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6 May 2013

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SUBMISSION IN RESPONSE TO CONSULTATION PAPER 200
Managed Discretionary Accounts: Update to Regulatory Guide 179

1. SUMMARY

1.1 Consultation Paper (CP) 200 should not have been published in its current form. It is deficient materially and, given the complexity of the range of regulatory and commercial landscapes faced by providers of Retail MDA Services, should not have been used to commence the consultation phase of what affected AFS Licensees hope will be a comprehensive, rigorous and considered review of the current conditions of relief (and related guidance).

1.2 CP 200 doesn't acknowledge and address (even by comprehensive summary) the diverse range of very different Retail MDA Service-Models, the different regulatory/enforcement landscapes each type of MDA Operator may face and (most significantly) does not include information the Commission already has at hand, which is necessary for an informed assessment of the need for re-regulation and the degree to which the risks faced by Retail MDA Clients and other AFS Licensees may be insufficiently addressed by CO 04/194. In short, it appears from CP 200 the Commission hasn't yet properly put itself in the shoes of all those likely to be directly affected by the Proposals. As a consequence, it's difficult to accept that the indirect consequences (e.g. the impacts on competition and innovation) can have been the subject of any meaningful consideration.

1.3 The wording of CO 04/194 has always been problematic. Although amended a number of times during the last decade, these opportunities weren't used to correct sources of confusion and clarify unnecessarily complex language. There's a clear case for amending CO 04/194 to express its requirements in much plainer English. The Commission shouldn't be leaving it to MDA Operators to detail these shortcomings. CO 04/194 is the Commission's (not Parliament's) child, and the operational benchmark for licensing Retail MDA Services. Difficulties interpreting

CO 04/194 would have been very evident from queries and the Application/Variation Proofs lodged during the last decade. This is also the opportunity to review the technical basis for construing any Retail MDA Service as a Registerable MIS, to review the prohibition on any General Advice relating to a Retail MDA, to review the general prohibition on investing in Unregistered MIS, and to revise the focus of CO 04/194 entirely.

1.4 CO 04/194 also mandates use of particular statements in the FSG, MDA Contract and Investment Program which have always been redundant given the General Obligations (Section 912A CA) and other provisions of the Corporations/ASIC Acts, which afford protections to all clients and require legally enforceable ethical (e.g. efficient, honest and fair) conduct on the part of AFS Licensees and their Representatives.

1.5 In addition to being redundant, it is actually counter productive to require a MDA Contract to specify that the MDA Operator must (Condition 1.12 of CO 04/194):

- act honestly;
- exercise the degree of care and diligence a reasonable person would exercise;
- act in the best interests of the client; and
- not use information to gain an improper advantage.

Not only can it be disquieting for a MDA Client to read such text, it also infers such fundamental protections might not apply to Non-MDA financial services provided by the MDA Operator or other AFS Licensees generally. These significant protections do apply generally, and would be imported into MDA Contracts anyway, and despite the best (but simplistic) intentions of the Commission, these elements of CO 04/194 work to dilute the confidence of MDA Clients in financial services regulation generally. Therefore, such redundant text should be removed from CO 04/194 or mandated for inclusion in all Retail Client Services Agreements. Likewise, the statements prescribed for confirming compliance with Subdivisions C and D of Part 7.7 CA, which are meaningless to Retail MDA Clients. Specify a compliance benchmark if the Commission must, but why also require the benchmark to be stated in client documentation? Also, for the same sake of regulatory efficiency, nothing should remain specified in CO 04/194 which is (or will be) required or addressed by the FoFA Reforms. By not justifying in detail why most of the text of CO 04/194 should remain (Section G of CP 200), the Commission is again fostering the unfortunate perception among affected AFS Licensees that it isn't interested in regulating efficiently and applying a lighter, less intrusive/costly touch when that should be sufficient.

