



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 83

Review of ASIC policy on investor directed portfolio services

June 2007

What this paper is about

1 We are reviewing Policy Statement 148 *Investor directed portfolio services* [PS 148] and associated class order exemptions. Your responses to this consultation paper will help us with that review. Following the consultation process, we propose to issue a revised policy statement and class orders.

2 This consultation paper also includes a specific set of proposals relevant to superannuation funds to which s1012IA of the *Corporations Act 2001* (the Act) applies. These proposals relate to when the holder of an Australian financial services (AFS) licence or their representative may act as an agent for receiving the PDSs that must be given under s1012IA. These are the only proposals in this consultation paper that are relevant to superannuation funds. They are set out in Section 4 under the heading ‘Passing on disclosures’: see paragraphs 4.35 to 4.39 and feedback questions Q28 to Q30.

Note 1: ASIC’s policy on how s1012IA applies to superannuation funds is in Policy Statement 184 *Superannuation: Delivery of product disclosure for investment strategies* [PS 184].

Note 2: Readers interested only in superannuation funds and not IDPSs need only read and comment on the ‘Passing on disclosures’ section of this paper (i.e. Section 4, paragraphs 4.35 to 4.39 and feedback questions Q28 to Q30).

3 In April 2006 the Parliamentary Secretary to the Treasurer (PST) published the *Corporations and Financial Services Regulation Review Consultation Paper*. One of the items in the paper sought comment on the need for a review of policy about investor directed portfolio services (IDPSs). Following public comment suggesting some changes to regulation of IDPSs, the Parliamentary Secretary asked ASIC to consider the matter.

Note: See item 7.2 of the *Corporations and Financial Services Regulation Review Consultation Paper* (April 2006) and item 7.2 of the table attached to the PST’s Press Release No. 28 of 2006.

Making a submission

4 We invite your comments on our proposals and questions in this paper. We would also like to receive any qualitative or quantitative information to support your comments.

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

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

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

7 Where possible, we are also keen to hear from you on any other issues you consider important.

8 Your comments will help us develop our policy on the regulation of IDPSs. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Business Cost Calculator Report and/or a Regulation Impact Statement: see Section 6.

9 All submissions will be treated as public documents unless you specifically request that we treat the whole or part of your submission as confidential.

Your comments

Comments are due by 4 September 2007 and should be sent to:

Ella Cebon

Senior Lawyer, Regulatory Policy Branch

Australian Securities & Investments Commission

GPO Box 9827, Melbourne Victoria 3001

fax: 03 9280 3306

email: IDPSreview@asic.gov.au

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

Development of final policy

10 This paper is not ASIC policy. Any application for relief outside existing policy will continue to be considered under the current framework in Policy Statement 148 *Investor directed portfolio services* [PS 148] read with Policy Statement 167 *Licensing: Discretionary powers* [PS 167] and Policy Statement 169 *Disclosure: Discretionary powers* [PS 169].

11 We plan to publish revised policy by March or April 2008, after considering any comments or feedback you send us on these proposals.

Contents

What this paper is about	2
Making a submission	2
Development of final policy	3
Section 1: Background.....	6
What this review is about.....	6
Relationship with other policy	7
History.....	7
IDPS industry	8
Objectives of current policy	8
Overview of current policy and law.....	9
Section 2: Overview of our proposals	11
Overall policy objectives	16
Section 3: Advice about an IDPS or IDPS-like scheme.....	18
Section 4: Disclosure.....	20
Disclosure about the IDPS or IDPS-like scheme.....	20
Disclosure about investments.....	23
Section 5: Operation and other issues	29
Compliance.....	29
Reporting to clients	33
Outsourcing	33
Custody.....	34
IDPS-like scheme relief.....	34
Failure to comply with terms of relief.....	34
Section 6: Regulatory and financial impact	35
Schedule 1: Current regulatory position	36
Characterisation of an IDPS.....	36
Current policy.....	36
Giving advice about an IDPS	37
Disclosure about the IDPS	37
Disclosure about investments.....	37
Reporting.....	38
Compliance.....	38

Outsourcing	39
Custody	39
Schedule 2: Effect of our proposals	40
Key terms	45
Related publications	48

Section 1: Background

What this review is about

1.1 This review is being undertaken against the background of experience with the reforms in the *Financial Services Reform Act 2001*, commercial changes, technological developments and expansion in the investor directed portfolio service (IDPS) industry.

Our aim in undertaking this review is to balance the following objectives:

- reducing complexity, barriers to entry and regulatory burden by removing regulation of IDPS operators beyond that applying to licensees performing dealing or custodial or depository services that do not involve an IDPS, where appropriate;
- adopting a more principles-based approach to the regulation of IDPS and IDPS-like schemes consistent with Chapter 7;
- treating the operation of IDPS and IDPS-like schemes similarly when there is no regulatory basis for different treatment; and
- maintaining adequate consumer protection by ensuring good advice about using an IDPS, adequate disclosure about the IDPS and securities and financial products accessible via the IDPS, reliable client reporting, effective compliance controls and custodial and transactional integrity.

1.2 We propose to achieve these objectives by continuing to:

- (a) provide conditional relief from the fundraising, financial product disclosure and managed investment provisions of the Act; and
- (b) apply appropriate conditions on AFS licences and requirements and conditions for relief,

to IDPS and IDPS-like schemes.

1.3 This paper includes two tables:

- (a) Table 1 in Section 2 contains a summary of our proposals and indicates whether a proposal changes or continues current policy.

- (b) Table 2 in Schedule 2 shows the effect of our proposals on both IDPS and IDPS-like schemes and compares this to the requirements that would apply in the absence of ASIC relief.

Key terms such as 'IDPS' and 'IDPS-like schemes' are defined at the end of this paper.

Relationship with other policy

1.4 If, following consultation, we adopt the proposals for superannuation entities in Section 4 under the heading 'Passing on disclosures' (paragraphs 4.35 to 4.39), we may amend Policy Statement 184 *Superannuation: Delivery of product disclosure for investment strategies* [PS 184]. We are not reviewing any other aspect of [PS 184].

1.5 We are separately reviewing our approach to the electronic delivery of disclosure and other documents. Our current policy in Policy Statement 148 *Investor directed portfolio services* [PS 148] facilitates the use of hyperlinks and other electronic communications. Our proposals on electronic delivery may impact on practices in relation to electronic communication for IDPSs. Any conditions or guidance to apply to IPDSs and IDPS-like schemes will be reviewed as part of that separate process.

History

1.6 In February 1999, we commenced a review of our policy on member discretionary master funds and wrap accounts.

Note: See Information Release [IR 99-10] *ASIC policy review of member discretionary master funds and 'wrap accounts'* (15 February 1999).

1.7 The review was prompted by:

- (a) commercial changes in wrap account services and master funds and in the scope of underlying products and services offered through these arrangements;
- (b) reform of the law relating to managed investment schemes; and
- (c) the impact on existing relief of proposed amendments to the fundraising provisions of the Act under the *Corporate Law Economic Reform Program Act 1999*.

1.8 Following that review, we issued [PS 148] and associated class orders [CO 00/1] and [CO 00/3].

1.9 Since they were first issued, the original class orders have been updated to reflect changes to the law and some refinements to policy. The current relief is contained in [CO 02/294] *Investor directed portfolio*

services and [CO 02/296] Investor directed portfolio-like services provided through a registered managed investment scheme.

1.10 This is the first time we have undertaken a broad policy review of [PS 148] since it was issued.

IDPS industry

1.11 The IDPS and IDPS-like schemes industry attracts significant funds and continues to grow. The Standard & Poor's Market Share Report for December 2006 values funds under administration in IDPSs and IDPS-like schemes at \$55.1 billion. When compared to the same month in 2004 and in 2005, that value represents a strong growth of 130% and of 60%, respectively.

1.12 The report also highlights that net flows of funds into IDPS and IDPS-like schemes reached \$2.6 billion for the quarter ending 31 December 2006, outstripping by \$2.4 billion flows into retail investment master funds for the same period.

1.13 The top five IDPS or IDPS-like scheme administrators hold \$51.8 billion in funds (approximately 94% of all funds in IDPS and IDPS-like schemes). The net flow of funds into schemes administered by the top five administrators reached \$2.5 billion for the quarter ending 31 December 2006.

Objectives of current policy

1.14 Objectives of the current regulatory framework for IDPSs and IDPS-like schemes under the provisions of the Act and ASIC policy are to:

- (a) ensure that retail investors receive adequate disclosure about investments accessed through the IDPS or IDPS-like scheme.
- (b) achieve appropriate regulation of the operation of IDPSs for the protection of retail clients.
- (c) minimise the regulatory differences between IDPSs and IDPS-like schemes.
- (d) reduce the regulatory burden on industry through relief and by providing certainty.

