients to whom the operator provides MDA services, where the operator carries out administrative services relating to clients' portfolio assets as a whole (we take this view even where client contributions are not pooled for investment purposes);
- (b) is likely to constitute a financial product in its own right even if it is not a managed investment scheme because it is a facility through which a client makes a financial investment;
- (c) is likely to constitute the provision of financial product advice relating to both the financial product constituted by the MDA service and the financial products in which the operator of the MDA service invests, in at least three circumstances:
 - (i) where the operator offers an investment strategy ("the investment program") that specifies financial products or classes of financial products in which the operator would invest the portfolio assets;
 - (ii) where the operator offers the financial product constituted by the MDA service to clients, generally the offer, unless it is contained in an exempt document (see s766B(3)); and/or
 - (iii) where the operator offers the MDA service and/or the investments that are to be made through the MDA service as financial products suitable for the particular client (which is personal advice); and

Note: In each of these cases, we consider that there is either an opinion or an express or implied recommendation intended to influence a decision a client would make relating to a financial product or class of financial products. When an MDA service operator complies with the class order relief proposed in this paper, the operator will certainly be providing financial product advice that constitutes personal advice: see paragraphs 24–25 of the Explanation in Section B.

- (d) may constitute a custodial and depository service within the meaning of s766E of the Corporations Act.

B What is our proposed relief?

Policy proposal	Your feedback
<p>A tailored regulatory approach</p> <p>B1 We propose to apply to MDA services a tailored regulatory regime that is:</p> <ul style="list-style-type: none"> (a) based on the licensing and conduct requirements in Parts 7.6–7.8 of the Corporations Act; and (b) supported by additional requirements that are functionally relevant to the nature of MDA services (see policy proposal paragraphs [B7]–[B24]). <p>B2 Under this tailored approach, we propose to give conditional relief to the operator of an MDA service from:</p> <ul style="list-style-type: none"> (a) the requirement to register the MDA service as a registered scheme under Chapter 5C (s601ED); and (b) the requirements relating to financial product disclosure (Part 7.9). <p>Note 1: To find out about when we are proposing to apply the new policy, see Section C.</p> <p>Note 2: An “operator” of an MDA service is defined in “Key terms” as a person that contracts with a client to provide services that comprise an MDA service.</p> <p>Note 3: Persons operating under an old Corporations Act licence will not be able to operate an MDA service under the relief proposed in this section. However, such persons would have the benefit of the transitional arrangements discussed in Section C.</p> <p>Note 4: We will also consider the need to exempt operators of MDA services from the requirement to have an AFS licence authorisation for providing financial product advice in its promotional material for</p>	<p>B2Q1 Do you agree with this approach to regulating MDA services? If not, what are your reasons and how should they be regulated? For example, should MDA services simply be regulated as managed investment schemes?</p>

Policy proposal

the MDA service. This relief may be appropriate if the operator is relying on an external licensee for the preparation and review of the investment program of the MDA service. (For more information about the preparation and review of the investment program by another licensee, see paragraphs 27 and 28 of the Explanation in this section.)

B3 We propose to give relief to only one operator for a particular MDA service.

Note: Other persons may carry out distinct functions relating to an MDA service, such as a custodian or financial product adviser. They will need to do so under their own AFS licence. See policy proposal paragraph [B4] for relief we propose for such persons.

B4 We will also give relief from Chapter 5C and Part 7.9 to entities that do not directly contract with the client to operate the MDA service, but who carry out distinct functions relating to it. These entities include those who:

- (a) act as a custodian for the MDA service; or
- (b) give financial product advice about the investment program of the MDA service (see policy proposal paragraphs [B13]–[B14]).

Note: Entities who provide these discrete services relating to an MDA service will have to do so under their own AFS licence.

Your feedback

B3Q1 Are there practical difficulties in relief being limited to a single operator? If so, what are they?

B3Q2 Are there other persons involved in the operation of an MDA service who may require relief? If so who are they, why should they be given relief and what relief is required?

Policy proposal	Your feedback
<p>B5 This relief will not apply if the entity:</p> <ul style="list-style-type: none"> (a) knowingly causes or procures the operator to breach the conditions of the operator's relief or the requirements of the Corporations Act; (b) knowingly engages in misleading or deceptive conduct in relation to the MDA service; or (c) fails to inform ASIC in writing as soon as practicable after it has become aware that it has engaged in misleading or deceptive conduct in relation to the MDA service and that this has had, or is likely to have a materially adverse effect on any client of the MDA service. <p>B6 We propose to apply to an operator of an MDA service the obligations relating to:</p> <ul style="list-style-type: none"> (a) the duties of a responsible entity in paragraphs (a), (b), (c), (e), (i) and (l) of s601FC(1); (b) the duties of officers of a responsible entity in paragraphs (a), (b), (c), (d), (e), (f)(i) and (f)(iv) of s601FD; (c) the duties of employees of a responsible entity in s601FE; and (d) the civil liability of a responsible entity to members of the managed investment scheme in s601MA, <p>as if the MDA service were a registered scheme, the operator were the responsible entity and the client's portfolio assets were scheme property.</p>	<p>B5Q1 Should there be other conditions subject to which relief should be provided? If so, what are they?</p> <p>B5Q2 Are there any practical difficulties in complying with these obligations? If so what are they and how should they be addressed?</p> <p>B6Q1 Should any of these obligations not apply to an operator of an MDA service? If so, what obligations should not apply and why?</p>

Policy proposal	Your feedback
<p>Conditions of relief</p> <p>Summary of conditions</p> <p>B7 Under the conditions of our proposed relief, the operator of an MDA service must:</p> <ul style="list-style-type: none"> (a) hold an Australian financial services licence (“AFS licence”) that has certain authorisations and conditions (see policy proposal paragraphs [B8]–[B10]); (b) include certain additional information in the Financial Services Guide (“FSG”) given to a client about the MDA service (see policy proposal paragraph [B11]); (c) enter into a contract with the client (“MDA contract”) to operate the MDA service in a certain manner (see policy proposal paragraph [B12]); (d) include in the MDA contract an investment program, which complies with certain requirements (see policy proposal paragraphs [B13]–[B14]); <p>Note: See the definition of “investment program” in “Key terms”.</p> <ul style="list-style-type: none"> (e) ensure that the investment program for each client is reviewed at least once every 12 months (see policy proposal paragraph [B15]); (f) ensure each client’s portfolio assets are applied as a discrete portfolio (see policy proposal paragraph [B16]); (g) have and comply with adequate documented compliance measures and arrange for their audit (see policy proposal paragraph [B17]); (h) report non-compliance and in some cases of breach, suspend operations (see policy proposal paragraph [B18]); 	<p>B7Q1 Are these conditions of relief appropriate? If not, why not?</p> <p>B7Q2 Are there other conditions of relief that should be included? If so, what are they and why should they be included?</p>

Policy proposal

- (i) comply with the client’s instructions on corporate actions and communications relating to the portfolio assets (see policy proposal paragraph [B19]);
- (j) report to the client about the performance of the client’s portfolio (see policy proposal paragraphs [B20]–[B21]);
- (k) maintain records of the documents provided to the client under our proposed relief (eg FSG and annual report) (see policy proposal paragraph [B22]);
- (l) restrict investments in unregistered schemes (see policy proposal paragraph [B23]); and
- (m) maintain an appropriate insurance policy (see policy proposal paragraph [B24]).

Note 1: See the Flowchart at the end of the Explanation in this section for steps an operator would generally have to take when providing an MDA service to a client under our proposed relief.

Note 2: For a comparison of the legal obligations on responsible entities, IDPS operators and MDA service operators, see the Table after the Flowchart at the end of the Explanation in this section.

Relief condition (a): Licensing of MDA operators

B8 Under our proposed relief, the operator must hold an Australian financial services licence (“AFS licence”) that requires them to comply with the conditions of relief and which authorises that person to:

- (a) deal in the financial product constituted by the MDA service and the financial products in which the operator of the MDA service invests;

Your feedback

B8Q1 Do operators of MDA services need any other authorisations? If so what are they and why?

Policy proposal	Your feedback
<p>(b) conduct custodial and depository services – if the service involves holding financial products for the client (unless another AFS licensee who is authorised to conduct custodial and depository services holds the financial products in the client’s portfolio); and</p> <p>(c) give financial product advice (unless another AFS licensee who is authorised to give financial product advice prepares and/or reviews the investment program included in the MDA contract: see policy proposal paragraph [B14]).</p> <p>Assessment of licensing applications</p> <p>B9 In assessing an application for the authorisations required to operate an MDA service, we propose to take into account the competency and ability of the operator to provide the type of financial services referred to in policy proposal paragraph [B8] that are offered as part of the MDA service.</p> <p>B10 Therefore, we propose to base our licensing assessment on:</p> <p>(a) the general requirements in:</p> <p>(i) Policy Statement 164 <i>Licensing: Organisational capacities</i> [PS 164] (so far as those requirements apply to custodial and depository services, dealing in financial products and giving financial product advice);</p> <p>(ii) Policy Statement 165 <i>Licensing: Internal and external dispute resolution</i> [PS 165]; and</p> <p>(iii) Section C of Policy Statement 166 <i>Licensing: Financial requirements</i> [PS 166]; and</p>	<p>B9Q1 Should the terms of assessment be different? If so what should be the appropriate terms of assessment and why?</p> <p>B10Q1 Does our proposed approach give rise to any practical difficulties? If so, what are they and how should they be addressed?</p>

Policy proposal

- (b) the more specific requirements in:
- (i) Section D of Policy Statement 130 *Managed investments: Licensing* [PS 130] (except [PS 130.60]);
 - (ii) Policy Statement 132 *Compliance plans* [PS 132]; and
 - (iii) Policy Statement 133 *Managed investments: Scheme property arrangements* [PS 133] (except subparagraph (a) of [PS 133.26]).

Note: We propose to apply the policies in subparagraphs (b)(i)–(iii) as if:

- (a) an MDA service is a registered scheme;
- (b) an operator of an MDA service is a responsible entity; and
- (c) the compliance plans are those relating to the compliance measures set out in policy proposal paragraph [B17].

Relief condition (b): Additional disclosure through an FSG

B11 The FSG for the MDA service must comply with the requirements in Division 2 of Part 7.7 and include, in as much detail as a client would reasonably require to make an informed decision to participate in the MDA service, the following additional information and statements:

- (a) information about who has custody of the client’s portfolio assets and if it is not the operator, then the name and details of that person (“the custodian”);
- (b) information about any significant risks associated with investing through the MDA service;

Your feedback

B11Q1 Do you agree with the proposed additional disclosure? If not, why not?

B11Q2 Are there other matters (information or statements) that should be included in the FSG? If so, what are they and why should they be included?

B11Q3 Are there any practical difficulties in complying with these requirements? If so what are they and how should they be addressed?

