

# From the Desk of Director Marija Pajeska



13 May 2016

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Response to ASIC Consultation Paper 254 – Regulating digital financial product advice

The Association of Securities and Derivatives Advisers of Australia (ASDAA) appreciates the opportunity to provide these comments to ASIC in respect of ASIC Consultation Paper 254 – Regulating digital financial product advice.

ASDAA is a newly formed association which represents its members from the Securities and Derivatives advisory profession. Its members are comprised of individuals who are either directors or employees of firms which hold Australian Financial Services Licences (AFSLs).

ASIC has drafted a regulatory guide for the purpose of bringing 'together some of the issues that persons providing digital advice to retail clients need to consider when operating in Australia – from the licensing stage ... through to the actual provision of advice.'<sup>1</sup>

The issues that ASIC has concentrated on are issues relating to the following:

- Organisational competency in a digital advice context; and
- Monitoring and testing of algorithms underpinning digital advice.

One issue that is significant and ASIC makes reference to however provides no guidance on is the dealing services involved with provision of digital advice. In RG000.36(b) ASIC highlights that a person becoming an authorised representative needs to consider the type of licence authorisation that an AFS Licensee would need for a business to operate a digital advice services and lists 2 options, being:

- Dealing on behalf of clients, which includes arranging; or
- Operating MDA Services.

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<sup>1</sup> ASIC Draft Regulatory Guide 000 – Providing digital financial product advice to retail clients

This is an important issue as the structure of the business in the digital environment makes a huge difference to the licence authorisation required and the capacity of the person nominated to be the Responsible Manager to support such business (if the business owners intend to apply for their own AFS Licence instead of becoming an Authorised Representative).

In the digital advice environment the means by which clients place instructions and the client's instructions are executed is generally via digital means. So, at a minimum, ASIC should provide guidance on what information a business should consider to determine whether the structure being implemented inadvertently means that an Authorised Representative or an AFS Licensee is operating an MDA Service. The important factor here is to increase awareness and educate business operators to ensure that they implement the appropriate structure which will safeguard clients, their funds and investments.

We recognise that in the draft Regulatory Guide ASIC refers business operators to RG179 Managed Discretionary Account Services however the problem is that RG179 does not deal with the provision of digital advice.

The main issue is that ASIC recognises and accepts the fact that advice can be given digitally, ie. no natural person being involved in the provision of advice, so in such circumstances does ASIC recognise that orders can be accepted and executed digitally (and potentially automatically) without a natural person being involved in the process. If so, does this imply an MDA Service is being provided to clients or is it accepted that the digital technology used replaces the natural person and thus the business is deemed to be dealing on behalf of clients.

In our mind, if no guidance is provided with regards to this matter then the Regulatory Guidance issued by ASIC is incomplete.

Other general matters we wish to highlight that we believe require further consideration and/ or clarification:

- RG000.48 implies that as there is no natural person directly involved in providing the advice then the training and competence standards do not apply. It is our understanding that a natural person, in the first instance is responsible for developing and testing the investment strategy. Once the investment strategy is tested and proven to work it is coded into an algorithm by IT professionals. It is our view that the natural person responsible for developing and testing the investment strategy and developing and implementing enhancements and adjustments to the strategy should meet the training and competence standards. We understand that ASIC has proposed in the Regulatory Guidance that the Responsible Manager meet these requirements however if the Responsible Manager is not directly involved in the development and/ or testing of the investment strategy we feel this is an ineffective approach.
- RG000.81 deals with the adequacy of compensation arrangements. One other point that should be included is the impact of jurisdictional limits on a business' PI Insurance cover. A typical jurisdictional limit is 'worldwide excluding United States of America' which generally would provide cover for Claims made against the insured anywhere in the world, except for Claims brought in a court in the United States of America, or that arise from a judgment or order of a court in the United States of America. If a business

intends to offer financial products traded on US markets or issued by US organisations then the business needs to assess the implications for it in regards to its PI Insurance.

- We refer to Section 944A of the Corporations Act which outlines the situations in which Division 3 of Part 7.7 of the Corporations Act applies, ie. in particular the requirement to provide an SOA to a retail client. Section 944A states that Division 3 of Part 7.7 of the Corporations Act applies where the advice is provided by a financial services licensee or a person in their capacity as authorised representative. ASIC should provide guidance, similar to that provided in RG000.85 regarding the requirement to issue an SOA to a retail client when personal advice is provided by a digital advice provider which is neither an AFS Licensee or a person, ie. the personal advice is offered through a computer program.

Our specific comments to each of ASIC's proposals in the Consultation Paper are detailed in Annexure A of this letter.

ASDAA appreciates the opportunity to provide this Submission to ASIC on these significant proposals. We would be happy to discuss any issues arising from our submissions on this issue, or to provide any further material that may assist. Should you require any further information, please contact Brad Smoling, Director of Communications, on (07) 5532 3930 or email [brad@asdaa.com.au](mailto:brad@asdaa.com.au).

Yours Sincerely



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## ASIC's proposed guidance to assist digital advice providers

A1 proposal: ASIC proposes to release draft Regulatory Guide 000 Providing digital financial product advice to retail clients (RG 000) to assist digital advice providers in complying with the law.