1.15 Current policy addresses these objectives by ensuring that:

Disclosure and advice

- (a) clients receive adequate disclosure and advice about the IDPS;
- (b) clients receive the same quality of disclosure about financial products held through an IDPS or IDPS-like scheme, as they do about financial products they invest in directly;
- (c) clients receive ongoing information about assets held through the IDPS or IDPS-like scheme;

Operation

- (d) IDPS operators have appropriate controls to comply with their obligations under the law;
- (e) client protections apply even if key functions are outsourced by an IDPS operator;
- (f) appropriate custodial and transactional standards are met for an IDPS and, in particular, that assets held by the IDPS operator on behalf of clients are not misappropriated;

Reducing regulatory burden

- (g) the operators of an IDPS are not required to register the IDPS as a registered scheme;
- (h) a Product Disclosure Statement (PDS) need not be given before a client uses an IDPS;
- (i) the PDS for an IDPS-like scheme need not include information about the accessible financial products and accessible securities; and
- (j) an issuer of accessible securities has certainty that it need not include in a Ch 6D disclosure document information about the implications of acquiring securities through an IDPS.

Overview of current policy and law

1.16 The rest of Section 1 is an overview of some key features of our current policy and the law for IDPSs. There is a more detailed description of current law and policy in Schedule 1 to this paper, which also covers IDPS-like schemes.

Disclosure

1.17 An IDPS operator must:

- (a) give clients an IDPS Guide containing information about the IDPS; and

- (b) make sure that clients investing through the IDPS receive the same information about financial products and securities that they would receive if they invested directly in those financial products and securities. For financial products, s1012IA generally requires this.

Note: For discussion of the operation of s1012IA see [PS 184].

Reporting

1.18 Clients must be given annual reports about transactions, investments and values and also receive quarterly reports or ongoing access to this information. Clients must be given a report by an auditor on the systems producing the client statements.

Compliance

1.19 An IDPS operator must be a public company and hold an Australian financial services (AFS) licence authorising it to operate an IDPS.

1.20 Licence conditions require an IDPS operator to:

- (a) maintain a minimum level of net tangible assets (NTA) that varies depending upon whether it performs transactional or custodial functions; and
- (b) enter into a written agreement containing prescribed conditions with other persons appointed to perform IDPS functions.

1.21 An IDPS operator must have annually audited internal control procedures to ensure compliance with the law and conditions of relief.

1.22 An IDPS operator is required to enter into a contract with IDPS clients (IDPS contract) containing prescribed conditions relating to the IDPS operator's conduct.

Custody

1.23 Client assets must be held in trust by the IDPS operator or custodian.

Advice

1.24 Persons making recommendations about whether to use an IDPS must comply with the specific obligations imposed on licensees when providing financial product advice.

Section 2: Overview of our proposals

Table 1: Summary of our proposals

Paragraph reference	Proposal	Change from or continuation of current policy
OVERALL POLICY OBJECTIVES		
2.1	We propose to give relief from the requirement that an IDPS be operated as a registered scheme, that a PDS be given before a retail client uses an IDPS and for the exclusion of details of accessible investments in an IDPS-like scheme's PDS.	This is a continuation of current policy: see [PS 148.29] to [PS 148.31] and [PS 148.109].
ADVICE		
3.1	We do not propose to give relief so that recommendations to use an IDPS or IDPS-like scheme are not regulated as financial product advice or personal advice as defined in the Act.	This is a continuation of current policy: see [PS 148.94] to [PS 148.99].
DISCLOSURE		
4.1	We propose to give IDPS operators exemption from the requirements of the Act to give a PDS if the IDPS operator gives an IDPS Guide to prospective clients.	This is a continuation of current policy: see [PS 148.29].
4.1	We do not propose to give relief to responsible entities of IDPS-like schemes from the requirements of the Act to give a PDS. We propose to continue to conditionally exempt responsible entities of IDPS-like schemes from having to provide information about the particular securities or financial products that may be acquired through the IDPS-like scheme if a list of these investments is available free of charge on request.	This is a continuation of current policy: see [PS 148.109].
4.4	We propose replacing the current specific content requirements for the IDPS Guide with a general obligation to disclose information that might reasonably be expected to materially influence a retail client's decision to use the IDPS. We also propose that the information must be worded and presented in a clear, concise and effective manner. We propose removing the current specific disclosure requirements for the PDS of an IDPS-like scheme.	This is a change from current policy.
4.5	We propose to allow for provision of information in an IDPS Guide by incorporation by reference to other documents. This will apply if the Government amends the Act to allow incorporation by reference for PDSs.	This is a change from current policy.

Paragraph reference	Proposal	Change from or continuation of current policy
4.6	We propose to allow non-materially adverse information that would otherwise have to be included in a new IDPS Guide, or Supplementary IDPS Guide to be provided through a facility like a website.	This is a change from current policy.
4.8	We propose that fees and costs of the IDPS be disclosed in a manner consistent with Schedule 10 of the Regulations (the enhanced fee disclosure regulations) as if the client's rights in the IDPS were a managed investment product.	This is a change from current policy.
4.11	We propose to facilitate the use of a single FSG when there are multiple providing entities providing financial services as part of an IDPS.	This is a change from current policy.
4.15	We propose that clients of IDPSs and IDPS-like schemes should have access to the same standard of information about accessible financial products and accessible securities that they would have if they held the financial product or securities directly.	This is a continuation of current policy: see [PS 148.50] to [PS 148.51].
4.19	We propose that investments for which a PDS must be given must be made in response to the relevant PDS and that investments in securities must be made under a Ch 6D disclosure document to ensure that remedies in the Act for defective disclosure apply.	This is a change from current policy.
4.21	<p>We propose that when the issuer provides notification of the option to withdraw under s724 or s1016E, the operator performing transactional functions for an IDPS or the responsible entity for an IDPS-like scheme must ensure that:</p> <ul style="list-style-type: none"> <li data-bbox="432 1458 1066 1518">(a) this option is communicated to the client as soon as practicable; <li data-bbox="432 1541 1066 1630">(b) the client is given access to any replacement or supplementary disclosure and informed of how it may be accessed; and <li data-bbox="432 1653 1066 1704">(c) the client's instructions as to how to exercise the option are implemented. 	This is a change from current policy.

Paragraph reference	Proposal	Change from or continuation of current policy
4.22	<p>We propose that a client who already holds financial products or securities through the IDPS or IDPS-like scheme need not be given a PDS or Ch 6D disclosure document for the acquisition of securities of the same kind if the IDPS operator or the responsible entity of an IDPS-like scheme reasonably believes that:</p> <ul style="list-style-type: none"> <li data-bbox="432 568 1066 651">(a) the client has access to and knows they have access to a PDS or Ch 6D disclosure document; and <li data-bbox="432 680 1066 824">(b) the PDS or Ch 6D disclosure document is the most current on issue or does not differ from the most current PDS or Ch 6D disclosure document on issue in a way that is materially adverse from the client's viewpoint. <p>This exemption would not apply if the IDPS operator performing transactional functions or the IDPS-like scheme responsible entity is aware that the PDS or disclosure document does not meet the requirements of the Act in a way that is materially adverse from the client's viewpoint.</p>	This is a change from current policy.
4.27–4.28	<p>We propose that the general requirement for a PDS or Ch 6D disclosure document to be given before financial products or securities are acquired through an IDPS or IDPS-like scheme not apply to dividend or distribution reinvestment plans and regular savings plans.</p> <p>We propose that it is sufficient for the terms of a regular savings plan to provide that the client be given access as soon as reasonably practicable and in any event within 5 business days of the acquisition to disclosures the IDPS operator or IDPS-like scheme responsible entity reasonably believes are current disclosures. The client would need to know that they have access to these disclosures.</p>	<p>The proposed exemption for dividend or distribution reinvestment plans and regular savings plans is a continuation of current policy: see [CO 02/294].</p> <p>The proposal in relation to the terms of a regular saving plan is a change from current policy.</p>
4.29	<p>We propose that the issuer of a Ch 6D disclosure document need not consent to the use of the Ch 6D disclosure document for IDPS clients.</p>	This is a change from current policy.
4.34	<p>We propose prohibiting investment in a scheme where the custodian is a related body corporate of the promoter and other members.</p>	This is a continuation of current policy: see [PS 148.52(b)].