Policy proposal

- (c) information about how the client may give instructions to the operator or any custodian on corporate actions and communications relating to financial products in the client's portfolio assets;
- (d) a statement that the client must first enter into an MDA contract with the operator before the MDA service can be provided;
- (e) a statement that the MDA contract includes an investment program that is prepared in accordance with the requirements in Division 3 of Part 7.7 and contains the following information:
 - (i) the nature and scope of the discretions that the operator will be authorised and required to exercise;
 - (ii) the risks associated with the investment program;
 - (iii) the basis on which the investment program is considered to be suitable for the client; and
 - (iv) warnings about the importance of any limitations relating to the investment program, which the client must consider before signing the MDA contract;

Note: See policy proposal paragraphs [B13]–[B14] for details about the investment program that must be included in the MDA contract.

- (f) a statement as to the extent to which any labour standards or environmental, social or ethical considerations are to be taken into account in the selection, retention or realisation of investments comprising the client's portfolio assets;

Your feedback

B11Q4 Is it appropriate to require the inclusion of a statement on whether any labour standards or environmental, social or ethical considerations have been taken into account when investing portfolio assets (see paragraph (f))? If not, why not?

Policy proposal

- (g) if the investment program is to be prepared and/or reviewed by another AFS licensee – the name and details of that licensee;
- (h) any other information that might reasonably be expected to have a material influence on the decision of a reasonable person (as a retail client) about whether to obtain the MDA service; and
- (i) a statement that the FSG complies with the conditions of the relief.

Relief condition (c): MDA contract

B12 The operator must enter into an MDA contract with a client before providing an MDA service to that client. The operator must ensure that the MDA contract includes:

- (a) an investment program of the kind referred to in policy proposal paragraph [B13] or [B14]; and
- (b) statements that the operator will:
 - (i) perform its obligations under the MDA contract honestly and with reasonable care and diligence;
 - (ii) act in the best interests of the client and, if there is a conflict between the client's and its own interests, give priority to the client's interests;
 - (iii) not make use of any information acquired through being a provider of financial services to the client in order to gain an improper advantage over or cause any detriment to the client;
 - (iv) be responsible to the client for the functions that the operator has contracted to perform including

Your feedback

B12Q1 Are there other obligations that should be included in the MDA contract? If so, what are they and why should they be included?

Policy proposal

functions connected with the performance of those functions, and acts and omissions of any of its agents engaged to perform those functions, as if they were acts or omissions of the operator; and

Note: This will mean that the operator of an MDA service will not be responsible for ordinary movements in the market performance of the investments in the client's portfolio. However, the operator will be responsible for any inappropriate financial product advice (ie relating to the investment program), where they are the providers of that advice.

- (v) comply with:
 - (A) the conditions of the relief;
 - (B) the MDA contract including the investment program (except where the client has agreed in writing to a variation); and
 - (C) any representations included in the FSG for the MDA service (see policy proposal paragraph [B11]).

Relief condition (d): Investment program

B13 Since it is personal advice, the operator must ensure that the investment program included in the MDA contract:

- (a) is appropriate for the client;
- (b) complies with the requirements in Division 3 of Part 7.7 of the Corporations Act (including the requirements to have a reasonable basis for the view that the program is appropriate for the client, and to provide a Statement of Advice ("SOA"); and

Your feedback

B13Q1 Are there any practical difficulties in complying with the conditions of relief that relate to the investment program? If so, what are they and how should they be addressed?

B13Q2 Would any additional relief be required to enable the operator to meet all its obligations under Division 3 of Part 7.7 through the

Policy proposal

- (c) sets out in as much detail as is necessary for the client to clearly understand:
- (i) the nature and scope of the investment program, including the discretions that the operator will be authorised and required to exercise to carry out that investment program;
 - (ii) any significant risks associated with the investment program;
 - (iii) the basis on which the operator considers the investment program to be suitable for the particular client in light of that client's personal objectives, needs and financial circumstances ("client's relevant circumstances");
 - (iv) how the client may give instructions to the operator to make any changes to the investment program;
 - (v) warnings that the investment program:
 - (A) may not be suitable for the client if the client has provided to the operator limited or inaccurate personal information relating to the client's relevant circumstances; and
 - (B) may cease to be suitable for the client if the client's relevant circumstances change; and
 - (vi) when the investment program will be reviewed and by whom (see policy proposal paragraph [B15]).

Note: See paragraphs 24–26 of the Explanation in this section for details about how an operator of an MDA

Your feedback

investment program (ie without having to give multiple documents to the client including at different times)? If so what is that relief and why should it be given?

Policy proposal

service could meet these obligations. For example, we believe an operator could meet both its obligation to provide an SOA and its obligations under our proposed relief for the investment program at the one time and in one document included in the MDA contract.

B14 The investment program included in the MDA contract may be prepared by another AFS licensee. In that case, the operator must:

- (a) have no reason to believe the investment program does not comply with the requirements in Division 3 of Part 7.7; and
- (b) include in the MDA contract the following information in as much detail as is necessary for the client to clearly understand:
 - (i) the name and details of the AFS licensee responsible for the preparation of the investment program;
 - (ii) if the investment program does not include the information required under subparagraphs (c)(i),(ii),(iv) and (vi) of policy proposal paragraph [B13] – that information; and
 - (iii) a statement that the investment program contains:
 - (A) the basis on which the AFS licensee who prepared the investment program considered it to be suitable for the client; and
 - (B) the warnings required under subparagraph (c)(v) of policy proposal paragraph [B13].

Note: See paragraphs 27–28 of the Explanation in this section for details about how another AFS licensee

Your feedback

B14Q1 Are there any practical difficulties in complying with these conditions? If so, what are they and how should they be addressed?

B14Q2 Would an external AFS licensee preparing an investment program have practical difficulties in complying with these requirements? If so, what are they and how should they be addressed?

B14Q3 Would such a licensee need any relief from Division 3 of Part 7.7 requirements? If so, what is that relief and why should it be given?

Policy proposal

who prepares an investment program for an MDA contract could meet their obligations under Division 3 of Part 7.7.

Relief condition (e): Annual review of the investment program

B15 At a minimum, the operator must ensure that the investment program is reviewed in light of the client's relevant circumstances at least once every 12 months. In doing so, the operator must comply with Division 3 of Part 7.7 and include with its annual report to the client (see policy proposal paragraph [B21]) information about:

- (a) when the investment program has been reviewed and by whom that review was made;
- (b) the basis on which the investment program is considered to continue to be suitable for the client in light of the client's relevant circumstances; and
- (c) if any changes to the investment program are considered necessary (including its termination) in light of any changes in the client's relevant circumstances – then whether and when those changes have been or will be made (subject to any prior instructions in the investment program).

Note: The operator may rely on another AFS licensee to undertake this review provided the above requirements are met. See paragraphs 27–30 of the Explanation in this section for details about how an operator or another AFS licensee could meet their obligations under Division 3 of Part 7.7 (such as the obligations for a SOA and to have a reasonable basis for advice) when conducting this review.

Your feedback

B15Q1 Should an investment program be subject to more regular review (eg quarterly or 6 monthly)? Why?

B15Q2 Are there any circumstances where an annual review of the investment program is not necessary? If so, when and why?

Policy proposal

Your feedback

Relief condition (f): Custody of client's assets

B16 The operator must ensure that:

- (a) if the client does not hold the legal title to the client's portfolio assets, those assets are:
 - (i) held or caused to be held separately from the assets of the operator and other clients and in trust for the client;
 - (ii) in so far as they comprise cash – held in an account under s981B; and
 - (iii) held in a manner that clearly identifies them as assets of the particular client;
- (b) if the client holds the legal title to the client's portfolio assets – the assets are held in a manner that makes them clearly identifiable as available for the purposes of transactional functions under the MDA contract; and
- (c) if there is an external custodian – the custodian has appropriate insurance of the kind referred to in policy proposal paragraph [B24].

Relief condition (g): Compliance measures and audit

B17 The operator must:

- (a) have, maintain and document adequate measures to ensure compliance with its obligations as an AFS licensee and the conditions of the class order relief; and
- (b) arrange for a registered company auditor to audit and lodge with its annual financial statements under s989B a

B16Q1 Are there practical difficulties with the condition in subparagraph (b)? If so, what are they and how should they be addressed?

B16Q2 Are there practical difficulties in complying with these requirements where an external custodian is appointed? For example, would there be difficulties in finding external custodians that carry insurance cover of this nature? If so, how should this be addressed?

B17Q1 Are there practical difficulties in complying with these conditions? If so, what are they and how should they be addressed?

Policy proposal

statement from the auditor as to whether:

- (i) the operator has complied with the documented compliance measures during the financial year to which the financial statements relate; and
- (ii) the documented compliance measures met the conditions of the relief during the financial year.

Relief condition (h): Non-compliance

B18 If the operator becomes aware that it can no longer meet or has breached any condition of proposed relief that has had, or is likely to have, a materially adverse effect on a client, it must:

- (a) notify ASIC in writing as soon as practicable after it becomes aware of the breach; and
- (b) not accept any further contributions from any client or use any client's portfolio assets for the purposes of the MDA service without the prior consent in writing of ASIC.

Note: Failure to comply with this condition will cause the relief to cease to apply to that operator.

Relief condition (i): Responsibility for corporate actions and other communications

B19 The operator must:

- (a) if the MDA contract expressly imposes a duty on the operator to consider exercising any rights that relate to the client's portfolio assets (such as rights in relation to sale, consenting to corporate actions or making dividend re-

Your feedback

B18Q1 Are there any practical difficulties in complying with this requirement? If so, what are they and how should they be addressed?

B19Q1 Are there any practical difficulties in complying with this requirement? If so, what are they and how should they be addressed?

Policy proposal

investments) – exercise those duties as provided in the MDA contract; or

- (b) if the MDA contract does not impose such a duty:
 - (i) give to the client, as soon as practicable after receipt, a copy of all the communications that are relevant to the exercise of any rights that relate to the client’s portfolio assets; and
 - (ii) take reasonable steps to implement any instructions given by the client about how any rights relating to the asset are to be exercised.

Relief condition (j): Client reporting

B20 An operator must give to the client either:

- (a) at least quarterly reports that:
 - (i) are given within one month after the end of 31 March, 30 June, 30 September and 31 December in each year; and
 - (ii) contain information about all transactions effected as part of the MDA service, the value of the assets (including any cash held in a trust account) in the client’s portfolio, and all revenue and expenses (including fees and charges) relating to the MDA service during the relevant quarter; or
- (b) electronic access to information about all transactions effected as part of the MDA service, the value of the assets (including any cash held in a trust account) in the client’s portfolio, and all revenue and expenses (including fees and charges) relating to the MDA

Your feedback

B20Q1 Are there any reasons why an obligation for a quarterly report or ongoing electronic access to information should not be imposed? If not, how should clients be given adequate information to review the ongoing performance of their portfolio?