1.6 The case justifying the proposals to re-regulate (i.e. impose additional compliance and capital adequacy requirements on) Retail MDA Operators and External MDA Advisers/Custodians is NOT made. Apart from identifying the Commission's concerns in relation to Conflicts Management and Resourcing/Outsourcing, and the growth in AFS Licensees having Authorisation to provide Retail MDA Services, there is no information about Enforcement/Licensing Action taken in relation to MDA Services during the last decade. No statistics in relation to actual or near financial failure, fraudulent conduct, qualifications to Audit Reports, the history of Complaints/FOS Determinations, PI Claims, Self-Reporting of CO 04/194 breaches, or the average capitalisation of the different types of MDA Operators. Such a deafening silence, even though Retail MDA Services would have been a surveillance focus and compliance with CO 04/194 is difficult. CP 200 simply asserts that harmonisation with requirements for Responsible Entities/IDPS Operators, and full-service Custodians, is desirable (i.e. these product providers/issuers are sort of equivalent, and bigger is somehow better) and on that basis all the proposals to re-regulate are sufficiently justified. Not only does the Commission appear careless of

all its duties under Section 1(2) of the ASIC Act, it also seems indifferent to the significant impacts on MDA Operators who've operated legitimate, compliant and unproblematic Service Models to date. And yet it falls to MDA Operators to make submissions why the proposals aren't required or need modification, and to provide detail of costs when much of that can be gleaned from the Commission's own files or knowledge.

1.7 The concern at the growth of those recently (and expected to be) Authorised to provide Retail MDA Services is overblown. Around 200 AFS Licensees in total, and 25% growth in number since 1 January 2011 (18 months). Hardly an explosion in absolute terms, and given the demands of the Application/Variation process, particularly the supporting Proofs, the Commission has ample opportunity to focus its surveillance on potentially problematic MDA Services to be aimed at SMSFs or designed to cover trading in particularly risky (e.g. unlimited recourse) products.

1.8 All this serves to undermine confidence in Consultation Processes in an environment where reforms are significant, frequent, costly and deadlines are tight. ASIC is not deploying the talent and information it has at hand to best effect. As a consequence, consultation has commenced without covering all the issues that should be on the table for a transparent and comprehensive review. And the example scenarios aren't nuanced or imaginative, and aren't as instructive as they could be. These criticisms apply to this Consultation Paper but are common to the library of Consultation Papers put to AFS Licensees during the last couple of years. To correct for these shortcomings, considerable additional work is required of respondents, which has its costs. There are limits to how comprehensively SME AFS Licensees can engage with the Commission/Treasury to correct flaws in policy development.

1.9 The prohibition on General Advice in relation to Retail MDAs should be reviewed in light of the growing prevalence of MDAs adopting a standardised Model Portfolio with particular collective and objective strategy/risk attributes, changes to which can be automated whenever the Research House or Manager responsible for 'maintaining' the Portfolio reviews or reweights the Model Portfolio. The Model Portfolio is effectively a 'product', and should (in logic) be selectable by a client for the purposes of a MDA without the need for Personal Advice. The client would still have a choice about whether to seek Personal Advice as to the suitability of a particular Model Portfolio(s). Model Portfolios will not replace individually designed Portfolios for a MDA which (by definition) should be the subject of Personal Advice.

1.10 The basis for the No-Action stance in relation to Family Accounts is, in our view, flawed and the pursuit of the related proposals will be counter-productive. Therefore, the No-Action stance should not be incorporated in the revised CO 04/194 or RG 179.

2. INTRODUCTION

2.1 This Submission is very critical of the case laid out in Consultation Paper 200 and its Proposals for re-regulating providers of Retail MDA Services. Our views are informed, considered, constructive, rational, and our own. This Submission has not been prepared or paid for at the instigation of any of our clients. Informed criticism, in the context of constructive engagement, should not be unwelcome. Very direct and considered feedback (whether positive or negative) is necessary to ensure a robust, efficient and professional consultation process. Criticism and praise should be welcomed equally.

2.2 We wouldn't have bothered to respond to CP 200 if we didn't have confidence in the Commission and respect for its vital role. This Submission is comprehensive. It doesn't simply dismiss CP 200 in a handful of angry paragraphs. But the fact that it has had to be so lengthy is a measure of the heights of frustration felt by AFS Licensees and Compliance Professionals, within the demographic we service, with the typical manner during recent years in which the Commission has (and Treasury and the Minister's Office have) managed consultation processes. We don't envy the Commission's (and Treasury's) extraordinary workload during recent and foreseeable years. FoFA Reforms, Market Integrity Rules, Market Supervision, Superannuation Reforms ... on and on it goes. In the face of rafts of diverse reforms passed by Parliament, and the late arrival of supporting regulations, implementation and guidance timetables have been far too tight. But time pressures must not be an excuse for lesser regulatory outcomes. The cost and other impacts of underdeveloped or insufficiently targeted regulation can be very damaging.