Paragraph reference	Proposal	Change from or continuation of current policy
4.35	<p>We propose to allow:</p> <ul style="list-style-type: none"> (a) IDPS operators; (b) responsible entities of IDPS-like schemes; and (c) trustees of superannuation entities within the meaning in s10(1) of the <i>Superannuation Industry (Supervision) Act 1993</i>, <p>to give clients documents by giving the documents to another person who is acting as agent of the client. This will apply even if the agent is an associate of the IDPS operator or responsible entity for the IDPS-like scheme or a licensee or an authorised representative of a licensee.</p> <p>Our proposal applies to disclosure documents about accessible investments. It does not apply to disclosure about the IDPS, IDPS-like scheme or superannuation entity itself or annual client statements and reports from auditors.</p> 	<p>This is a change from current policy.</p>
OPERATION AND OTHER ISSUES		
5.1	<p>We propose that an IDPS operator need not be a public company.</p>	<p>This is a change from current policy under which an IDPS operator may be a proprietary company only in limited circumstances.</p>
5.4	<p>We propose to apply Policy Statement 132 Managed investments: Compliance plans [PS 132] to IDPS operators who perform transactional functions and Policy Statement 133 Managed investments: Scheme property [PS 133] to IDPS operators that are responsible for custody. We propose to continue to require a specific AFS licence authorisation to be an IDPS operator.</p> <p>We propose that [PS 132] not apply to IDPS operators that do not perform transactional functions and are not providers of a custodial or depository service.</p>	<p>This is a continuation of current policy: see [PS 148.20] to [PS 148.24].</p> <p>Our proposal for IDPS operators that do not perform transactional functions and are not providers of a custodial or depository service is a change from current policy.</p>

Paragraph reference	Proposal	Change from or continuation of current policy
5.5–5.8	<p>We propose that where transactional functions are performed by the IDPS operator we will retain the current NTA requirements on a scale from \$50,000 to \$5 million.</p> <p>We propose that where custodial functions are performed we will retain the current NTA requirement of at least \$5 million.</p> <p>We propose that where no transactional or custodial functions are performed and the IDPS operator only administers client assets, we will remove the current NTA requirement of \$50,000.</p>	<p>Except for the situation where no transactional or custodial functions are performed, this is a continuation of current policy: see Policy Statement 166 Licensing: Financial requirements [PS 166] at [PS 166.60] to [PS 166.63].</p>
5.9	<p>We propose that only internal controls to ensure compliance with the Act that relate to custodial and transactional functions will need to be audited.</p>	<p>This is a change from current policy. Under current policy all internal controls to ensure compliance with the requirements for ASIC relief must be audited.</p>
5.12	<p>We propose that no particular conditions are required in the IDPS contract that relates to conduct of the IDPS operator.</p>	<p>This is a change from current policy.</p>
5.16	<p>We propose that clients be provided with an annual report, quarterly reports or continuous electronic access to client account information and reports by an auditor.</p>	<p>This is a continuation of current policy: see [PS 148.56] to [PS 148.62].</p>
5.18	<p>We propose that a written agreement is required between the IDPS operator and the person performing the custodial functions or the transactional functions.</p>	<p>This is a continuation of current policy: see Pro Forma 209 Australian financial services licence conditions [PF 209], conditions 34 and 38.</p>
5.22–5.24	<p>We propose that all investments must be held on trust for the relevant client and that all money received from clients be paid into a trust account.</p>	<p>This is a continuation of current policy: see [PS 148.36]</p>
5.25	<p>We propose to continue relief for responsible entities of IDPS-like schemes from certain provisions of Ch 5C.</p>	<p>This is a continuation of current policy: see [PS 148.112].</p>
5.26	<p>We propose that contravention of a condition of relief would not automatically result in loss of relief.</p>	<p>This is a change from current drafting of [CO 02/294] and [CO 02/296].</p>

Overall policy objectives

2.1 We propose to continue to give relief to IDPS operators and responsible entities of IDPS-like schemes. We propose to revise the terms of relief to balance the following objectives:

- (a) reducing complexity, barriers to entry and regulatory burden by removing regulation of IDPS operators beyond that applying to licensees performing dealing or custodial or depository services that do not involve an IDPS, where appropriate;
- (b) adopting a more principles-based approach to the regulation of IDPSs and IDPS-like schemes consistent with Chapter 7;
- (c) treating the operation of IDPSs and IDPS-like schemes similarly when there is no regulatory basis for different treatment; and
- (d) maintaining adequate consumer protection by ensuring good advice about using an IDPS, adequate disclosure about the IDPS and securities and financial products accessible via the IDPS, reliable client reporting, effective compliance controls and custodial and transactional integrity.

2.2 These objectives reflect our regulatory experience and aim to improve and update current arrangements for regulation of IDPSs.

2.3 In developing our proposals we have focused on whether there are particular risks relating to IDPSs and IDPS-like schemes that additional regulation, beyond that applying to AFS licensees and financial product product issuers generally, needs to address.

2.4 In particular, in light of the objective in sub-paragraph (a) of paragraph 2.1, we think that it is important to consider whether the cumulative effect of the relief and the associated conditions create unnecessary complexity or make regulatory requirements less transparent. We think that, overall, the proposals will simplify regulation and, when published as a revised policy statement, will be understood by those who want to rely on the policy.

Note: Table 2 in Schedule 2 shows the effect of our proposals on both IDPS and IDPS-like schemes and compares this to the requirements that would apply in the absence of ASIC relief.

Your feedback

- Q1** Do you think 'investor directed portfolio service' is an appropriate name? If not, why not? Should ASIC redefine 'IDPS' or 'IDPS-like scheme'? If so, why?
- Q2** Do you think that our proposed policy objectives are appropriate? If not, why not?
- Q3** Are there any other policy objectives we should consider? If so, please specify.
- Q4** Should ASIC continue to provide the relief it provides for IDPS operators and responsible entities of IDPS-like schemes? If not, why not?
- Q5** Do you think that any other relief or guidance is needed for IDPS or IDPS-like schemes? If so, please specify.
- Q6** Are any other substantive change to the policy in [PS 148] or the terms of [CO 02/294] or [CO 02/296] not discussed in this paper appropriate? If so, please specify.
- Q7** Do you think that the proposals in this consultation paper are cumulatively burdensome, complex or lacking in transparency? If so, please specify how and suggest how they could be lessened or simplified consistently with our objectives in this review.
- Q8** Do you think that we should give the proposed relief for IDPS operators and responsible entities operating IDPS-like schemes on an unconditional basis? If so, please specify how the interests of consumers will be protected and confidence in the use of IDPSs and IDPS-like schemes maintained?

Section 3: Advice about an IDPS or IDPS-like scheme

3.1 We **propose** to maintain the current position that recommendations to use an IDPS or IDPS-like scheme are financial product advice and may be personal advice as defined in the Act. We do **not propose** to give relief to change the requirements that apply to financial product advice under the Act.

Note: The obligation to determine a client's relevant personal circumstances and to make client enquiries are 'scaleable': see Policy Statement 175 *Licensing: Financial product advisers—Conduct and disclosure* [PS 175] at [PS 175.103].

3.2 A Statement of Advice (SOA) must generally be given when personal advice is provided. If a recommendation is made to switch from one IDPS or IDPS-like scheme to another, then the additional switching disclosures in s947D are required. Personal advice that is intended to influence a decision to use an IDPS or IDPS-like scheme must be appropriate, taking into account the matters in s945A.

3.3 We think these protections are appropriate because the decision whether to use (or switch to) an IDPS or IDPS-like scheme is a significant decision and consumers should be able to assess any advice they receive about that decision. Fees are associated with investment via an IDPS or IDPS-like scheme and there can be tax and cost implications in switching.

3.4 An SOA (or portion of an SOA) relating to advice about an IDPS or IDPS-like scheme would not need to be lengthy. We expect it would include advice about:

- (a) the service offered by the IDPS or IDPS-like scheme and how that service will benefit the client;
- (b) the fees and costs associated with the IDPS or IDPS-like scheme;
- (c) any significant tax implications from using the IDPS or IDPS-like scheme;
- (d) any significant implications if the client later wishes to leave the IDPS or IDPS-like scheme.

We expect that it would also include disclosures:

- (e) required by s947D if the recommendation to use an IDPS or IDPS-like scheme includes a recommendation to replace another financial product;

- (f) about any benefits or remuneration the providing entity or certain connected persons receive that might reasonably be capable of affecting the providing entity in providing the advice.

The length of these disclosures will depend on the complexity of the remuneration arrangements relating to the IDPS or IDPS-like scheme.

Your feedback

- Q9** Do you think that retail clients should be entitled to receive appropriate advice about whether to use (or switch to) an IDPS or IDPS-like scheme, together with an SOA that reflects that advice? If not, why not?
- Q10** Are there any practical difficulties in complying with the requirements about personal advice for a switch from one IDPS or IDPS-like scheme into another? If so, please specify.
- Q11** Can you quantify any costs that would be incurred in an AFS licensee meeting the requirements for financial product advice for an IDPS or IDPS-like scheme?
- Q12** Do you agree that the items in 3.4 are the key points that should be addressed in an SOA for an IDPS or IDPS-like scheme? If not, why not?
- Q13** Are there any other key points that should be addressed in an SOA for an IDPS or IDPS-like scheme? Please specify.
- Q14** Would it assist if ASIC provided guidance on how the personal advice and SOA obligations in Part 7.7 apply to the provision of advice to retail clients about whether to use (or switch to) an IDPS or IDPS-like scheme? If so, please give details as to what guidance should be given. Would it be appropriate for ASIC, in consultation with industry, to prepare sample wording on the basis of a recommendation to switch to an IDPS or IDPS-like scheme?
- Q15** What financial impact would arise if compliance with the personal advice obligations in Part 7.7 was not required? If possible, please quantify.

Section 4: Disclosure

Disclosure about the IDPS or IDPS-like scheme

General content requirements

4.1 We **propose** to give IDPS operators exemption from the requirement to give a PDS provided the IDPS operator gives an IDPS Guide to prospective clients. We do **not propose** to give relief to a responsible entity of an IDPS-like scheme from the requirement to give a PDS. We **propose** to continue to conditionally exempt responsible entities of IDPS-like schemes from having to provide information about accessible financial products and accessible securities if a list of these investments is available free of charge on request.