Policy proposal	Your feedback
<p>service for the last 12 months (or any shorter period since the date of the MDA contract) that:</p> <ul style="list-style-type: none"> (i) covers all transactions up to a date no more than 48 hours before the time of access; (ii) contains a statement of the time at which the information is current; and (iii) contains a reasonably current valuation as at that time. <p>B21 The operator must give to the client within 3 months of the end of each financial year:</p> <ul style="list-style-type: none"> (a) a summary of the information required under subparagraph (a)(ii) of policy proposal paragraph [B20]; (b) a report of a registered company auditor as to whether or not the auditor, having conducted a review, has reason to believe that any information provided under subparagraph (a) or (b) of policy proposal paragraph [B20] (as relevant) for the financial year is materially misstated; and (c) a copy of the annual review of the investment program required under policy proposal paragraph [B15]. 	<p>B21Q1 Is there any information that should not be required to be included in the annual report? If so, what is that information and why should it not be included?</p>
<p><i>Relief condition (k): Record keeping</i></p> <p>B22 The operator must keep for at least 7 years after it has last been in use a copy of:</p> <ul style="list-style-type: none"> (a) each FSG; (b) each MDA contract; and (c) any document that is required to be given to the client under the proposed relief (eg investment program/SOA and annual report). 	<p>B22Q1 Are there other documents that should be included in the record-keeping obligation? If so, what are they and why should they be included?</p>

Policy proposal

Note: This proposal is consistent with the proposal on record keeping in our policy proposal paper *Licensing: Financial product advisers – Conduct and disclosure* (December 2002): see policy proposal paragraphs [B13]–[B14], [C10]–[C11] and [D8] of that paper.

Relief condition (l): Investments in unregistered schemes

B23 The operator must not include in a client’s portfolio, investments in:

- (a) interests in a managed investment scheme that is not a registered scheme – unless it would be permitted if the MDA service were a registered scheme (see Class Order [CO 98/55]); or
- (b) interests in a scheme that is not required to be registered under paragraph (e) of the definition of “managed investment scheme” in s9 (that is, a scheme where the promoter and all investors in the scheme are related bodies corporate).

Relief condition (m): Professional indemnity and fraud insurance

B24 The operator must maintain an insurance policy covering professional indemnity and fraud by officers and employees that:

- (a) is adequate having regard to the nature of the activities carried out by the AFS licensee in relation to the MDA service; and
- (b) covers claims amounting in aggregate to whichever is the lesser of:
 - (i) \$5 million; or
 - (ii) the sum of the value of all clients’ portfolio assets in all MDA services for which it is the operator.

Your feedback

B23Q1 Are there other circumstances in which investments in unregistered schemes should be permitted? If so, what are they and why should they be permitted?

B24Q1 Are there any practical difficulties in complying with this requirement? If so, what are they and how should they be addressed?

Policy proposal

Relief for MDA services provided to wholesale clients

B25 Our proposals will generally not apply if MDA services are provided only to wholesale clients as defined in s761G(4) of the Corporations Act. They will however apply if MDA services are provided by the same operator to both retail and wholesale clients. In this case, we propose not to apply the proposed conditions of relief that relate to particular clients (ie the conditions in subparagraphs (b), (c), (d), (e), (i), (j) (k) and (l) of policy proposal paragraph [B7]) to provision of the MDA services to wholesale clients.

Note: Generally, operators of MDA services for wholesale clients will need an appropriate AFS licence and must comply with the obligations of a licensee including the obligations under Part 7.8, although they will not be subject to the requirements in Parts 7.7 and 7.9 (except s1017E) with regard to those services. However, if an operator of an MDA service has both retail clients and wholesale clients, the operator may be required to register its services under Chapter 5C (s601ED).

Your feedback

B25Q1 Should any of our proposals apply to MDA services offered only to wholesale clients? If so, why?

B25Q2 Where MDA services are provided to both retail and wholesale clients, should any of our conditions of relief that apply in relation to particular clients apply to wholesale clients? If so, why?

Explanation

How are MDA services currently regulated?

1 Generally, persons who operate MDA services without the benefit of the relief available to SFE participants and ex-associate participants of SFE, or the no-action position available to ASX participants, must fully comply with the requirements in the Corporations Act and old Corporations Act (as applicable).

Note 1: For details of our current regulatory approach to MDA and similar services operated by ASX and SFE participants and ex-associate participants of SFE: see Section C.

Note 2: We also impose conditions on persons who provide discretionary portfolio accounts (“DPAs”) (which are a kind of an MDA service as defined in these proposals): see paragraph 9 of the Explanation in this section.

Note 3: Generally, during the FSR transition, which ends on 11 March 2004, financial service providers will be subject to the old Corporations Act until they obtain an AFS licence.

Corporations Act

2 The Corporations Act (as amended by the FSR Act) creates obligations for operators of MDA services to the extent an MDA service:

- (a) is a managed investment scheme;
- (b) is a financial product;
- (c) constitutes financial product advice; and
- (d) involves custody of a client’s assets.

3 To the extent an MDA service is a managed investment scheme offered to retail clients, generally, the operator must comply with a range of regulatory requirements including:

- (a) the managed investment provisions in Chapter 5C (which include the requirements that the operator must be a public company holding a licence which authorises it to be a responsible entity and register the scheme);
- (b) the disclosure requirements in Part 7.9; and
- (c) the conduct obligations that apply to AFS licensees providing dealing and other financial services, including the obligations to comply with Divisions 2 and 3 of Part 7.7 (eg giving an FSG and SOA) and Part 7.8 (including the hawking

prohibitions), and the requirement to have internal and external dispute resolution mechanisms.

Note: For details about our more specific approach to the licensing of responsible entities, see:

- (a) Policy Statement 130 *Managed investments: Licensing* [PS 130];
- (b) Policy Statement 132 *Compliance plans* [PS 132];
- (c) Policy Statement 133 *Managed investments: Scheme property arrangements* [PS 133];
- (d) Policy Statement 134 *Managed investments: Constitutions* [PS 134]; and
- (e) Sections B and C of Policy Statement 166 *Licensing: Financial requirements* [PS 166].

4 Even if an MDA service is not a managed investment scheme, it is still a financial product because it is a facility for making a financial investment. Therefore, where it is offered to retail clients, the operator, as the issuer of that financial product, must hold an AFS licence authorising it to deal in financial products, comply with the relevant conduct requirements that apply to AFS licensees and, unless a specific disclosure exemption applies, comply with the disclosure requirements in Part 7.9.

5 In addition to these obligations, to the extent that the operator of an MDA service gives financial product advice, the operator will generally (unless using another AFS licensee to give such advice) need to be authorised in its licence to give financial product advice and comply with the relevant advisory conduct requirements in Part 7.7 (such as the obligations to give an FSG, to have a reasonable basis for advice and give a SOA if personal advice is given).

6 Similarly, to the extent an MDA service involves custody of the client's assets, the operator or the custodian will need to have an AFS licence authorising it to provide custodial and depository services and comply with the relevant conduct requirements. They will not be entitled to the licensing exemption otherwise available to a person providing custodial service as part of operating a registered scheme or a regulated superannuation fund.

Note: For details about our general approach to licensing of financial service providers described in paragraphs 4–6 of the Explanation in this section, see:

- (a) Policy Statement 146 *Licensing: Training of financial product advisers* [PS 146];
- (b) Policy Statement 164 *Licensing: Organisational capacities* [PS 164];
- (c) Policy Statement 165 *Licensing: Internal and external dispute resolution* [PS 165];
- (d) Policy Statement 166 *Licensing: Financial requirements* [PS 166]; and

(e) Policy Statement 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)* [PS 168].

Old Corporations Act

7 Like the current Corporations Act, the old Corporations Act (which still applies to operators who have not transitioned to the FSR regime) created obligations for operators of MDA services. These included, among others, obligations to the extent that an MDA service:

- (a) is a managed investment scheme; and
- (b) involved dealing in securities.

8 To the extent that an MDA service is a managed investment scheme offered to retail clients, generally, under the old Corporations Act, the operator was required to comply with a range of regulatory requirements including:

- (a) the managed investment provisions in Chapter 5C; and
- (b) the disclosure requirements in Part 6D.2.

Note 1: For details about our specific approach to licensing of responsible entities under the old Corporations Act, see the policy statements described in the note under paragraph 3 of the Explanation in this section. However, please refer to Policy Statement 131 *Managed investments: Financial requirements* [PS 131] instead of Policy Statement 166 *Licensing: Financial requirements* [PS 166].

Note 2: We have given relief from some of the above current and old Corporations Act requirements until 30 June 2003 for MDA services operated by SFE participants and ex-associate participants of SFE. We have also taken a no-action position on some of the above requirements until 11 March 2004 for similar services operated by ASX participants. See Section C.

Existing licence conditions

9 Currently, ASIC imposes specific licence conditions on AFS licensees where the financial services offered by them include the operation and management of Discretionary Portfolio Accounts (“DPAs”). DPAs are a type of MDA service (as defined in this paper) involving investment in securities (as defined in the old Corporations Act). If an applicant for an AFS licence indicates they do not intend to operate DPAs, ASIC imposes a condition in the AFS licence prohibiting the operation of DPAs.

Note: SFE participants and ex-associate participants of SFE generally do not operate DPAs because they invest in futures (a type of derivative) rather than securities (as defined in the old Corporations Act). They have class order relief: see note 2 under paragraph 8 of the Explanation in this section.

10 The AFS licence conditions imposed on an AFS licensee who carries out the operation and management of DPAs require the licensee to:

- (a) obtain prior written authorisation from clients containing the terms and conditions of operating a DPA;
- (b) issue quarterly reports to clients setting out information relating to:
 - (i) the transactions and revenue and expenses (such as fees and charges) of the DPA including commissions and transaction fees; and
 - (ii) any material conflicts of interests;
- (c) cause systems audits to be carried out; and
- (d) prepare and lodge audit reports relating to the DPA.

Note 1: Currently, there are no AFS licence conditions dealing specifically with MDA services, other than those relevant to DPAs.

Note 2: DPA licence conditions are applied in substantially the same manner for dealers who have a licence under the old Corporations Act.

A tailored regulatory approach

11 We propose to apply a set of regulatory requirements that are tailored to the type of financial services involved in the operation of MDA services. Our proposed approach is intended to minimise the unnecessary costs of operating an MDA service without reducing consumer protection.

12 We consider our proposed approach is a more appropriate basis for regulating MDA services because it:

- (a) is consistent with the similar regulatory approach we have adopted for the regulation of IDPS;

Note: For our policy on IDPS and IDPS-like services, see Policy Statement 148 *Investor directed portfolio services* [PS 148]. For a comparison of MDA services with IDPS and IDPS-like services, see Schedule 1.