2.3 One-size-rarely(if ever)-fits-all, and the Commission should always be careful to avoid being perceived as careless of how the direct and indirect impacts of any particular reform or guidance affect any particular AFS Licensee(s). Unless the 'current' requirements are the subject of reform, the 'current' must be shown to be fundamentally broken before the 'new' can be justified. And the design of the 'new' should always take full account of the wider regulatory landscape impacting the AFS Licensees and the practices being targeted by a reform. The Commission's Parliamentary Committee appearances, Regulatory Impact Statements and guidance don't demonstrate these considerations. The Commission happens to be a large organisation itself, and it seems to have the default position that, in general, a larger rather than smaller organisation is far better placed to meet the Commission's goals for investor protection and systemic risk. While capitalisation and depths of competence are presented as legitimate concerns in relation to smaller AFS Licensees, there's never any detailed balancing commentary in relation to concentration-risk, price-competition and facilitation of innovation. Bigger isn't always necessarily better. It shouldn't be a surprise that smaller MDA Operators, who've operated for the last decade with a good compliance and audit record, are frustrated (even angered) by the carelessness with which the Commission has put its case for harmonisation with the regime applying to Responsible Entities and IDPS Operators.

2.4 It's noteworthy that the construction of 'MDA Services' as a Financial Product, and the regulation of MDA Operators (and External MDA Advisers/Custodians), is achieved by means of a Legislative Instrument (i.e. CO 04/194) rather than direct legislation or regulation. Opportunities to legislate for MDA Services have been available but not taken. This review of MDA Services regulation is not driven directly by any legislative timetable. Unless there is a clear, immediate and pressing risk to MDA Clients, and a need for urgent and targeted re-regulation (which isn't the case put by CP 200), then the Commission's review can take the time necessary to ensure an effective consultation process and well-targeted re-regulation. This review should include revisiting the original analysis which construed any Retail MDA Service as a Registerable Managed Investment Scheme. It's worth reminding the Commission that many with the necessary technical competence do not accept this analysis as correct for the entire range of MDA Service-Models. Even the Commission's limited guidance for Licensing purposes (i.e. the choice of product categorisations – see RG 2.100) fosters that doubt. This review should also revisit whether it is necessary in all circumstances to prohibit advice other than Personal Advice in relation to a Retail MDA.

3. BACKGROUND

3.1 Securities & Futures Compliance Services Pty Ltd is a specialist provider of compliance and risk management support services; predominantly to AFS Licensees (Market Participants or otherwise) providing Retail and/or Wholesale Services in relation to Financial Products traded (or to be traded) on a 'live' Market (Australian or Foreign). We have been doing so since 1995. A concise description of our experience and range of services is included as an Appendix to this Submission. Our clients include Market Participants, Portfolio/Wealth Managers, Corporate Advisers and MIS Operators (including Responsible Entities).

3.2 The current regulatory regime for Managed Discretionary Account Services provided to Retail Clients, which has applied since 11 December 2004, is set out in Class Order 04/194 (first released on 11 March 2004 and amended variously during the intervening years) and Regulatory Guide 179 (which was issued on 15 March 2004). Class Order (CO) 04/194 is the premier source of regulation, being a legislative instrument. It is not entirely consistent with the text and expectations of RG 179.

3.3 The current regulatory regime parallels the Corporations Act. CO 04/194 has force and effect by virtue of the Corporations Act, but MDA Services aren't named or described explicitly in the Corporations Act.

3.4 CO 04/194 was poorly drafted and has remained an unnecessarily complex document. Its shortcomings and ambiguities have been raised with the Commission by those affected. The Commission's Licensing Team have struggled with it, as have those providing or intending to provide MDA Services. There was no reason it couldn't have been worded better at the outset, or amended to be made more clear in the interim. It is disappointing that the Commission hasn't identified or hasn't seen fit to list all the elements of its text which are ambiguous (in the experience of the Commission) to AFS Licensees or are (or will become) redundant.