4.2 We consider that the limited services provided as part of an IDPS, and in particular the fact the operator does not have any role in choosing investments, means that it is appropriate to continue to give PDS relief if the service is not provided as part of a registered scheme. We do not think an IDPS-like scheme should be exempt from the PDS requirements. This is because IDPS-like schemes may involve more discretion on the part of the responsible entity than is permitted under the definition of an IDPS. Further, as IDPS-like schemes are registered schemes, we think they should generally comply with the disclosure and other requirements that apply to registered schemes.

4.3 We consider that the nature of an IDPS means that there are a number of risks and benefits of which clients should be aware that would not generally be disclosed in an FSG. If clients did not receive adequate disclosure about the IDPS there would be a risk that they would not have the information necessary to enable them to make an informed decision about whether to use the IDPS. For this reason we propose to continue to require an IDPS Guide.

4.4 However, we **propose** replacing the current specific content requirements for the IDPS Guide and the PDS of an IDPS-like scheme, with a general obligation to disclose all information that might reasonably be expected to materially influence a retail client's decision to use the IDPS or IDPS-like scheme. Such disclosures must be worded and presented in a clear, concise and effective manner. This proposal reflects general PDS disclosure requirements: see s1013C(3) and 1013E.

4.5 If the Government amends the Act to allow incorporation by reference in PDSs, we **propose** allowing for provision of information in an IDPS Guide by incorporation by reference to other documents. We

will allow incorporation by reference on the same basis as it is allowed in the Act for PDSs.

Note: See draft regulation 7.9.15DA of the draft Corporations Amendment Regulations 2007 (No.) March 2007.

4.6 We also **propose** to allow for non-materially adverse information that would otherwise have to be included in a new IDPS Guide, or Supplementary IDPS Guide, to be provided through a facility like a website. This would be based upon the same approach as applies to PDSs.

Note: See Class Order [CO 03/237] *Updated information in product disclosure statement*. We note this may be affected by changes to the law under consideration by the Government. See draft regulation 7.9.99 of the draft Corporations Amendment Regulations 2007 (No.) March 2007.

4.7 This would mean that the IDPS Guide would not need to be corrected or withdrawn where there was a change to its content unless the change were materially adverse from the viewpoint of a retail client deciding whether to use the IDPS.

Fees and costs disclosure

4.8 We **propose** that fees and costs of the IDPS be disclosed in a manner consistent with Schedule 10 of the Regulations (the enhanced fee disclosure regulations) as if the client's rights in the IDPS were a managed investment product.

4.9 We think that understanding the fees and costs of an IDPS is an important part of the decision to use an IDPS. Applying the enhanced fee disclosure regulations so that the IDPS Guide would include a fees and costs template, a worked dollar example of annual fees and costs and a boxed consumer advisory warning would assist consumer understanding.

4.10 We would also expect the IDPS Guide to explain (and illustrate by a worked example) that the client will be bearing the impact of fees and costs at the IDPS level and at the level of accessible investments, as well as any fees they pay for financial product advice. We do **not propose** to continue to prescribe a statement about the importance to investors of understanding the fees and charges associated with the service. We do **not propose** to require disclosure of fees for particular accessible investments in the IDPS Guide.

Single FSG

4.11 We **propose** to facilitate the use of a single FSG when multiple providing entities are providing financial services as part of an IDPS.

4.12 The IDPS Guide is often contained in the FSG of an IDPS operator. Each person who provides financial services to retail clients generally must also provide an FSG to the client.

4.13 So that a single FSG can be given, we propose to allow each person involved in the operation of the IDPS to accept responsibility only for those parts of the FSG referable to their activity.

4.14 The FSG must, however, clearly identify the person responsible for each disclosure that is made or required.

Your feedback

Q16 Do you agree with our proposal to replace the current specific content requirements of the IDPS Guide with a general disclosure test? If not, why not? Can you quantify any costs that would be incurred in meeting the proposed disclosure requirement?

Q17 Do you think that applying the PDS content and presentation requirements of the enhanced fee disclosure regulations and the proposed explanation about the impact of fees in the IDPS and in accessible investments will assist consumers to understand the fees and costs of an IDPS? If not, why not?

Q18 Do you foresee any practical problems with applying the PDS content and presentation requirements of the enhanced fee disclosure regulations to IDPSs? If so, please give details. Can you quantify any costs that would be incurred in making these disclosures?

Q19 Are there any other disclosures that should be specifically required to be made about the IDPS or IDPS-like scheme? If so, what are they and why is it not sufficient to rely on a general disclosure test?

Q20 Do you agree with our proposal to facilitate multiple IDPS operators preparing a single FSG? If not, why not?

Q21 What benefits do you think will result from the proposals in this section? Do you think it is possible to quantify those benefits?

Q22 Will the proposals in this section have any financial impacts that you have not referred to in the answers to the questions above? Please quantify.

Disclosure about investments

General disclosure requirements

4.15 We **propose** retaining the current policy that clients of IDPSs and IDPS-like schemes should have access to the same standard of information about securities and financial products available through the IDPS or IDPS-like scheme that they would receive if they held them directly. This applies to disclosures required before investment, and other disclosures to which a holder may be entitled.

4.16 We are doing this because the intermediated structure of an IDPS or IDPS-like scheme can mean that clients may not receive relevant disclosures about investments if the IDPS operator or IDPS-like scheme responsible entity were not responsible for making disclosures.

4.17 Retail clients using an IDPS or members of an IDPS-like scheme are making decisions about investments similar to those they would make if they invested directly and they should therefore have access to similar disclosures. This policy currently applies to IDPSs and is also a basis for the requirements in s1012IA for financial products for which a PDS is required.

4.18 Adopting an approach similar to s1012IA for offers of securities for which a Ch 6D disclosure document is required is consistent with current policy.

Access to remedies for defective disclosure

4.19 We **propose** requiring that investments for which a PDS must be given must be made by the custodian for an IDPS or IDPS-like scheme in response to the relevant PDS and that investments in securities must be made under a Ch 6D disclosure document. We think this can be satisfied by the relevant application for investment being expressed as being made on that basis or by a standing arrangement that any investments of a certain kind that include the relevant investment are made on that basis.

4.20 Adopting this approach will ensure that the custodian holding IDPS assets or scheme property of an IDPS-like scheme, and through it the IDPS clients or members of the IDPS-like scheme, will also receive the benefit of provisions of the Act relating to defective Ch 6D disclosure documents and PDSs: see s724 and 1016E.

4.21 We **propose** requiring that when the issuer provides notification of the option to withdraw under s724 or 1016E, the operator performing transactional functions for an IDPS or the responsible entity for an IDPS-like scheme must ensure that:

- (a) this option is communicated to the client as soon as practicable;
- (b) the client is given access to any replacement or supplementary disclosure and informed of how it may be accessed; and
- (c) the client's instructions as to how to exercise the option are implemented.

Currency of disclosure about accessible investments

4.22 We **propose** that a client who already holds financial products or securities through the IDPS need not be given a PDS or Ch 6D disclosure document if the IDPS operator reasonably believes that the:

- (a) client has access to and knows they have access to a PDS or Ch 6D disclosure document; and
- (b) PDS or Ch 6D disclosure document is the most current on issue or does not differ from the most current PDS or Ch 6D disclosure document in a way that is materially adverse from the viewpoint of the client.

This would not apply if the IDPS operator performing transactional functions or the IDPS-like scheme responsible entity is aware that the PDS or Ch 6D disclosure document does not meet the requirements of the Act in a way that is materially adverse from the client's viewpoint.

4.23 Subsection 1012D(2) exempts an IDPS operator or IDPS-like scheme responsible entity from giving a client a PDS for financial products that are to be acquired on the client's instructions if:

- (a) a financial product of that kind has already been acquired on the client's instructions through the IDPS or IDPS-like scheme;
- (b) the IDPS operator has a reasonable belief that the client has access to all the information required to be in a PDS through a PDS and other regulated disclosures; and
- (c) the client knows they have this access.

4.24 We appreciate that it can be difficult for an IDPS operator or responsible entity of an IDPS-like scheme to form a reasonable belief about the content of information contained in a disclosure document because these documents are prepared by the relevant issuers.

4.25 Our proposal seeks to assist IDPS operators by only requiring them to form a reasonable belief that the PDS or Ch 6D disclosure document the client can access is the most current document (or differs from the most current only in a way that is not materially adverse to the client).

4.26 Even if a PDS or Ch 6D disclosure document need not be given to the client as we propose, the investment on behalf of the client would still have to be made under the relevant document to ensure s1016E or 724 applies. In that way the issuer will be responsible for ensuring that there is an option to withdraw if the disclosure is defective in a way that is materially adverse to the client.

Note: See QFS 144: 'Does a regulated person need to actively notify clients of the availability of information that would have been included in a Product Disclosure Statement in order to rely upon s1012D?' This frequently asked question is on the ASIC website at www.asic.gov.au/fsrfaq.