- (b) removes the costs of having to structure the MDA service as a registered scheme under Chapter 5C (particularly, as some of the structural safeguards in Chapter 5C are not relevant for MDA services). For example, the requirements designed to address potential risks to consumers arising from pooling of clients' funds and assets for investment and transactional purposes are not generally relevant to MDA services;

- (c) retains some relevant aspects of the managed investment provisions in Chapter 5C – both as conditions of relief and contractually (eg duty to act honestly) (see policy proposal paragraphs [B6] and [B12]);
- (d) incorporates select requirements designed to address risks to the safety of client contributions and portfolio assets (eg the requirement to take reasonable steps to act on client instructions about rights attaching to assets in the client’s portfolio) in place of the structural safeguards in Chapter 5C (see policy proposal paragraphs [B17] and [B19]);
- (e) ensures retail clients are given more relevant information relating to an MDA service, through FSG disclosure, on the basis that it is a composite financial service; and
- (f) ensures clients also have the full benefit of the advisory conduct requirements that apply to personal advice in Division 3 of Part 7.7 with regard to the investment program of an MDA service.

Note 1: See the Flowchart at the end of the Explanation in this section for steps an operator would generally have to take when providing an MDA service to a client under our proposed relief.

Note 2: For a comparison of the legal obligations on responsible entities, IDPS operators and MDA service operators, see the Table after the Flowchart at the end of the Explanation in this section.

Conditions of relief

Relief condition (a): Licensing of MDA operators

13 The operation of an MDA service would generally involve the provision of a number of financial services (some of which may be carried out by a person other than the operator). Such a service may involve:

- (a) dealing in both the financial product constituted by an MDA service and the financial products comprised in the client’s portfolio;
- (b) operating a managed investment scheme, which will generally need to be registered (unless there are less than 20 members and the service is not promoted by a person who is in the business of promoting such services);
- (c) providing a custodial and depository service (unless the operator relies on another AFS licensee to hold portfolio assets); and

- (d) giving financial product advice (unless the operator relies on another AFS licensee to prepare and/or review the investment program).

Note: An operator of an MDA service is likely to provide financial product advice when it promotes its MDA service: see paragraph 16(c) of the Explanation in Section A. We will consider exempting operators of MDA services from the requirement to have an AFS licence authorisation for providing financial product advice if they are relying on an external licensee for the preparation and review of the investment program.

Assessment of licensing applications

14 We do not propose that the operator of an MDA service obtains an AFS licence that authorises it to operate a registered scheme. However, when assessing an application to operate an MDA service that will be offered to retail clients, we will assess the applicant's ability to operate the services using our assessment criteria for responsible entities. We have adopted this approach because MDA services share some common features with other managed investment schemes, particularly relating to investment management functions. Although there is no pooling of different clients' funds and assets for investment purposes in an MDA service, the operator, like a responsible entity, has the day-to-day control of those assets for investment selection and management purposes.

15 In addition, we will require the operator to have the necessary competencies to deal in financial products, operate custodial and depository services and give financial product advice (unless those services are outsourced to other persons who operate under an AFS licence authorising them to provide those services).

Relief condition (b): Additional disclosure through an FSG

16 We propose to exempt operators of MDA services from the financial product disclosure requirements in Part 7.9 on condition that they provide disclosure through an FSG that complies with Division 2 of Part 7.7 and includes certain additional information as set out in policy proposal paragraph [B11]. This is because we consider that clients (and prospective clients) of MDA services can be given appropriate and effective disclosure, enabling them to make an informed decision and compare similar services, by supplementing the disclosure requirements in the Corporations Act relating to financial services rather than through the provisions of Part 7.9.

17 Therefore, in addition to complying with the requirements in Division 2 of Part 7.7, an FSG relating to an MDA service must include the following disclosure and statements:

- (a) *Information about who holds custody of assets in the client's portfolio* – This information is important because the operator may not necessarily hold custody of the assets in the client's portfolio. For example, the client or a third party custodian may hold the legal title to those assets. Where custody is held by a third party custodian, the FSG must include information relating to that arrangement. We will also consider the need to exempt such a custodian from the obligation to give an FSG, although that person would need to operate under a licence authorising it to operate custodial and depository services (see policy proposal paragraphs [B4]–[B5]);
- (b) *Information about any significant risks associated with investing through an MDA service* – Because of the particular nature of the financial services involved in an MDA service, there may be additional risks to persons using such services. Such risks, if any, should be disclosed;
- (c) *Information about how the client may give instructions* – This aspect is particularly important as the client may wish to deal with assets in their portfolio for taxation and other purposes;
- (d) *Information about socially responsible investments* – On the basis it is important for the client to know whether or not their portfolio would be invested in socially responsible investments;

Note: At [B11Q4], we seek your feedback about the appropriateness of this disclosure requirement.

- (e) *Certain statements relating to the investment program* – While the investment program itself must be included in the MDA contract under policy proposal paragraph [B13] or [B14] (as relevant), the FSG must required to alert clients to the importance of understanding the significance of the investment program before entering into an MDA contract; and
- (f) *Other material information* – This is a catch-all requirement and obliges the operator to provide any other information that is likely to have a material impact on the decision of a retail client to use the service.

Relief condition (c): MDA contract

18 The proposed requirements relating to the MDA contract are designed to ensure that retail clients using MDA services have an adequate level of protection provided through contractual arrangements, including some of the relevant Chapter 5C obligations applying to responsible entities. Our proposed relief requires the operator to enter into an MDA contract before it provides an MDA service to a client, and include in the MDA contract an investment program that meets the requirements in policy proposal paragraph [B13] or [B14] (as relevant).

19 One of the risks a client may face with an MDA service is the risk that the operator may generate excessive transactions relating to the client's portfolio to produce benefits for itself or a related entity. To address this risk, in addition to the disclosure about to remuneration and other benefits that must be included in the FSG, SOA (which could be either the investment program or a separate document: see paragraphs 27–28 of the Explanation in this section) and the additional reports to the client (such as quarterly reports), we require the operator to act in the best interests of the client and give priority to the client's interests when operating the MDA service.

Note: These obligations are in addition to the Chapter 5C obligations that we propose to continue to apply to the operator and its officers and employees under policy proposal paragraph [B6].

Relief condition (d): Investment program

20 We consider the investment program to be a critical aspect of any MDA service. Therefore, in addition to the information about the investment program that must be included in the FSG under policy proposal paragraph [B11], we propose that the investment program included in an MDA contract must:

- (a) contain certain specified information (“information content requirements”); and
- (b) comply with Division 3 of Part 7.7 (“personal advice conduct requirements”).

This approach enables retail clients obtaining MDA services to have additional contractual rights relating to the way in which the investment program is established and implemented by the operator.

21 Our requirements are designed to provide flexibility in:

- (a) the nature of the program that may be included in an MDA contract. For example, an investment program could be very

detailed and identify financial products or classes of financial products in which the operator of the MDA service would invest, or alternatively, it may contain a broad investment strategy or an identified goal, which allows the operator a broad discretion to make investments to achieve an agreed outcome; and

- (b) who may prepare (or annually review) such a program. For example, an operator may be able to include in the MDA contract an investment program that is prepared by another AFS licensee where certain conditions are met (see policy proposal paragraph [B14]). Similarly, an operator may rely on another AFS licensee to undertake the annual review of the investment program required under policy proposal paragraph [B15]. Where an MDA operator relies on another AFS licensee for the preparation and/or annual review of the investment program, it would be able to provide an MDA service under our relief without having to obtain an authorisation to provide financial product advice on its AFS licence.

Information content requirements

22 Our proposals require the investment program included in an MDA contract to include information about:

- (a) the nature and scope of the investment program (such as whether the investment program identifies specific financial products or classes of products, an investment strategy or a specific objective);
- (b) what discretions are given to the operator to implement the investment program;
- (c) risks associated with the program, which may include risks associated with any investment strategy (eg investing in emerging markets or particular speculative financial products, as well as risks associated with any broad discretions given to the operator);
- (d) the basis on which the program is considered to be suitable for the client in light of that client's personal objectives, needs and financial circumstances ("client's relevant circumstances");
- (e) what discretions the client retains relating to their portfolio and how the client may change existing instructions;
- (f) warnings required under s945B about incomplete or inaccurate personal information; and

- (g) when the investment program will be reviewed. The investment program must be reviewed at least once every 12 months and the annual report provided to the client must include information as to when that review will be carried out, by whom and how and when any changes resulting from that review have been or will be effected.

23 If an operator of an MDA service includes an investment program prepared by another AFS licensee in the MDA contract, the operator must (in addition to not having any reason to believe that the investment program does not comply with the requirements in Division 3 of Part 7.7) include the following information in the MDA contract:

- (a) the name and details of the licensee who is responsible for the preparation of the investment program;
- (b) if that program does not include the information required under subparagraphs (c)(i),(ii), (iv) and (vi) of policy proposal paragraph [B13] – that information; and
- (c) a statement that the investment program contains the basis on which the AFS licensee who prepared the investment program considers the program to be suitable for the client and any warnings required under subparagraph (c)(v) of policy proposal paragraph [B13].

This information must be provided in as much detail is necessary to enable the client to clearly understand who is responsible for the preparation of the investment program and its importance.

Personal advice conduct requirements

24 We understand that some MDA services rely on rather standard or generic investment programs with only a very limited range of investment aspects that could be personalised for an individual client. Regardless of how broad or narrow the degree of flexibility available for the customisation of an investment program, we consider that MDA services are offered (directly or indirectly) as a mechanism for clients to allow someone else to make investments suited to their particular needs, objectives and financial circumstances. Therefore, under our proposals, an investment program must include a statement (ie an opinion or recommendation) about its suitability for the particular client in light of that client's relevant circumstances.

Note: For example, the operator may accommodate a client's wishes not to invest the portfolio assets in a particular type or class of financial products that are otherwise included in a generic investment program available to all its MDA service clients. Such restrictions may involve exclusion of investments that do not take into account some specified ethical consideration.

25 Against this background, we consider an investment program would typically constitute personal advice. Therefore, the operator (or if the investment program is prepared by another AFS licensee, that other licensee) must comply with the personal advice conduct requirements in Division 3 of Part 7.7 for the investment program included in the MDA contract. These requirements include:

- (a) having a reasonable basis for recommending that the investment program contained in the MDA contract is suitable for the particular client in light of the client's relevant circumstances (s945A);

Note: Before making the suitability statement that is required under our relief to be included in the investment program, the operator must follow the requirements in s945A.

- (b) giving certain warnings where incomplete or inaccurate personal information is given by the client (s945B);
- (c) giving an SOA (which is the means by which the advice is provided or a separate record of the advice) containing certain information (s946A and s947B); and
- (d) giving additional information required where replacement of one financial product with another product is recommended (s947D).

Note: For general guidance on the obligations of a provider of financial product advice, see: *Licensing: The scope of the licensing regime: Financial product advice and dealing — An ASIC guide* (November 2001, updated November 2002). For discussion of our proposed policy on compliance by advisers with the conduct and disclosure obligations in Part 7.7 of the Corporations Act, see ASIC policy proposal paper *Licensing: Financial product advisers – Conduct and disclosure* (December 2002).