ASIC Question		Response
A1Q1	Overall, is the proposed guidance helpful? If not, why not?	Overall the guidance is helpful however it appears to be incomplete as it has not addressed the following: <ul style="list-style-type: none"><li>• How the dealing services offered to clients within the business model impact the licence authorisation required?</li><li>• How the training and competence requirements apply to the person who developed and tested the investment strategy before it was converted to an algorithm?</li><li>• How the obligation to provide a Statement of Advice is to be handled when the personal advice provider is a computer program?</li></ul>
A1Q2	Is ASIC's proposed guidance (in Section D of the draft regulatory guide) helpful in assisting digital advice providers to provide scaled advice that is in the best interests of clients? If not, why not?	Yes, as it prompts the persons operating or intending to operate in the digital advice environment to consider critical information during the development stages of their setup which will allow them to incorporate policies, procedures and systems that will ensure compliance with the best interest duties.

ASIC's proposed requirements for responsible managers of digital advice licensees

B1 proposal: ASIC proposes to require that a digital advice licensee has at least one responsible manager who meets the minimum training and competence standards for advisers.

To assist existing AFS licensees that may not have a responsible manager who meets these standards, we propose a transition period of six months.

ASIC Question		Response
B1Q1	Do you agree with this proposal? Please provide supporting arguments.	<p>No, the provision of digital advice involves the development of an investment program which is then translated to an algorithm used to provide digital advice. It is our view that the person(s) responsible for developing the investment program must meet the training and competence requirements as they are the person(s) that understands the rationale, risk and rules behind the algorithm. They will be responsible for testing the algorithm to ensure it operates as it should, and for providing instructions for future developments and changes to the algorithm.</p> <p>Ensuring that at least one Responsible Manager meets the training and competency requirements should be accepted only if they have an understanding of the investment program, and the rationale, risk and rules behind the algorithm. Furthermore, the Responsible Manager should be actively involved in the business.</p>
B1Q2	<p>Do you agree that, if the changes proposed in the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 become law, at least one responsible manager should:</p> <p>(a) meet the new higher training and competence standards (i.e. have a degree or equivalent, pass an exam, complete a professional year and undertake continuing professional development); and</p> <p>(b) comply with the proposed ethical standards (i.e. comply with a code of ethics and be covered by an approved compliance scheme)?</p>	<p>We refer to our response to B1Q1 and are of the view that the persons we have listed in the response for B1Q1 (ie. the person(s) responsible for developing the investment program and/ or at least one Responsible Manager if they have an understanding of the investment program, and the rationale, risk and rules behind the algorithm) should meet the higher training and competence standards and the proposed ethical standards that apply to the type of advice that they provide. It is noted that the new higher training and competence standards are intended to apply to individuals that provide personal advice to retail clients and this should apply in these circumstances as well.</p>

ASIC Question		Response
B1Q3	Are there any aspects of the proposed higher training and competence standards in the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 that should not apply to at least one responsible manager of a digital advice licensee?	It is important to maintain a level playing field and ensure that the standards apply equally across the board regardless of the means by which the advice is delivered. Therefore, the new higher training and competence standards should be applied to the person(s) we identified in response to B1Q1 only when the business model includes the provision of personal advice to retail clients.
B1Q4	Is the proposed transition period of six months long enough for existing AFS licensees to comply with the requirement to have a responsible manager who meets the minimum training and competence standards? If not, why not?	An AFS Licensee that is currently operating in the digital advice environment holds the relevant authorization to provide advice to clients in the underlying products. These licensees have already gone through an ASIC assessment process and their licence was approved on the basis that ASIC was satisfied that the Responsible Manager(s) met the organizational competency requirements. For ASIC to impose a six (6) month transitional period to ensure that at least one Responsible Manager meets the training and competence requirements when the requirements themselves are about to change does not appear to add any value or give any further comfort to clients. The transitional period should tie into the implementation of the new higher training and competence standards instead thus avoiding an unnecessary additional burden to a redundant requirement to meet the training standards setout in RG146 during a transitional period which may commence after the new standards are released.
B1Q5	Please provide feedback on any costs or benefits that may apply to your business under the proposal.	The costs of requiring at least one Responsible Manager of an existing AFS Licensees to meet the current training standards setout in RG146 appears unnecessary and burdensome when the new training standards are due to be released, potentially prior to the commencement of the transition period.

ASIC's proposed requirements for monitoring and testing of algorithms by digital advice providers

C1 proposal: ASIC proposes to issue guidance on the ways in which we think digital advice licensees should monitor and test the algorithms underpinning the digital advice being provided.

ASIC Question		Response
C1Q1	Do you think we should be more detailed in our guidance on the ways in which we think digital advice licensees should monitor and test algorithms? If so, what additional guidance should we provide?	The guidance provided by ASIC on the ways digital advice licensees should monitor and test algorithms appears sufficient.
C1Q2	Please provide feedback on any costs or savings to your business as a result of this proposed guidance.	We are of the view that monitoring and testing of the algorithm should be part of the processes and procedures implemented by any business operating in the digital advice environment. We feel that appropriate monitoring and testing can lead to long term savings as the services delivered to clients will most likely meet client's expectations and as a result manage the risk of receiving any complaints leading to long terms cost savings.
C1Q3	Do you think we should introduce a self-certification requirement which would require digital advice licensees to certify that their algorithms have been adequately monitored and tested	A self-certification process may be useful however we note that all licensees must be audited annually. To incorporate the requirements into the annual audit of internal controls by the ASIC Registered Auditor may be more appropriate. The idea would be for the auditor to assess the adequacy of the monitoring and testing procedures adopted by the digital advice licensee at the time of the annual audit.
C1Q4	Should we require independent third-party monitoring and testing of algorithms? If so, in what circumstances would this be warranted	This should only be considered if ASIC has concerns about the appropriateness of a licensee's operations. To require independent third-party monitoring and testing of algorithms would increase costs and negate any benefit to clients.