Dividend reinvestment and regular savings plans

4.27 We **propose** retaining the current provisions that a PDS or Ch 6D disclosure document need not be given before financial products or securities are acquired through an IDPS or IDPS-like scheme for dividend or distribution reinvestment plans and regular savings plans.

4.28 This relief allows for investments to proceed on the client's standing instructions, even if the IDPS operator is aware that the client does not have documents that contain disclosure information that is materially adverse from the client's viewpoint. In the case of a regular savings plan, the exemption currently requires that there be an agreement for the updating disclosure to be given to the client as soon as reasonably practicable and in any event within 5 business days. We **propose** that it be sufficient for the client to be given access to what the IDPS operator or responsible entity of the IDPS-like scheme reasonably believes are the most recently issued PDS or Ch 6D disclosure document. The client must however know that they have access to those documents. The documents must therefore be identified and the client informed of their existence.

Consent of product issuer

4.29 We **propose** removing the current requirement for the issuer of a Ch 6D disclosure document to consent to the use of the disclosure document for IDPS clients. Currently, we require the issuer to consent to the use of the disclosure document in order to establish the issuer's liability for defects in the Ch 6D disclosure document. However, we consider that for an investment that is made on the basis of an application under the Ch 6D disclosure document as required under the proposal in paragraph 4.19, liability will be clear without the need for specific consent.

Investment in unregistered schemes

4.30 We **propose** removing the specific prohibition on investment in unregistered schemes because we consider that the provisions of the Act achieve this outcome.

4.31 Retail clients receive a number of protections when investing in registered managed investment schemes. These protections are not available to investors in unregistered schemes. It is for this reason that retail clients cannot generally invest in unregistered schemes.

4.32 Our current policy prevents IDPS clients from investing in a financial product via an IDPS if they cannot invest in that financial product directly. Consequently, IDPS clients are prohibited from investing in unregistered schemes via an IDPS.

4.33 We consider this outcome is achieved by s601ED. A managed investment scheme must generally be registered unless s601ED(2) excludes registration. Subsection 601ED(2) excludes registration if all the issues of interests in the scheme that have been made did not require, a PDS to be given. We consider the reference in s601ED(2) to the giving of a PDS covers the situation where a PDS must be given under s1012IA. If an IDPS or IDPS-like scheme client gives instructions for an investment to be made in the scheme, s1012IA will apply and a PDS must be given. Therefore no specific prohibition is needed to ensure retail clients cannot invest in unregistered schemes through an IDPS.

4.34 To prevent an IDPS or IDPS-like structure avoiding the outcome in paragraph 4.31, we **propose** retaining a specific prohibition on investment in a scheme where the custodian is a related body corporate of the promoter and other members. This type of scheme may fall outside the definition of managed investment scheme in s9 under paragraph (e).

Your feedback

Q23 Do you think that retail clients should be entitled to:

- receive the same quality of information about investments accessed via an IDPS; and
- benefit from the same remedies,

as they would receive if they invested directly? If not, why not?

Q24 Can you quantify the cost of giving or ensuring access to PDSs and Ch 6D disclosure documents to IDPS and IDPS-like scheme clients before they make an investment?

Q25 Can you quantify the cost of the custodian making investments on behalf of IDPS or IDPS-like scheme clients in response to a PDS or under a Ch 6D disclosure document, and informing clients of any rights they have in relation to defective disclosure if an option is given by the issuer?

Q26 What benefits do you think will result from the proposals in this section? Do you think it is possible to quantify those benefits?

Q27 Will the proposals in this section have any financial impacts that you have not referred to in the answers to the questions above when making disclosure about investments to IDPS clients? Please quantify.

Passing on disclosures

4.35 We propose allowing:

- (a) IDPS operators;
- (b) responsible entities of IDPS-like schemes; and
- (c) trustees of superannuation entities within the meaning in s10(1) of the *Superannuation Industry (Supervision) Act 1993*,

to give clients documents by giving the documents to another person who is acting as agent of the client. This will apply even if the agent is an associate of the operator or responsible entity. We also **propose** to give relief from s1015C(3) so that an AFS licensee or an authorised representative of an AFS licensee can act as an agent to receive a PDS.

4.36 This proposal reverses our current general rule that giving documents to clients of an IDPS or IDPS-like scheme cannot be done by giving them to an agent who is an associate of the operator or responsible entity. This proposal applies to certain documents required to be given under our proposed exemptions for IDPS operators and IDPS-like scheme responsible entities and any documents required to be given under s1012IA or the relief from it provided by ASIC to superannuation entities under [PS 184]. This proposal would not apply to:

- (a) annual client statements and reports from auditors;
- (b) a PDS for an IDPS-like scheme or superannuation entity; and
- (c) an IDPS Guide.

4.37 We are considering the following measures to reduce the risk that the disclosures will not be passed on to clients:

- (a) requiring the agent to enter into a contract with the IDPS operator performing transactional functions, the responsible entity for an

IDPS-like scheme or the superannuation trustee binding the agent to give the disclosures to the client; or

- (b) modifying the Act so that where an AFS licensee or authorised representative agrees to act as agent in receiving the disclosures, it must give the disclosures to the client or contravene the Act.

4.38 Under our current policy the IDPS operator performing transactional functions and the responsible entity of an IDPS-like scheme must be reasonably satisfied that certain disclosures have been given. A superannuation trustee must give a PDS when required by s1012IA as modified by relief under [PS 184] in [CO 06/636] *Superannuation: Delivery of product disclosure for investment strategies*. We are aware that in many cases disclosures are given through associated AFS licensees or authorised representatives. Those responsible for giving disclosures currently use a range of practices to reasonably satisfy themselves that disclosures have been passed on by such advisers to clients.

4.39 Our proposal would shift responsibility for passing on disclosures to those who accept responsibility to act as agent.

Your feedback

Q28 Do you agree with our proposal to allow IDPS operators, IDPS-like scheme responsible entities and superannuation trustees to rely on agents who are associated persons or licensees and authorised representatives passing on disclosures to IDPS clients and members? If not, why not?

Q29 Our proposal for passing on disclosures gives two options to reduce the risk of non-disclosure to clients and members. Which option do you think is preferable or should both apply? Please give reasons and quantify the costs associated with your preferred option(s). Are there any other ways to achieve this outcome? If so, please give details.

Q30 Should this approach also apply to the IDPS Guide or the PDS for an IDPS-like scheme or superannuation entity? If so, why? Do IDPS operators rely on associated licensees or authorised representatives who receive documents to give them to clients? If so, how do they ensure compliance and what costs apply? Please quantify.

Section 5: Operation and other issues

Compliance

Public company

5.1 We **propose** removing the requirement that an IDPS operator must be a public company.

5.2 We think this requirement adds complexity and has limited regulatory benefit. Under the Act, AFS licensees generally do not have to be public companies although under Ch 5C responsible entities must be public companies.

AFS licensing

5.3 Currently Policy Statement 130 *Managed investments: Licensing* [PS 130], Policy Statement 132 *Managed investments: Compliance plans* [PS 132] and Policy Statement 133 *Managed investments: Scheme property arrangements* [PS 133] are generally applied to IDPS operators. All IDPS operators must have a specific authorisation in their AFS licence to operate an IDPS.

Note 1: We have separately consulted on [PS 130] in the consultation paper *Updating [PS 164]: Organisational competence* (November 2006). When policy is published following consideration of public comments, it will include our policy in relation to the application of the content in [PS 130] to IDPSs.

Note 2: We are consulting separately on compensation arrangements as required by s912B and when professional indemnity insurance will be required. This will include any requirements applying to IDPS operators.

Note 3: [PS 132] and [PS 133] apply to persons who provide a custodial or depository service, whether or not they are an IDPS operator.

5.4 We **propose** to continue to apply [PS 132] to IDPS operators who perform transactional functions as defined in [PS 148] and [PS 133] to IDPS operators who are responsible for custody. We do **not propose** to apply [PS 132] to IDPS operators who do not perform transactional functions and do not provide a custodial or depository service. We **propose** to continue to require a specific AFS authorisation to be an IDPS operator. This will help ASIC ensure that these policies are complied with and appropriate conditions apply to outsourcing and custody arrangements as set out in conditions 34, 35 and 38 of Pro Forma 209 *Australian financial services licence conditions* [PF 209].

Net tangible assets

5.5 Where transactional functions are performed by the IDPS operator, we **propose** to retain the current net tangible assets (NTA) requirements on a scale from \$50,000 to \$5 million.

5.6 Where custodial functions are performed, we **propose** to retain the current NTA requirement of at least \$5 million.

5.7 To ensure that AFS licensees have the necessary resources to operate a financial services business, all AFS licensees are required to meet certain financial requirements, which vary depending on the nature, scale and complexity of the financial services business: see Policy Statement 166 *Licensing: Financial requirements* [PS 166].

5.8 However, where no transactional or custodial functions are performed, we see less justification to retain the current requirement of \$50,000 NTA. Therefore, we **propose** removing this requirement. The other financial requirements under [PS 166] would not be affected.