26 Although our proposed information content requirements for the investment program are designed to be consistent with the personal advice conduct requirements in Division 3 of Part 7.7, they do not incorporate all these requirements. However, we think that an operator has the flexibility to fully comply with the requirements in Division 3 of Part 7.7 through the investment program it prepares for a client under our relief without having to give a separate SOA. For example, we believe an operator could meet its obligation relating to a SOA under Division 3 of Part 7.7 and the proposed conditions of relief in one document (ie the investment program included in the MDA contract). This could be done by, among other things:

- (a) displaying prominently on the cover of the investment program the title "Statement of Advice" (s947A(1));

- (b) including all the other information required to be included in an SOA (such as the information relating to remuneration, benefits and other interests of the provider and its associates required under s947B(d),(e) and (f)); and
- (c) to the extent the investment program contains discretions that authorise or require the operator to replace financial products in the client's portfolio – including the additional information that must be provided to the client under s947D and s947B(5) in the investment program.

Note 1: Our relief does not preclude an operator from using a separate document such as an SOA to comply with Division 3 of Part 7.7 in relation to the investment program.

Note 2: We will consider feedback about whether any further relief from the requirements in Division 3 of Part 7.7 is needed to “streamline” the information provided by an MDA service operator to a client under the proposed relief to facilitate full compliance with Division 3 of Part 7.7 through the investment program without compromising investor protection intended by those provisions: see [B13Q2].

Flexibility on who may prepare the investment program

27 Under the proposed approach, the operator itself need not prepare the investment program (nor carry out the annual review of the investment program as required under policy proposal paragraph [B15]) under its own licence. The operator may rely on another person who is operating under an appropriate AFS licence (that is, a licence which authorises the giving of financial product advice) to prepare (or review) the investment program. However, if the operator includes in the MDA contract an investment program prepared by another AFS licensee, as a condition of relief the operator must have no reason to believe that the investment program does not satisfy the requirements in Division 3 of Part 7.7 (as we consider that the investment program constitutes personal advice given to the client).

28 Although the primary responsibility for compliance with the requirements in Division 3 of Part 7.7 in relation to the investment program rests with the other AFS licensee who prepares it, as a condition of relief, the operator of the MDA service must ensure that it contains all the information required under paragraphs (c)(i), (ii), (iv) and (vi) of policy proposal paragraph [B13]. Alternatively, the operator can provide that information in the MDA contract as set out in paragraph 23 of the Explanation in this section. We do not envisage that the MDA operator must undertake a comprehensive review of the investment program or endorse the personal advice contained in the

program. This aspect of our relief is designed to provide flexibility to an operator of an MDA service to operate such a service without having to obtain a financial product advice authorisation in its AFS licence, while maintaining investor protection intended by the Corporations Act.

Note 1: Our relief does not preclude an external AFS licensee who prepares the investment program from using separate documents such as an SOA to comply with Division 3 of Part 7.7 in relation to the investment program.

Note 2: We will consider whether any further relief from our proposed conditions and the requirements in Division 3 of Part 7.7 is needed to “streamline” the information provided by an external AFS licensee who prepares (or reviews) the investment program to facilitate full compliance with Division 3 of Part 7.7 without having to issue multiple documents: see [B13Q1] and [B13Q2].

Relief condition (e): Annual review of the investment program

29 As a minimum, the investment program must be reviewed once every 12 months under our proposed relief (see policy proposal paragraph [B15]). This requirement is designed to ensure that retail clients obtaining MDA services have investment programs that continue to be suitable for them. Therefore, we require that:

- (a) the review must find out whether the investment program continues to be suitable for the client in light of the client’s relevant circumstances;
- (b) a statement be made in the annual report provided to the client as to its suitability for the client. Because this is personal advice, the person conducting that review must comply with the requirements in Division 3 of Part 7.7.

30 We will apply the same approach we have adopted for the preparation of the investment program to how the operator or other AFS licensee who conducts the review should comply with their obligations under Division 3 of Part 7.7.

Relief condition (f): Custody of client’s assets

31 An MDA service may involve:

- (a) the operator or any third party custodian holding the legal title to the assets in the client’s portfolio;
- (b) the client holding legal title to those assets but the operator being able to have access and day-to-day control of those assets for the purposes of implementing the investment

program through a power of attorney or other signatory arrangement.

32 Our proposals distinguish between the two arrangements. An MDA service which involves the operator or other custodian holding client's assets would require:

- (a) the assets to be held in trust for the client;
- (b) any cash component of assets to be held in an account that meets s981B (eg in a trust account held in an Australian authorised deposit-taking institution (ADI)); and
- (c) the assets to be held in a manner clearly identifiable as assets of the particular client.

33 If the MDA service involves the client holding the legal title to portfolio assets, the operator must still ensure that the client's assets that are available for the purposes of implementing the investment program are segregated and held in a manner that enables their easy identification as assets falling within the investment program.

Note: We apply a similar requirement to operators of IDPS.

Relief condition (g): Compliance measures and audits

34 The proposed requirements for compliance measures and audit of those compliance measures through a registered company auditor are designed to ensure that an operator of MDA services will have and maintain adequate compliance measures. These measures must be adequate for the operator to be able to meet on an ongoing basis its licensee obligations and the conditions of the class order relief proposed in this paper when operating MDA services.

Note: We apply a similar requirement to operators of IDPS.

Relief condition (h): Non-compliance

35 An AFS licensee must notify ASIC of any breaches of the licensee obligations as soon as practicable and in any case within 3 business days: s912D(1). Therefore, both the obligation to report to ASIC about any failure to comply with the operator's obligations that has a material impact on client's interests and the suspension of contributions pending ASIC's consent are consistent with the general obligations of an AFS licensee. Failure to comply with any of the requirements will be a breach of the licence conditions, a breach of the MDA contract and in certain circumstances, may result in ASIC revoking the exemption. Failure to notify ASIC of material breaches will cause the relief to

cease operating in relation to that operator, and as a result, the operator will be required to windup the MDA service.

Note 1: Custodians and financial product advice providers who provide their services in relation to an MDA service are also subject to similar reporting obligations: see policy proposal paragraph [B5].

Note 2: We apply a similar requirement to operators of IDPS.

Relief condition (i): Responsibility for corporate actions and communications

36 Depending on the nature of the MDA service, an operator or custodian of an MDA service may receive communications relating to financial products held in the client's portfolio (eg annual reports, takeover documents, or documents concerning proxy voting in corporate actions). Even where the client holds the legal title to the portfolio assets, the client may direct all communications to be sent to the operator or custodian. Under our proposals, the operator must either:

- (a) incorporate in the MDA contract provisions dealing with how the communications relating to financial products in the client's portfolio will be dealt with, and comply with those provisions; or
- (b) where the MDA contract does not contain such express provisions:
 - (i) give to the client, as soon as practicable after receipt, a copy of all the communications that are relevant to the exercise of that right; and
 - (ii) take reasonable steps to implement any instructions given by the client about how any right relating to the asset is to be exercised.

Note: We apply a similar requirement to operators of IDPS.

Relief condition (j): Client reporting

37 Our proposals require the client to be provided with either quarterly reports, or electronic access to information relating to all transactions effected for the client's portfolio on an ongoing basis. This information will enable the client to monitor the performance of their portfolio, and promote accountability on the part of the operator in implementing the investment program. This supplements the annual reporting obligations to the client.

Note: We apply a similar requirement to operators of IDPS.

Relief condition (k): Record keeping

38 The proposed record keeping obligations are designed to ensure that the key documents relating to an MDA service such as the FSG, the MDA contract, the SOA (which we anticipate is likely to be included in the investment program: for details see paragraph 26 of the Explanation in this section), the investment program (if not part of the SOA) and annual reports provided to the client are maintained for at least 7 years after it has last been used. This will assist in the resolution of any disputes between a client and the operator relating to an MDA service provided to that client.

Note 1: This proposal is consistent with our policy proposals in *Licensing: Financial product advisers – Conduct and disclosure* (December 2002). We considered that for AFS licensees to meet their obligations, they must ensure that copies of FSGs are kept for a reasonable period of time after they are provided. We also proposed to impose a licence condition requiring licensees to keep (or cause to be kept) copies of FSGs for at least 7 years from the date they were provided.

Note 2: We apply similar reporting obligations to operators of IDPS.

Relief condition (l): Investments in unregistered schemes

39 We consider that clients using MDA services for investments are similar to investors in registered schemes. Both are retail investors relying on the operator's competence and skills to acquire and manage assets to generate profits or other benefits for the client. Registered schemes are prohibited from investing in unregistered schemes: s601FC(4). To provide a similar level of protection to retail clients using MDA services, we will require that portfolio assets are not invested in interests in unregistered schemes, except where such investments would be permitted if the MDA service were a registered scheme: see Class Order [CO 98/55].

Note: We apply a similar prohibition against investments in unregistered schemes to operators of IDPS.

Relief condition (m): Professional indemnity and fraud insurance

40 We consider it is appropriate for operators of MDA services to have professional indemnity and fraud insurance, which provides levels of protection to retail clients using MDA services consistent with those provided to members of registered managed investment schemes and IDPS. Consequently we will require operators of MDA services to have levels of professional indemnity and fraud insurance consistent with

those imposed on AFS licensees authorised to operate a registered managed investment scheme in the capacity of a responsible entity and/or operate an IDPS as an IDPS operator.

Note: For details of requirements for professional indemnity and fraud insurance that are imposed on AFS licensees authorised to operate a registered managed investment scheme in the capacity of a responsible entity and/or operate an IDPS as an IDPS operator, see Pro Forma [PF 209] *Australian Financial Services Licence conditions*.

Relief for MDA services provided to wholesale clients

41 Our proposed conditions of relief do not apply if an operator provides MDA services only to wholesale clients as defined in s761G(4) of the Corporations Act. However, without the benefit of our proposed relief, an operator of MDA services that has both retail and wholesale clients may be required to have the MDA service registered under s601ED. We intend to provide relief as proposed in policy proposal paragraph [B25] in such circumstances, ie not apply the proposed conditions of relief that relate to a particular client (ie the conditions referred to in subparagraphs (b), (c), (d), (e), (i), (j) (k) and (l) of policy proposal paragraph [B7]) to MDA services provided to wholesale clients. We consider this is consistent with the retail investor protection rationale of the provisions of the Corporations Act (such as personal advice requirements) on which our conditions of relief that relate to a particular client are based.

How are MDA services regulated in other jurisdictions?

42 We consider that our proposals to regulate MDA services are generally consistent with the regulatory approach adopted in the United States and the United Kingdom. Where MDA services are specifically regulated in these jurisdictions, they may be variously regulated as a financial product, as investment advice, or as a distinct type of financial service.

United States

43 In the United States, persons who offer services that are similar to MDA services (called investment advisory programs (IAPs), separately managed accounts (SMAs), and individually managed accounts (IMAs)) may be subject to regulation under the *Investment Company Act 1940* (“Investment Company Act”) and the *Securities Act 1933*. This is on the basis that such a service falls within the definition of an investment contract for the purposes of the Investment Company Act

and the Securities Act. Therefore a person offering such a contract may be offering a security in circumstances that attract those acts. As SMAs and IMAs contain an investment program, such programs are treated as investment advice for the purposes of the Investment Company Act.