3.5 Regulatory Guide 179 is also not what it could be. It is disappointing that the Commission hasn't demonstrated its own recognition of this by listing (even by means of an Appendix to CP 200) those elements of RG 179 which could be better expressed, or are often queried by AFS Licensees for the purposes of interpretation.

3.6 Many among the Financial Services Compliance and Risk Management community, with a close interest in ensuring (in order to ease the burden of procedural and training design) a consistent technical logic pervades the regulatory environment, who participated during 2003 and 2004 in or monitored the review which lead to CO 04/194 and RG 179, did not (and still don't) accept the validity of the Commission's expert advice that found that all Discretionary Account Services, however structured, are a Managed Investment Scheme and therefore registerable (in accordance with Chapter 5C) when provided to a Retail Client. MDA Operators would each have to be Authorised as a Responsible Entity unless relief was granted (hence, the need for CO 04/194). The regulatory solution included construing a Retail Discretionary Account Service as a separate category of Financial Product.

3.7 Even the Commission didn't appear convinced by its own analysis. Its guidance for those needing to vary their AFS Licence by COB 10 December 2004 permitted Applicants to select one or both of the alternative Categories of Financial Product (i.e. MIS Interests limited to MDA Services, where the Operator felt their service was a MIS, or Miscellaneous Financial Facility limited to MDA Services, where the MDA Operator felt otherwise). Because of the distinction and the possibility of separate

regulatory environments developing in future for each category, many sought Authorisation covering both alternatives.

3.8 RG 179.11 states that a MDA Service is both a Managed Investment Scheme and a Facility for making a Financial Investment. It is the presumption that any Retail MDA Service is a Managed Investment Scheme (and registerable in accordance with Chapter 5C CA) that is most controversial. "Managed Investment Scheme" is defined at Section 9 CA. Section B of RG 179 (How we define MDA Services) has to over-interpret each of the three features of a MIS in order to construe a Retail MDA as such. Although MDA Clients, in a technical sense, give up (but retain the MDA Contract right to reclaim) day-to-day control over operation of their MDA, the Commission's position is weak because it relies so heavily on the MDA Client-MDA Operator relationship being a common enterprise simply as a consequence of the MDA Operator being authorised as an Agent of the MDA Client. However, the sense of the MIS definition relies on some form of sufficiently distinct pooled structure being interposed between the investments made and the investors. Because of the prohibition on pooling MDA Portfolio Assets, contributions to be invested are NOT made to acquire rights to benefits produced by the interposed structure. MDA Portfolios are registered (or accounted for) separately, MDA Client by MDA Client. MDA Clients acquire (and are allocated) rights through means of direct legal title or beneficial ownership, NOT by means of some right vested by some sufficiently distinct trust structure.

4. SHORTCOMINGS IN THIS AND OTHER RECENT CONSULTATION PROCESSES

4.1 No fair-minded person within the community of AFS Licensees would deny the complexity, scope, and in many cases the urgency of the issues (including the Government's reform agenda) faced by the Commission during and since the Global Financial Crisis. The Commission and Treasury had the skill-set to assist our Financial Markets and Financial Services sectors navigate those storms, through to these less uncertain times.

4.2 Good policy development relies on sophisticated understanding of the issues, imagination and effective communication and consultation. It would be fair to say, in general, that the Financial Services sector would support (albeit, grudgingly at times) the policy goals of successive, recent Governments.

4.3 Likewise, good implementation of policy (in the form of efficient, targeted regulation and guidance) requires a sophisticated and practical understanding of the issues, and effective consultation and drafting skill to ensure an efficient and targeted regulatory solution. In general, policy implementation performance, the responsibility of Treasury and the Commission has been woeful. Draft proposals/regulations have tended to evidence the lack of understanding of the businesses which the Commission (and Treasury) regulates and the practicalities of their current and proposed regulatory environments. Rarely are proposals/regulations clever in targeting problematic conduct or arrangements, and Government seems so insensitive to timing and costs. The necessary corrective work has typically been cut short by arbitrarily short deadlines or 'selective-deafness' on the part of the Commission (and Treasury, and the Minister's office). Experience has often required the later amendment of the regulation, reflecting the concerns raised earlier. The spend on the initial procedural and system change, usually considerable, is often wasted.