Internal controls and audit

5.9 We **propose** that an IDPS operator must document and audit internal controls to ensure compliance with the Act that relate to custodial and transactional functions. This is in addition to:

- (a) requirements in Ch 7 for an audit on the effectiveness of internal controls used by an AFS licensee to comply with obligations about dealing with client money and property: see s981B and 984B and reg 7.8.13; and
- (b) standard licence conditions that require all AFS licensees to have compliance measures to ensure compliance with the Act: see condition 4 of [PF 209]. Internal controls to comply with the Act would include complying with the obligations of the IDPS operator as an AFS licensee and the conditions of relief that relate to custodial or transactional functions.

We do **not propose** to require an audit of any other internal controls.

5.10 We think that our proposal to require an audit of transactional and custodial functions is warranted because:

- (a) existing requirements of Ch 7 do not address all the transactional and custodial functions of an IDPS. For example, the obligation to pay money into a s981B account does not cover money paid to acquire a financial product; the obligation to hold property in safe custody in s984B does not deal with all actions of the custodian in relation to client property such as exercising rights as holder of the asset;

- (b) documented controls for transactional functions are needed so that annual reports by an auditor on annual statements can be given to clients: see paragraph 5.16; and
- (c) the role of an IDPS operator is similar to that of a responsible entity, which must have a documented and audited compliance plan.

5.11 An alternative option is to require an audit of internal controls only in relation to transactions involving IDPS trust accounts. However, because the protections in Ch 7 do not address all activities in relation to client property (as noted in sub-paragraph (a) of paragraph 5.10), we do not favour this option.

Contractual duties

5.12 We do **not propose** to require particular conditions in the IDPS contract which relate to the conduct of the IDPS operator. We are considering departing from our current policy because we believe that the *Australian Securities and Investments Commission Act 2001* (ASIC Act) and Ch 7 adequately protect IDPS clients from the operator's failure to properly provide the service.

5.13 Where an IDPS operator (or its agents) has failed to perform functions it has contracted to undertake, IDPS clients should be able to rely on the implied warranty in s12ED of the ASIC Act. In addition, IDPS clients will have access to ASIC-approved external dispute resolution schemes: see s912A(1)(g).

5.14 Other obligations imposed on AFS licensees under s912A to:

- (a) ensure that financial services are provided efficiently, honestly and fairly (s912A(1)(a)); and
- (b) comply with financial services laws (s912A(1)(c)),

reflect the prescribed contractual obligations in the IDPS contract and should promote similar compliance by IDPS operators.

5.15 Breaches of these obligations by agents of the IDPS operator will generally also be a breach of the Act by the IDPS operator: see s769B.

Your feedback

- Q31** Do you agree with our proposal for the continuing application of [PS 132] and [PS 133] to some IDPS operators? If not, why not?
- Q32** Do you agree with our proposal to retain the current NTA requirements where transactional functions are performed? If not, why not?
- Q33** Do you think we should continue to require IDPS operators not performing custodial or transactional functions to have at least \$50,000 NTA? Please give reasons.
- Q34** Do you agree with our proposal to limit the requirements for auditing of internal controls to those relating to custodial and transactional functions? If not, why not? Can you quantify the costs that would be saved as a result of this proposal?
- Q35** Alternatively, do you think we should not require any additional requirements beyond those in reg 7.8 13 and [PF 209] adapted to refer to the IDPS trust account? Please give reasons. What reduction in compliance costs would occur? Please quantify.
- Q36** Alternatively, do you think we should continue to require that internal controls to ensure compliance with the Act should be documented and audited? Please give reasons.
- Q37** Do you agree with our proposal to remove requirements for particular conditions of the IDPS contract and rely on existing obligations and rights under current legislation? If not, why not?
- Q38** What benefits do you think will result from the proposals in this section? Do you think it is possible to quantify those benefits?
- Q39** What effect (if any) will the proposals in this section have on compliance costs? Please quantify.

Reporting to clients

5.16 We **propose** retaining the requirements for:

- (a) an annual report; and
- (b) quarterly reports or continuous electronic access to client account information.

We **propose** to retain existing requirements for reports by an auditor.

Note: We intend to shortly amend Class Order [02/294] for IDPSs and Class Order [02/296] for IDPS-like schemes to clarify what an auditor's report on continuous electronic access must contain.

5.17 We think that these requirements are of benefit to consumers. Reporting by the IDPS operator or the IDPS-like scheme responsible entity helps IDPS clients and IDPS-like scheme members identify any custodial or transactional failures and assists them to make informed decisions about their portfolios. An auditor's report about this information is important to provide adequate assurance of the reliability of reporting by the IDPS operator or the IDPS-like scheme responsible entity.

Outsourcing

5.18 We **propose** to retain the current licence conditions requiring a written agreement between the IDPS operator and the person performing the custodial functions or the transactional functions. The agreement would specify (among other things) how instructions will be given by the IDPS operator to the custodian or person performing transactional functions and how clients will be compensated if they suffer loss as a result of the person breaching its agreement with the IDPS operator: see [PF 209] at conditions 34 and 38.

5.19 We consider that where functions are outsourced, the IDPS operator responsible for the function should have in place appropriate contractual arrangements to protect clients.

5.20 We think it is important that the IDPS operator has compliance measures to address compliance risks in the outsourced functions and we think that they are different from those it would need if it provided the functions itself.

5.21 An alternative approach would be to rely on the general licensee obligations as discussed in Policy Statement 164 *Licensing: Organisational capacities* [PS 164] at [PS 164.25] to [PS 164.29].

Your feedback

- Q40** Do you think we should retain the current licence conditions applying to an IDPS operator outsourcing custodial or transactional functions? If not, why not? Should we instead rely on the general outsourcing obligations in [PS 164]? Please give reasons for your preferred option.
- Q41** Does complying with a licence condition in the form of conditions 34 or 38 of [PF 209] impose costs? Can you quantify those costs?
- Q42** What benefits do you think will result from the proposals in this section? Do you think it is possible to quantify those benefits?

Custody

5.22 We **propose** retaining the current requirement that all investments must be held on trust for the relevant client.

5.23 We also **propose** retaining the current requirement that all money received from clients be paid into a trust account.

5.24 These requirements address custodial risks. Custodial risks include misappropriation of client assets or funds, failure by the IDPS operator to exercise rights relating to client assets and failure by the IDPS operator (or person appointed to perform transactional functions) to execute client instructions. Our proposals seek to ensure that client assets and funds are protected and overcome technical issues with the application of the client money and client assets protections in Part 7.8: see subparagraph (a) of paragraph 5.10.

IDPS-like scheme relief

5.25 We **propose** to continue the current relief for responsible entities from certain provision of Ch 5C: see Class Order [CO 02/296], paragraphs 3 to 7. These paragraphs include relief for cooling off and modification to the provisions concerning withdrawal. In addition, they include relief from the conditional requirement to send scheme accounts to members.

Failure to comply with terms of relief

5.26 We **propose** that contravention of a condition of relief would not automatically result in complete loss of relief. We will consider the nature, scope and effect of any breach to determine a proportionate regulatory response and this may include exclusion from relief.

Section 6: Regulatory and financial impact

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

- (a) protecting consumers, including by ensuring that they receive adequate disclosure about IDPSs and IDPS-like schemes and accessible financial products and accessible securities, and by appropriate regulation of IDPS operators and responsible entities of IDPS-like schemes; and
- (b) facilitating activity within the IDPS industry by simplifying the manner in which IDPSs are regulated and consequently reducing compliance costs.

6.2 Before settling on a final policy, we will comply with the requirements of the Office of Best Practice Regulation (OBPR) by:

- (a) considering all feasible options;
- (b) if regulatory options are being considered, undertaking a preliminary assessment of the impacts of the options on business and individuals or the economy;
- (c) if our proposed option has more than low impact on business and individuals or the economy, consulting with OBPR to determine the appropriate level of regulatory analysis; and
- (d) conducting the appropriate level of regulatory analysis, including as appropriate to complete a Business Cost Calculator Report (BCC Report) and /or a Regulation Impact Statement (RIS).

6.3 All BCC Reports and RISs are submitted to the OBPR for approval before we make a final decision.

6.4 To ensure that we are in a position to properly complete any required BCC Report or RIS, we ask you to provide feedback as requested and generally provide us with as much information as you can for our proposals or any alternative approaches about:

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

Note: See 'Making a submission' on page 2 of this paper.

Schedule 1: Current regulatory position

Characterisation of an IDPS

- 1 ASIC's current regulatory position is primarily contained in [PS 148], [CO 02/294] and [CO 02/296].
- 2 [PS 167] and [PS 169] discuss the impact of the reforms in the *Financial Services Reform Act 2001* on IDPSs.
- 3 We consider that an IDPS is generally a managed investment scheme. We have, however, exempted operators from the managed investment provisions and financial product disclosure provisions of the law provided that the conditions set out in [CO 02/294] are met.
- 4 Where IDPS-like services are provided through a registered scheme, we have conditionally exempted responsible entities from the fundraising and financial product disclosure provisions of the law that would require details of securities or financial products accessible through the IDPS-like scheme to be included in the PDS.