44 Taking into account practical difficulties for persons offering SMAs and IMAs to comply with the Investment Company Act and the need to provide an appropriate level of investor protection to persons using such services, the SEC has given a safe harbour within which such services could be offered without having to comply with the Investment Company Act. The safe-harbour conditions require the investment program offered under an SMA or IMA to be developed subject to requirements for the giving of investment advice to a client (such as the requirements relating to suitability of advice and the review of the program).

United Kingdom

45 In the United Kingdom, most MDA services fall within the “regulated activity” category of “managing investments” as defined in article 37 of the *Financial Services and Markets Act 2000 (Regulated Activities) Order 2001*. Persons generally need authorisation to provide these services by way of business. This activity is distinct from other regulated activities of “dealing in investments” (as principal or agent), “advising on investments”, “safeguarding and administering investments” and “establishing and operating a collective investment scheme”.

46 There are three elements involved in the regulated activity of “managing investments”:

- (a) the person managing the property must exercise discretion in relation to the composition of the portfolio;
- (b) the property that is managed must belong beneficially to another person (the client); and
- (c) the property that is managed must be (or include) financial products that are securities (eg shares, debentures, government securities, units, options to subscribe for any of these) or contractually based investments (eg options, futures, contracts for differences).

47 There are exceptions for these services provided by a person appointed under a power of attorney (on certain conditions) and for the private management of investments by trustees and personal representatives that are not carrying on (paid) business as managers of investments (eg solicitors or accountants handling estates). Other

exclusions also exist for corporate groups and certain incidental investment managing activity.

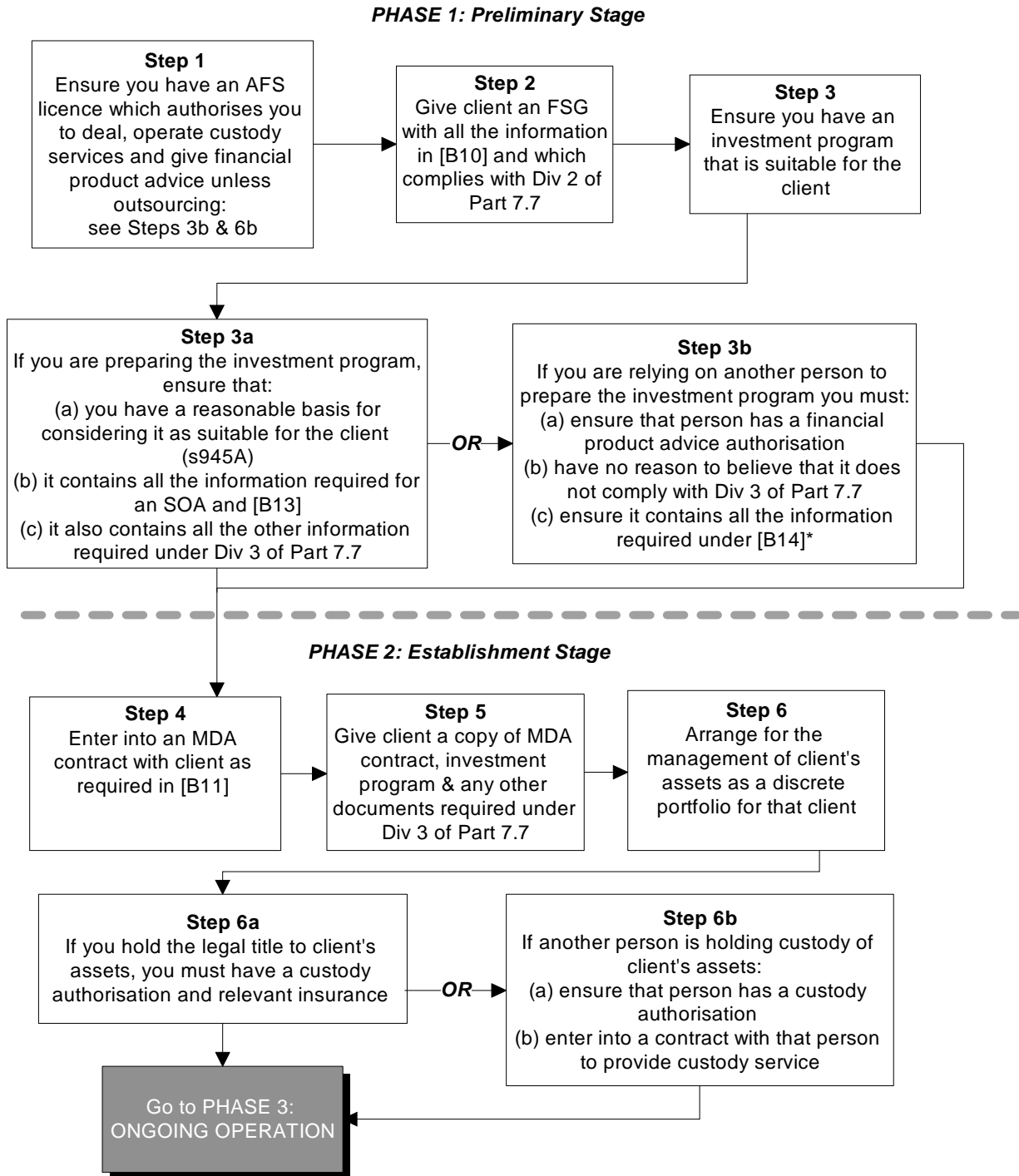
48 Persons managing investments are regulated through the authorisation process and business standards, particularly the Conduct of Business rules. Different prudential requirements may apply based on whether managing investments is the main regulated activity of an investment management firm, a securities and futures firm or a personal investment firm.

Flowchart: Operating an MDA service under our proposed relief

You will need to complete the following:

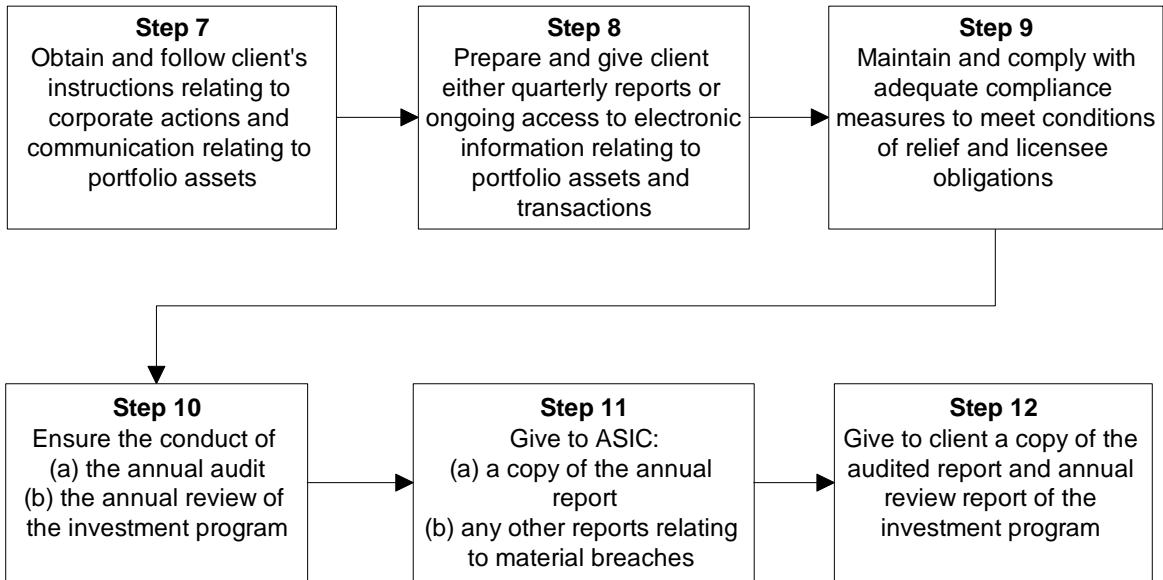
PHASE 1: Preliminary Stage / PHASE 2: Establishment Stage /

PHASE 3: Ongoing Operation / PHASE 4: Termination





PHASE 3: Ongoing Operation



PHASE 4: Termination

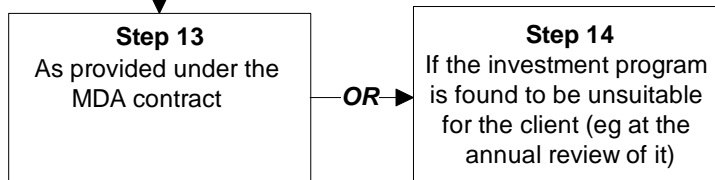


Table: Summary comparison of key legal obligations of a responsible entity, an IDPS operator and an MDA service operator under the Corporations Act¹

A – Licensing

Nature of ongoing obligation	Responsible entity (“RE”)	IDPS operator	MDA service operator
<i>Obligation to hold an AFS licence with appropriate authorisations</i>	Applies – must have authorisations for operating a registered scheme dealing and, if giving financial product advice, financial product advice	Applies – must have authorisations for dealing, operating custodial and depository services (unless custody function is outsourced) and, if giving financial product advice, financial product advice. Relief provided from authorisation to operate a registered scheme	Applies – must have authorisations for dealing, operating custodial and depository services (unless custody is outsourced) and financial product advice (unless the preparation and review of the investment program is outsourced). Relief provided from authorisation to operate a registered scheme
<i>Financial resources requirements under [PS 166]: Section B (cash requirements) Section C (NTA requirements) and Section E (SLF requirement)</i>	Apply	Apply	Apply
<i>Organisational competency requirements</i>	Apply – see ASIC Policy Statements 130 and 164	Apply – see ASIC Policy Statements 130 and 164	Apply – see ASIC Policy Statements 130 and 164
<i>Professional indemnity insurance requirement</i>	Applies – by licence condition (pending transition to s912B)	Applies – by licence condition (pending transition to s912B)	Applies – under proposed CO ² (pending transition to s912B)
<i>Membership with internal and external dispute resolution system requirements</i>	Apply	Apply	Apply

¹ This table does not set out obligations that apply to persons providing above services under the old Corporations Act (ie before their transition to the FSR regime).

² CO means ASIC Class Order.

B – General conduct requirements

Nature of ongoing obligation	Responsible entity (“RE”)	IDPS operator	MDA service operator
<i>Financial records, statements and audit requirements (Div 6 of Part 7.8)</i>	Apply	Apply	Apply
<i>Duties to act properly</i>	Apply under s601FC and s601FD	Apply – as contractual obligations imposed on the operator under conditions of CO	Apply under s601FC and s601FD (as modified where relevant) and also, as contractual obligations imposed on the operator under proposed CO
<i>Custody related obligations</i>	Apply – must hold MIS assets in trust for the client under s601FC(2)	Apply – must hold assets in trust for client and in a clearly identifiable manner as belonging to the client under licence conditions	Apply – must hold assets in trust for the client and in a clearly identifiable manner as belonging to the client under proposed CO
<i>Reporting obligation to ASIC</i>	Applies – see s601FC(1)(1) and s912D	Applies – see s912D	Applies – see s912D
<i>Compliance measures and audits specific to MIS, IDPS or MDA</i>	Apply – see Chapter 5C (including the specific compliance plan obligations)	Apply – under conditions of CO	Apply – under proposed CO
<i>Obligation to give client enforceable rights</i>	Requirements for a constitution under s601GA	Requirements for a client agreement apply – under conditions of CO	Requirements for a client agreement apply – under proposed CO
<i>Obligations relating to corporate actions and communications relating to assets</i>	Do not apply	Apply – under conditions of CO	Apply – under proposed CO
<i>Obligation for quarterly or continuous reporting to client</i>	Does not apply (but, there are obligations to provide members annual financial reports and information upon request)	Apply under conditions of CO	Apply under proposed CO
<i>Obligation to maintain records of client communications</i>	Applies – under the general obligations of the Act and the proposed licence conditions under Conduct and Disclosure PPP	Apply – under conditions of CO	Apply – under proposed CO

B – General conduct requirements (cont.)

Nature of ongoing obligation	Responsible entity (“RE”)	IDPS operator	MDA service operator
<i>Specific corporate governance requirements</i>	Apply – under Chapter 5C (eg external directors or compliance committee)	No	No
<i>Restriction against investments in unregistered schemes</i>	Applies (s601FC(4))	Applies – under conditions of CO	Applies – under proposed CO
<i>Prohibition against hawking</i>	Applies (s992AA)	Applies (s992A)	Applies (s992A)

C – Financial services disclosure (Part 7.7)

Nature of ongoing obligation	Responsible entity (“RE”)	IDPS operator	MDA service operator
<i>Financial Services Guide (“FSG”) (Division 2 of Part 7.7)</i>	Does not apply if the RE is merely operating the scheme (s941C(3)) (on the basis a PDS is provided to retail clients before they become members of a registered scheme)	Applies – must give an IDPS Guide that may provide FSG in same document	Applies – must give an FSG with additional information required under the CO
<i>Reasonable basis for advice and warnings (Division 3 of Part 7.7)</i>	Does not apply, unless RE gives personal advice that investments in the MIS is suitable for the client	Does not apply, unless IDPS operator gives personal advice that investments through the IDPS structure is suitable for the client	Applies – for the investment program and its annual review under the CO (as personal advice is provided)
<i>Statement of Advice (“SOA”) (Division 3 of Part 7.7)</i>	Does not apply, unless RE gives personal advice that investments in the MIS is suitable for the client	Does not apply, unless IDPS operator gives personal advice that investments through the IDPS structure is suitable for the client	Applies – investment program and its annual review report under CO must comply with SOA requirements (as personal advice is provided)

D – Financial product disclosure (Part 7.9)

Nature of ongoing obligation	Responsible entity	IDPS operator	MDA service operator
<i>Financial product disclosure (Part 7.9)</i>	Applies	Does not apply – instead, disclosure through IDPS Guide	Does not apply – instead, disclosure through an FSG

C When will our new policy apply?

Policy proposal	Your feedback
<p>Our general approach</p> <p>C1 We expect the proposed policy to be finalised by about October 2003 (“new policy”). We propose to apply our new policy to persons other than certain market participants (see policy proposal paragraphs [C2]–[C3]) as follows:</p> <ul style="list-style-type: none"> (a) if you offer MDA services for the first time after the policy is finalised – we propose to apply our new policy to you; and (b) if you are offering MDA services before the policy is finalised and you comply with the old Corporations Act and any existing ASIC policy that applies to you – you have the option to: <ul style="list-style-type: none"> (i) continue to operate MDA services as you do now until 11 March 2004; or (ii) operate MDA services under our new policy before then. <p>Note: If you are operating under an old Corporations Act licence, you will not be able to operate an MDA service under the proposed relief in Section B. You will need an AFS licence to operate MDA services under the new policy: see policy proposal paragraphs [B8]–[B10].</p>	<p>C1Q1 Are there any practical difficulties with the proposed transition to the new policy, which have not been dealt with by the proposals? If so, what are they and how should they be addressed?</p>

Policy proposal

ASX and SFE participants and ex-associate participants of SFE

C2 We allow participants of ASX and SFE and ex-associate participants of SFE, who operate MDA services under ASIC's current regulatory approach, to continue to operate their MDA services under that approach until 11 March 2004.

Note 1: See paragraphs 6–8 of the Explanation in this section for details of the current ASIC policy on MDA services operated by ASX and SFE participants and ex-associate participants of SFE.

Note 2: We have already extended the existing class order relief applicable to SFE participants and ex-associate participants until 11 March 2004. We have also extended the no-action position available to participants of ASX until 11 March 2004.

C3 After 11 March 2004, we propose to apply our new policy on the regulation of MDA services (as proposed in Section B) to participants of ASX and SFE and ex-associate participants of SFE, who operate MDA services.

Your feedback

C3Q1 Should ASX and SFE participants be granted relief after 11 March 2004 on different terms than those that apply to AFS licensees generally? If so, why and on what conditions?

Explanation

Our general approach

1 Following public consultation on our proposals, we expect to finalise our policy on MDA services by October 2003 (“new policy”). Our general position is that, except where there are special circumstances, once the new policy is in place, we expect persons offering MDA services to comply with it. We consider there are special circumstances in the case of ASX and SFE participants and ex-associate participants of SFE (see paragraphs 4–5 of the Explanation in this section), and non-market participants currently complying with the Corporations Act: see paragraph 2 of the Explanation in this section.

2 There may be persons who currently (and at the time of the new policy) lawfully offer MDA and MDA type services by complying with the Corporations Act and any relevant existing ASIC policy. For example, they may operate the MDA service by only offering it to wholesale clients, or they may operate the MDA service as a registered scheme. These persons will have the option of complying with the new policy at any time until 11 March 2004. If they have obtained an AFS licence before they opt-in to the new policy, we propose to alter their AFS licence conditions on the basis referred to in policy proposal paragraphs [B8]–[B10].

ASX and SFE participants and ex-associate participants of SFE

Transitional arrangements

3 Our proposals in Section B incorporate some of the current requirements that ASX and SFE participants have to comply with under the relevant operating rules when operating MDA services (such as requirements relating to client agreements and quarterly reporting to clients). However, our proposals also include additional requirements such as the obligation to provide an investment program that complies with Division 3 of Part 7.7 and the conditions of our proposed relief (as the investment program constitutes personal advice).

4 We consider that in the case of ASX and SFE participants and ex-associate participants of SFE, it is appropriate to have different arrangements for transitioning to the new policy. This is because:

- (a) they operate MDA services under current ASIC policy (that is, no-action position for ASX participants and class order relief for SFE participants and ex-associate participants (see paragraphs 6–8 of the Explanation in this section); and

- (b) alternative supervision by the relevant market operators may provide sufficient grounds for continuing the no-action position or class order relief for ASX and SFE participants.

Note: Subparagraph (b) above is not relevant to ex-associate participants of SFE because they are no longer subject to alternative supervision by a market operator. Under Class Order [CO 02/1022], these ex-associate participants of SFE are subject to certain special conditions of relief.

5 To enable a smooth transition to the new policy, we have extended the current relief available to ASX and SFE participants and SFE ex-associate participants from 30 June 2003 until the end of the transitional period (ie 11 March 2004). As a result, those persons will be able to have the full benefit of the FSR transitional period for their MDA services under the current ASIC policy.

ASX participants

6 We have taken a no-action position in relation to ASX participants for MDA services they operate: see Policy Statement 169 *Disclosure: Discretionary powers and transition* at [PS 169.39] and Information Release [IR 02/11]. Under this no-action position, ASIC does not enforce the managed investment provisions and product disclosure provisions for MDA services operated by ASX participants based on alternative supervision by ASX. We have now extended this no-action position until 11 March 2004: see policy proposal paragraph [C2].

SFE participants

7 SFE participants have relief from the managed investment provisions, the advertising and hawking prohibitions and some of the ongoing disclosure requirements relating to financial products in the Corporations Act until 11 March 2004: see Class Orders [CO 02/186] and [CO 01/1598]. We have provided this relief based on the alternative regulation by SFE under their operating rules for MDA services operated by SFE participants.

Ex-associate participants of SFE

8 Ex-associate participants of SFE had relief from the managed investment provisions, the advertising and hawking prohibitions and some of the ongoing disclosure requirements relating to financial products in the Corporations Act based on the alternative regulation by SFE under its operating rules for MDA services operated by SFE participants. To minimise disruption as a result of SFE ceasing to have an associate participant status, we have given relief by Class Order [CO 02/1022] to ex-associate participants, which relief is now extended

until 11 March 2004 (see paragraph 5 of the Explanation in this section).

Future arrangements

9 Our proposal is that after 11 March 2004, ASX and SFE participants and SFE ex-associate participants, together with all other market participants, must comply with our policy for regulating MDA services, as set out in Section B of this paper.

10 We do think, however, that there may be scope for additional relief to be provided to ASX and SFE participants after 11 March 2004 if the operating rules and supervisory arrangements of the relevant market could produce outcomes similar to those we intend to achieve through our proposed policy.

11 We intend to consult with ASX and SFE before determining what, if any, continuing relief is appropriate on the basis of their operating regime for providers of such services.

12 We do not think there is scope for additional relief to be provided to ex-associate participants of SFE beyond 11 March 2004. This is because the ex-associate participants are no longer supervised by a market operator.

Schedule 1: MDA services comparisons

Comparison with IDPS and IDPS-like services

1 While MDA services are not the same as IDPS and IDPS-like services, there are a number of similarities, for example, in MDA services:

- (a) the operator (or a custodian) may have legal ownership of the portfolio assets;
- (b) the investments that affect each client's returns are tailored to each client rather than common to all clients;
- (c) there may be pooling of assets for administrative purposes (for example, the operator may carry out administrative services relating to all clients' portfolios as a whole, although each of the clients' portfolio assets are not pooled with those of other clients for investment and transactional purposes);
- (d) reporting to clients would be individualised rather than, as in the case of unit trusts, common reports being sent to all clients; and
- (e) withdrawals or sales by a client would be out of the client's portfolio rather than, as in the case of unit trusts, out of the common assets of the fund.

2 The differences between MDA services and IDPS and IDPS-like services include that, for example, in MDA services:

- (a) the operator rather than the client makes the underlying investment (asset) selection; and
- (b) there is no pooling of client contributions or portfolio assets for investment purposes as there may be in IDPS and IDPS-like services.

Note: For our policy on IDPS and IDPS-like services: see Policy Statement 148 *Investor directed portfolio services* [PS 148] and Policy Statement 149 *Nominee and custody services* [PS 149].

Comparison with MIS/unit trusts

3 Like a unit trust, an MDA service is likely to be a managed investment scheme (“MIS”). However, MDAs have some features that are different to a MIS that is a unit trust, such as:

- (a) in an MDA service, unlike in a unit trust, different client’s client contributions are not pooled for the purposes of accessing wholesale investments; and
- (b) in a unit trust, unlike in an MDA service, there is no customisation of investments to any degree to suit each individual client.