Current policy

- 5 Key features of our current policy and the relevant provisions of the Act are directed at ensuring that:
 - (a) clients receive adequate disclosure about the IDPS itself;
 - (b) clients receive adequate disclosure about accessible financial products and accessible securities;
 - (c) clients receive regular reporting about transactions and investments;
 - (d) IDPS operators comply with their obligations under the law and maintain robust internal controls;
 - (e) appropriate agreements to protect clients' rights are in place when transactional functions are outsourced;
 - (f) investments acquired via the IDPS are held in trust; and
 - (g) appropriate advice is provided to clients about whether to use an IDPS.
- 6 Similar conditions apply to responsible entities of IDPS-like schemes where generally equivalent requirements are not found in relevant provisions of the Act applying to registered managed investment schemes. Under our relief, members of IDPS-like schemes receive similar disclosure about accessible financial products and accessible securities and similar reporting on their portfolios as persons who invest through an IDPS.

Giving advice about an IDPS

7 Because a client's rights in an IDPS are a financial product, persons making recommendations about whether to use an IDPS must comply with general obligations imposed upon licensees when providing personal advice. That is, personal advice to use an IDPS must be appropriate and an SOA must generally be given. The same requirements apply to membership of an IDPS-like scheme.

Disclosure about the IDPS

8 Before acquiring any investments, IDPS clients must receive an IDPS Guide, which contains information about the IDPS. Before becoming a member of an IDPS-like scheme a retail client must be given a PDS.

9 There are specific content requirements for the IDPS Guide directed at giving IDPS clients the key information they need when deciding whether or not to use an IDPS. Requirements include information about differences in rights that clients will have between investing through the IDPS and investing directly, what investments can be acquired through the IDPS and information about the fees and charges for the IDPS and investments acquired through the IDPS.

10 The IDPS Guide must be updated when there is a change to information it is required to contain.

Disclosure about investments

11 A client must be given the current disclosure document for an investment before it is acquired through the IDPS or IDPS-like scheme, if a disclosure document would be given to the client before they acquired the investment directly. Some exemptions apply. For example, a PDS or Ch 6D disclosure document need not be given if the client already holds the investment and the IDPS operator or IDPS-like scheme responsible entity reasonably believes that the client has access to, and knows they have access to, up-to-date information through a PDS or other regulated disclosures: see s1012D(2).

12 The issuer of a Ch 6D disclosure document must give its prior written consent to the use of the disclosure document for IDPS or IDPS-like scheme clients.

13 Similar requirements apply when securities are offered or issued through an IDPS or IDPS-like scheme as apply to other financial products under s1012IA.

14 The IDPS operator or IDPS-like scheme responsible entity must also ensure that a client is given, on request, a copy of all communications required to be given to them as the holder of a particular investment.

15 These requirements ensure that a person investing through an IDPS or IDPS-like scheme can access the same disclosures they would be able to access if they were investing directly. Similarly, investments cannot be acquired through an IDPS or IDPS-like scheme if they cannot be offered directly, such as interests in an unregistered managed investment scheme.

Reporting

16 IDPS and IDPS-like scheme clients must receive quarterly reports containing information about transactions, investments and values. Alternatively, if a client agrees, this information can be provided to them electronically.

17 IDPS and IDPS-like scheme clients must also receive an annual report containing information about transactions, investments and values together with a report of the annual report by an auditor on the systems to produce that information.

Compliance

18 Like a responsible entity, an IDPS operator must generally be a public company and hold an AFS licence authorising it to operate an IDPS. To ensure that the operator has the necessary skills and experience to operate an IDPS we apply licensing requirements similar to those used when licensing responsible entities.

19 Licence conditions impose prescribed levels of net tangible assets (NTA). IDPS operators must have at least \$50,000 NTA and up to \$5 million NTA if they perform transactional functions. Custodians must have at least \$5 million NTA.

20 [PS 148] defines transactional functions as arranging for acquisition and disposal of assets in accordance with client instructions and maintenance of investment records for reporting purposes.

21 IDPS operators must have adequate internal control procedures to ensure compliance with the law and the conditions of relief. These procedures must be audited annually. This is similar to the requirements that apply to compliance plans for IDPS-like schemes.

22 An IDPS operator must enter into an IDPS contract with the IDPS client. Prescribed conditions of the IDPS contract relate to the conduct of the operator and deal with duties of honesty, care and diligence, liability

for acts or omissions and holding client assets on trust. These obligations are similar to those imposed on responsible entities under the Act.

Outsourcing

23 Licence conditions require that where an IDPS operator appoints another person to perform transactional or custodial functions of the IDPS, there must be a written agreement between that person and the IDPS operator. The agreement must specify how instructions will be given and how clients will be compensated if the agreement is breached. For an IDPS-like scheme, the responsible entity is responsible for the acts and omissions of its agents.

Custody

24 The IDPS operator or custodian must hold client assets and money on trust. ASIC applies standards for custody. Corresponding requirements apply for IDPS-like schemes.

Schedule 2: Effect of our proposals

Table 2: Effect of our proposals

Para reference	Effect on IDPS	Effect on IDPS-like scheme	Position if there is no relief
ADVICE			
3.1	Recommendations to use an IDPS are financial product advice and may be personal advice as defined in the Act.	Recommendations to use an IDPS-like scheme are financial product advice and may be personal advice as defined in the Act.	No change.
DISCLOSURE			
4.1	IDPS operators will not need to give a PDS if the IDPS operator gives an IDPS Guide to prospective clients.	Information about accessible financial products and accessible securities that can be acquired through the IDPS-like scheme need not be included in the PDS provided that a list of these investments is available free of charge on request.	A PDS would be required for an IDPS. The PDS for both the IDPS and the IDPS-like scheme would need to contain information about investments that can be acquired through the scheme.
4.4	The IDPS Guide will need to disclose information that might reasonably be expected to materially influence a retail client's decision to use an IDPS. The information must be worded and presented in a clear, concise and effective manner.	The same requirements apply under the Act as would apply to an IDPS Guide under our relief.	Same as IDPS-like schemes.
4.5	Certain information need not be included in an IDPS Guide if it is capable of being incorporated by reference if, and on the same basis as, permitted for a PDS under any future modifications to the Act under proposals that have been announced by the Government.	The Government's proposals would apply when implemented by modifications to the Act.	Same as IDPS-like schemes
4.6	Non-materially adverse information that would otherwise have to be included in a new or Supplementary IDPS Guide could be provided to clients through a facility like a website.	Same as IDPS.	Same as IDPS.

Para reference	Effect on IDPS	Effect on IDPS-like scheme	Position if there is no relief
4.8	Fees and costs of the IDPS would be disclosed in a manner consistent with Schedule 10 of the Regulations (the enhanced fee disclosure regulations).	The requirement applies under the Regulations.	The requirement applies under the Regulations.
4.11	A single FSG can be given where the IDPS operator has appointed other persons to perform transactional functions.	The responsible entity can produce a PDS that has the information required. As a responsible entity, other service providers will not be providing services directly to retail clients and no FSG will be required.	Same as for IDPS-like schemes.
4.15	Clients will have access to the same standard of information about securities and financial products available through the IDPS that they would receive if they held them directly.	Same as IDPS.	PDSs must be given under s1012IA. Information about accessible financial products and accessible securities is also needed in the PDS.
4.19	Investments must be made in response to the relevant PDS or Ch 6D disclosure document so that clients will have access to the same remedies for defective disclosure as if they had invested directly.	Same as IDPS.	This is not required. However information in the PDS may need to be updated if there is a change in relation to the accessible financial products or accessible securities.
4.21	Clients will be able to exercise their option to withdraw from a product where there is defective disclosure.	Same as IDPS.	If disclosure is defective, it may be that the responsible entity has failed to comply with its obligations under s1012IA.

Para reference	Effect on IDPS	Effect on IDPS-like scheme	Position if there is no relief
4.22	<p>A client who already holds financial products or securities through the IDPS need not be given a PDS or Ch 6D disclosure document for the acquisition of securities of the same kind if the IDPS operator reasonably believes that the client has access to and knows they have access to a PDS or Ch 6D disclosure document that is the most current on issue or does not differ from the most current on issue in a way that is materially adverse from the client's viewpoint.</p> <p>This exemption will not apply if the IDPS operator is aware that the PDS or Ch 6D disclosure document does not meet the requirements of the Act in a way that is materially adverse from the client's viewpoint.</p>	Same as IDPS.	To rely on s1012D(2) so as not to provide a PDS under s1012IA, the responsible entity would need to believe on reasonable grounds that the disclosures provided were the disclosures that the issuer was required to make in the PDS.
4.27–4.28	<p>For dividend or distribution reinvestment plans and regular savings plans, a PDS or Ch 6D disclosure document will not need to be given before financial products or securities are acquired through an IDPS.</p> <p>It will be sufficient for the client to be given access to what the IDPS operator performing transactional functions reasonably believes are current disclosures as soon as reasonably practicable and in any event within 5 business days after the acquisition. This would apply if the client knows they have access to the disclosures.</p>	Same as IDPS.	A PDS may have to be given before an acquisition of accessible financial products even if in the acquisition is in accordance with a distribution reinvestment plan or regular saving plan.
4.29	There will be no need to seek the consent of the issuer of a Ch 6D disclosure document to use the disclosure document for IDPS clients.	Same as IDPS.	Same as IDPS, but issuers of accessible securities may need to include in Ch 6D disclosure documents information about the implications of acquiring securities through an IDPS.