4 However, MDA services are similar to MIS (whether or not they are structured as a unit trust) because, in both cases, the operator carries out investment management functions.

Schedule 2: Why might a client use an MDA service?

1 We understand that a client might use an MDA service for reasons other than profits and benefits to be generated by the operator's efforts in managing the client's portfolio. Such purposes might often include taxation benefits derived because the client's portfolio is managed as discretely belonging to the client.

2 For example, a client using an MDA service may be able to set-off capital gains arising from the sale of an asset held outside the client's portfolio against negative returns arising from the realisation of an asset held within the client's portfolio. This also allows flexibility for the client to determine the timing of realisation of assets held in the client's portfolio. As a result, the client may have more control over their income and tax liabilities as a whole while being able to outsource to the operator the responsibility for making investment decisions on a day-to-day basis. This is feasible because the operator does not pool one client's assets with the assets belonging to any other client for investment purposes (as is the case for a normal pooled managed investment scheme).

3 An MDA service may be combined with other services such as:

- (a) research or access to research relating to any financial products;
- (b) advice to the client about their taxation obligations; and
- (c) administration of the client's tax liabilities relating to the client's portfolio assets including for the purposes of operating a self managed superannuation fund.

4 In particular, an MDA service may offer one or more of the following benefits to a client:

- (a) *customisation* – to incorporate a client's specific preferences/aversions. For example, a client may wish to avoid possible conflicts of interests when making investment decisions because they are (or are perceived to be) privy to inside or market sensitive information;
- (b) *portability* – if a client is unhappy with the current manager of the client's portfolio, the client could transfer their entire client portfolio to another manager without liquidating the assets;

- (c) *tax advantages* – given that the client holds legal or beneficial ownership of the client’s portfolio assets, the client could determine when to realise specific assets to gain maximum taxation benefits; and
- (d) *more transparency* – than in traditional managed investment schemes due to individualised reporting and research while relying on the manager’s expertise.

Regulatory and financial impact

We have considered the likely regulatory and financial impact of the policy proposals in this paper. Based on the information that we currently have, we believe that our proposals strike an appropriate balance between facilitating financial services activity and investor protection. To ensure that we have achieved an appropriate balance, we are also developing a Regulatory and Financial Impact Statement (RIS).

The RIS will address the following seven key elements:

1 Issue/problem

This will discuss the nature and magnitude of the problem.

2 Objective(s)/analysis of the problem

The objective(s), or the outcome sought in relation to the identified issue / problem, will be addressed.

3 Options / solutions

This will identify all the alternative options that could achieve the objective(s) stated above for dealing with the issue being considered (eg no specific action; ASIC policy proposal; media release; information statement; self regulation/quasi regulation; codes of conduct; and co-regulation, compliance and enforcement strategies).

4 Impact analysis (costs and benefits) of each option

Impact analysis will include:

- (a) analysis of the benefits and costs of the options, including any restriction on competition for different persons affected;
- (b) identification of persons or bodies affected by the problem; and those that will be affected by the solutions or options identified (ie applicant/proponent of issue; other interested parties, consumers, business and government);
- (c) a consideration of how each of the proposed options will affect existing Act, regulations or policies;
- (d) identification and categorisation of the expected impacts of the proposed options as likely benefits or likely costs against each of the person/bodies identified as likely to be affected;

We will try to quantify these effects where possible (for example, will there be any restriction on competition as a result of the proposed regulation?)

Costs to businesses affected by a regulatory initiative might include: administrative costs; complying with new regulatory standards; licence fees; delays etc.

Costs to consumers affected could also include higher prices for goods and services; reduced utility of goods and services; delays and more difficult or expensive options for seeking redress.

- (e) benefits of the options will also be identified (even where they are not quantifiable); and
- (f) the data sources used and assumptions made in making these assessments will be identified.

5 Consultation

The consultation undertaken in the policy process will be detailed.

6 Conclusions and recommended option

The preferred option(s) will be given, and reasons why.

7 Implementation and review

We will discuss how the proposed option will be administered, implemented, or enforced (eg instrument of relief, policy statement, practice note, no action letter).

8 Important details sought from you

In order for us to fully assess the financial and regulatory impact of our proposals, we invite you to consider possible options that would achieve our objectives, comment on the impact that these policy proposals might have, and in particular, give consideration to the costs and benefits of these proposals. Where possible, we are seeking both quantitative and qualitative data.

Any comments that we receive will be taken into account when preparing our final RIS.

Development of policy proposal

We have developed this policy proposal paper by considering:

- (a) the intention of the *Financial Services Reform Bill 2001* as indicated in the first and second CLERP 6 papers, Explanatory Memorandum to the Bill and the Second Reading Speech in the House of Representatives on the introduction of the Bill into Federal Parliament;
- (b) the *Managed Investments Act 1998*;
- (c) the intention of the *Managed Investments Act 1998* as indicated in the Explanatory Memorandum to the Bill;
- (d) Discretionary futures accounts public hearing by ASIC in 1991;
- (e) ASIC's Licensing review report, investment advisory services – "Good Advice" – November 1995;
- (f) relevant comparisons between current and previous legislative requirements for the regulation of financial services activity under the law;
- (g) relevant comparisons with current legislative requirements for the regulation of discretionary account activity in similar overseas jurisdictions (in particular, the United States and United Kingdom);
- (h) existing ASIC policies and practices relevant to the regulation of financial services activity under the law;
- (i) common law decisions relevant to the regulation of financial services activity under the law; and
- (j) relevant market operators' operating rules.

Key terms

Note: Where expressions in this policy proposal paper (eg “retail client” or “SOA”) are defined in the Corporations Act, those expressions have the same meaning as in the Corporations Act, unless otherwise indicated.

In this policy proposal paper:

“AFS licence” means an Australian financial services licence issued under s913B

“ASIC” means Australian Securities and Investments Commission

“ASX” means Australian Stock Exchange Ltd

“ASXF” means ASX Futures Exchange Pty Ltd

“Chapter 5C” (for example) means a Chapter of the Corporations Act (in this example numbered 5C)

“[CO 98/55]” (for example) means an ASIC class order (in this example numbered 98/55)

“client” means a person to whom an operator provides services which meet the description of MDA services in policy proposal paragraph [A1]

“client contributions” are contributions of money or money’s worth made by that client to the operator in the manner described in policy proposal paragraph [A1]

“client’s portfolio” and “clients portfolio assets” mean financial products and other assets derived directly or indirectly from the client’s contributions

“Corporations Act” means the *Corporations Act 2001* as amended by the FSR Act and includes regulations made for the purposes of the Corporations Act

“custodian” means a person appointed by the operator to hold the legal title to client’s portfolio assets

“discretionary portfolio account” (DPA) has the meaning given to it in ASIC Pro Forma [PF 209] *Australian Financial Services Licence conditions*

“ex-associate participants” means each person in the class of persons referred to in Schedules A and B of ASIC Class Order [CO 02/1022] *Sydney Futures Exchange Limited – associate participants*, or any class order that replaces it

“FSR Act” means the *Financial Services Reform Act 2001*

“FSR commencement” means 11 March 2002, the date fixed by proclamation under s2(2) of the FSR Act on which Schedule 1 of the FSR Act commenced

“IDPS” means an investor directed portfolio service and has the same meaning given to “IDPS” in ASIC Class Order [CO 02/294], or any class order that replaces it

“IDPS-like service” has the same meaning given to “IDPS-like scheme” in ASIC Class Order [CO 02/296], or any class order that replaces it

“investment program” is the document required to be included in an MDA contract under policy proposal paragraph [B12] that meets the requirements in policy proposal paragraph [B13] or [B14]

“licence” means an AFS licence

“market participant” means a participant of a licensed market

“MDA contract” means the contract between the operator and the client relating to the provision of an MDA service

“MDA service” means a managed discretionary account service as defined in policy proposal paragraph [A1]

“MDPS” means a managed discretionary portfolio service

“MIS” means a managed investment scheme as defined in the Corporations Act

“nominee and custody service” (NCS) has the same meaning as in ASIC Class Order [CO 02/295], or any class order that replaces it

“old Corporations Act” means the *Corporations Act 2001* as in force immediately before FSR commencement (ie 11 March 2002)

“old Corporations Act licence” means a licence that existed as at FSR commencement (ie 11 March 2002)

“operator” means a person that contracts with a client to provide an MDA service, and includes any agent of the operator

“Part 7.7” (for example) means a part of the Corporations Act (in this example numbered 7.7)

“s761 (for example) means a section of the Corporations Act (in this example numbered 761)

“SFE” means Sydney Futures Exchange Ltd

“unit trust” means a MIS structured as a unit trust.

What will happen next?

Stage 1

15 April 2003 PPP released for public comment

Stage 2

April–May 2003 Public consultation

29 May 2003 Public consultation period closes

June–July 2003 Review of public comments

Stage 3

August–September 2003 Drafting of final policy

October 2003 Release of final policy

Your comments

We invite your comments on the proposals and issues for consideration in this paper.

Comments are due by 29 May 2003 and should be sent to:

**Erica Gray
Regulatory Policy Branch
Australian Securities & Investments Commission
GPO Box 9827
Sydney NSW 2001
email: erica.gray@asic.gov.au**

You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.

Related papers

- Policy Statement 130 *Managed investments: Licensing* [PS 130]
- Policy Statement 131 *Managed investments: Financial requirements* [PS 131]
- Policy Statement 132 *Compliance plans* [PS 132]
- Policy Statement 133 *Managed investments: Scheme property arrangements* [PS 133]
- Policy Statement 134 *Managed investments: Constitutions* [PS 134]
- Policy Statement 136 *Managed investments: Discretionary powers and closely related schemes* [PS 136]
- Policy Statement 146 *Licensing: Training of financial product advisers* [PS 146]
- Policy Statement 148 *Investor directed portfolio services* [PS 148]
- Policy Statement 149 *Nominee and custody services* [PS 149]
- Policy Statement 164 *Licensing: Organisational capacities* [PS 164]
- Policy Statement 165 *Licensing: Internal and external dispute resolution* [PS 165]
- Policy Statement 166 *Licensing: Financial requirements* [PS 166]
- Policy Statement 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)* [PS 168]
- Policy Statement 169 *Disclosure: Discretionary powers and transition* [PS 169]
- Pro Forma 209 *Australian Financial Services Licence conditions* [PF 209]
- Information Release [IR 02/11] *ASIC undertakes review relating to managed discretionary accounts* (28 June 2002)
- Information Release [IR 02/19] *Sydney Futures Exchange associate participant class order relief* (27 September 2002)
- ASIC policy proposal paper *Licensing: Financial product advisers – Conduct and disclosure* (December 2002)
- Licensing: The scope of the licensing regime: Financial product advice and dealing — An ASIC guide* (Nov 2001, updated Nov 2002)

Copies of papers

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