Para reference	Effect on IDPS	Effect on IDPS-like scheme	Position if there is no relief
4.34	Investment in a scheme where the custodian is a related body corporate of the promoter and other members is prohibited.	Same as IDPS.	Does not apply.
4.35	Responsibility for passing on disclosures about investments would be shifted to those who accept responsibility to act as agent for the clients, even if they are an associate of the IDPS operator or a licensee or authorised representative of a licensee.	Same as IDPS.	Under s1012IA, the responsible entity would be responsible for giving disclosures and could not rely on an AFS licensee or authorised representative to receive the disclosures as the client's/ member's agent.
OPERATION AND OTHER ISSUES			
5.1	An IDPS operator need not be a public company.	A responsible entity must be a public company.	Same as IDPS-like scheme.
5.4	[PS 132] will apply to IDPS operators that perform transactional functions and [PS 133] to IDPS operators who are responsible for custody. A specific AFS authorisation to be an IDPS operator will be required.	[PS 132] and [PS 133] apply.	Same as IDPS-like scheme.
5.5–5.8	Where transactional functions are performed by the IDPS operator we will retain the current NTA requirements on a scale from \$50,000 to \$5 million. Where custodial functions are performed we will retain the current NTA requirement of at least \$5 million. Where no transactional or custodial functions are performed and the IDPS operator only administers client assets, we will remove the current NTA requirement of \$50,000 and rely upon the general financial requirements imposed upon licensees under [PS 166].	A responsible entity must have NTA based on a scale from \$50,000 to \$5 million. The holder of scheme property must have \$5 million NTA.	Same as IDPS-like scheme.

Para reference	Effect on IDPS	Effect on IDPS-like scheme	Position if there is no relief
5.9	Internal controls to comply with the Act that relate to custodial and transactional functions will need to be documented and audited.	IDPS-like schemes must have a documented and audited compliance plan.	Same as for IDPS-like scheme.
5.12	No particular conditions that relate to conduct of the IDPS operator are required in the IDPS contract .	A member of a registered scheme can take action if there is any breach of the responsible entity's obligations.	Same as for IDPS-like scheme.
5.16	An annual report and quarterly reports or continuous electronic access to client account information instead of quarterly reports and reports by an auditor will be required.	Same as for IDPS. Periodic reporting requirements apply under s1017D but can be included with annual client statement required. Scheme accounts are required to be available on request.	Annual report is required to be available under Ch 2M relating to the scheme and periodic statement requirements would apply.
5.18	A written agreement is needed between the IDPS operator and the person performing the custodial functions or transactional functions.	Same as IDPS for custodial functions. The IDPS-like scheme responsible entity remains liable for acts of agents performing transactional functions.	Same as IDPS-like scheme.
5.22–5.24	All investments must be held on trust for the relevant client and all money received from clients be paid into a trust account.	Under Ch 5C responsible entity holds scheme property in trust.	Same as for IDPS-like scheme.
5.25	Ch 5C does not apply.	Relief from certain provisions of Ch 5C such as cooling off and modification to the provisions concerning withdrawal.	There would no exemptions from Ch 5C.
5.26	Contravention of a condition of relief would not automatically result in loss of relief.	Same as IDPS for the PDS relief.	No relief applies.

Key terms

In this paper, these terms have the following meanings:

accessible financial product a financial product that is acquired through an IDPS

accessible securities securities that are acquired through an IDPS

Act The *Corporations Act 2001*, including regulations made for the purposes of the Act

AFS licence Australian financial services licence as defined in s761A

AFS licensee Australian financial services licensee as defined in s761A

ASIC Australian Securities and Investments Commission.

ASIC Act *Australian Securities and Investments Commission Act 2001*

Ch 6D (for example) a chapter of the Act (in this example chapter 6D)

Ch 6D disclosure document a prospectus, short form prospectus, profile statement or offer information statement as referred to in s705 that would be able to be used for an offer of the securities to the client of the IDPS or IDPS-like scheme

FSG Financial Services Guide, as defined in s761

FUA funds under administration

IDPS an investor directed portfolio service, consisting of a number of functions including a custody, settlement and reporting system and service with the following features:

- (a) the clients of the service have the sole discretion to decide what (but not necessarily when) assets will be acquired or disposed of, except where:
 - (i) there are any prior written directions to acquire or dispose of a particular asset in particular circumstances that the client has agreed not to vary (other than on the exercise of any discretion on the part of an operator); or
 - (ii) the client has authorised the operator or another person to give directions on their behalf, for the purpose of the other person receiving or securing payment of money owing by the client to the person; and

- (b) subject to any prior contrary directions in order to ensure payment of money for which the client is liable, a client may direct the operator to:
 - (i) take reasonable steps to transfer assets to or to the order of the client;
 - (ii) realise assets held on account for the client and either:
 - (A) pay the proceeds to or to the order of the client; or
 - (B) if the operator and the client agree, hold the proceeds under the IDPS in an account with an Australian ADI designated as a trust account,

unless the assets cannot be transferred or realised under law or the terms of their issue; and
- (c) except where otherwise mentioned in paragraph (a) or (b), any discretion of the holder of assets held through the service may be exercised only in accordance with the directions from time to time of the relevant client; and
- (d) the service is provided in such a way that clients are led to expect, and are likely to receive, benefits in the form of:
 - (i) access to investments that the client could not otherwise access directly; or
 - (ii) cost reductions by using assets contributed by the client or derived directly or indirectly from assets contributed by the client with assets contributed by other clients or derived directly or indirectly from assets contributed by other clients

Note: Cost reductions may arise from the pooling of client funds to make large investments that can be acquired on more favourable terms than if the investments were made by each client on their own behalf. They may also arise from the 'netting' of transactions whereby directions of clients to buy and sell assets are offset against each other and a transaction for the net amount is entered into.

IDPS contract a contract between an IDPS operator and a client under which the operator provides the client with an IDPS.

IDPS Guide a document provided by an IDPS operator instead of a PDS to help retail clients decide if they should use the IDPS

IDPS-like scheme a registered managed investment scheme that has a constitution with provisions to the effect that:

- (a) a member may direct that an amount of money corresponding to part or all of the amount invested by the member in the scheme be invested in specified accessible investments; and

- (b) the distributions of capital and income from the scheme to the member in relation to their interests in the scheme will be determined by reference to amounts received by the custodian in relation to the accessible investments acquired in accordance with that direction.

NTA net tangible assets, as defined in Policy Statement 166 *Licensing: Financial requirements* [PS 166]

PDS Product Disclosure Statement, as defined in s761A

providing entity an AFS licensee or an authorised representative of an AFS licensee

[PS 170] (for example) an ASIC policy statement (in this example numbered 170).

Regulations Corporations Regulations 2001

s761A (for example) a section of the Act (in this example numbered 761A)

SOA Statement of Advice, as defined in s761A

transactional functions means:

- (a) acquisition and disposal of accessible financial products or accessible securities in accordance with the instructions of the client or otherwise in accordance with the terms of the IDPS contract; or
- (b) maintenance of records of investments of clients for the purposes of consolidated reporting functions under the IDPS

Related publications

Class orders and pro formas

Class Order [CO 02/294] *Investor directed portfolio services*

Class Order [CO 02/296] *Investor directed portfolio-like services provided through a registered managed investment scheme*

Class Order [CO 03/237] *Updated information in product disclosure statements*

Class Order [CO 06/636] *Superannuation: Delivery of product disclosure for investment strategies*

Pro Forma 209 *Australian financial services licence conditions* [PF 209]

Policy statements

Policy Statement 130 *Managed investments: Licensing* [PS 130]

Policy Statement 132 *Managed investments: Compliance plans* [PS 132]

Policy Statement 133 *Managed investments: Scheme property arrangements* [PS 133]

Policy Statement 148 *Investor directed portfolio services* [PS 148]

Policy Statement 164 *Licensing: Organisational capacities* [PS 164]

Policy Statement 166 *Licensing: Financial requirements* [PS 166]

Policy Statement 167 *Licensing: Discretionary powers* [PS 167]

Policy Statement 169 *Disclosure: Discretionary powers* [PS 169]

Policy Statement 175 *Licensing: Financial product advisers—Conduct and disclosure* [PS 175]

Policy Statement 179 *Managed discretionary account services* [PS 179]

Policy Statement 184 *Superannuation: Delivery of product disclosure for investment strategies* [PS 184]

Legislation

Draft Corporations Amendment Regulations 2007 (No.) March 2007

Consultation papers and reports

Corporations and Financial Services Regulation Review Consultation Paper (April 2006)

Consultation Paper *Updating [PS 164]: Organisational competence*
(November 2006)

The Standard & Poor's Market Share Report for December 2006

Media and information releases

The Parliamentary Secretary to the Treasurer's Press Release No. 28 of
2006

Information Release [IR 99-10] *ASIC policy review of member
discretionary master funds and 'wrap accounts'* (15 February 1999)