4.4 The Commission and Treasury get paid for their contributions to the consultation process. The Financial Services sector (other than its Industry Associations) does not.

The Associations facilitate formal and informal consultations with Government and Regulators, host consultation meetings with Members and prepare Submissions. The more underdone a regulatory or reform solution, the more that the sector has to do to educate and refine. At times it has been galling to face the prejudice within the Commission (and Treasury, and the Minister's Office) that the sector's response is only and always motivated entirely by commercial self-interest and politics, and as a consequence can be dismissed or discounted heavily. It has been galling to have to bear the Minister's and the Commission's very public portrayal of the Retail Financial Services sector as all one and the same as Opes Prime, Storm Financial etc. Such an unnuanced portrayal unnecessarily damages the Commission (for not preventing the failures) and the sector in the eyes of the public. If all in the Financial Services sector were similarly operated or led, the sector would be rightly shunned by investors and be nothing like as large and service-centred as it is today.

4.5 The Commission (and Treasury, and the Minister's Office) are unlikely to correct this current perception of consultation processes without considerable, concerted effort. The Commission would need to deploy staff with direct practical experience of those impacted, make its case in a robust and transparent manner, bringing to the table its knowledge of the service arrangements and compliance/complaints performance of the businesses impacted, and ENGAGE meaningfully.

4.6 Even though Consultation Paper 200 makes it clear that it only sets out the Commission's *"...proposed changes to our regulatory approach to Managed Discretionary Accounts (MDAs)..."*; that the *"...proposals, explanations and examples... are... at a preliminary stage only..."*; and that they are *"...only an indication of the approach we may take and are not our final policy..."*, the proposals and questions nevertheless fill **62 pages** and can be assumed to reflect significant momentum within the Commission in the direction of the proposals. This is of concern because the explanations, proposals and questions do not present or reflect the depth of knowledge the Commission has regarding the range of Retail MDA Service-Models and the compliance performance of MDA Operators in relation to CO 04/194 (and their other General Obligations). The more work that has to be done to correct the shortcomings, the less likely SME AFS Licensees will engage in depth given the size of the task and the need for additional drafting resources. This tends to focus the process on the issues faced by larger AFS Licensees.

4.7 The Commission requests *"...alternative approaches you think would achieve our objectives..."*, yet the Consultation Paper doesn't list those objectives explicitly.

4.8 CP200 reports that around 200 AFS Licensees are authorised to operate/advise on Retail MDA Services. Around 50 have obtained their Authorisation since 1 January 2011 (Paragraph 11). The numbers aren't large, and can be expected to grow (as a consequence of FoFA and other developments). Despite the limited numbers, the Commission has chosen not to report detail of the range of MDA Service structures and arrangements (e.g. how MDA Client property is registered, the involvement of third-party Custodians), when it has the information at hand in its archive of Licence Application/Variation Proofs and Compliance Reviews. While listing qualitative findings (Paragraph 18), CP 200 does not present detail of compliance breaches/weaknesses (other than to highlight weak management of conflicts and outsourcing arrangements), financial standing, Audit findings or complaints performance. Yet, apparently, all these matters have been reviewed (Paragraph 15). The little that is presented is supposedly sufficient basis for (Paragraph 24):

- requiring MDA Operators to meet enhanced financial requirements similar to those applying to Responsible Entities; and

- requiring MDA Operators that provide Custodial/Depository Services, and External MDA Custodians, to meet enhanced financial requirements equivalent to those proposed in Consultation Paper 194.

The simple assumption that MDA operation and Registered MIS operation are equivalent is a nonsense. Some MDAs are offered by (or use) a Responsible Entity. Others are not. That is a choice on the part of the provider (and the MDA Client). Any harmonisation by raising barriers-to-entry and costs must be justified for all service-models and arrangements.

4.9 As a consequence, Consultation Paper 200 is underdone. A considered and legitimate consultation process will be lengthened as a consequence, unnecessarily adding to the costs to the Commission, Financial Services Providers and the Industry Associations engaged in the process.

4.10 Although the Commission makes it clear it is *"...keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches..."*, and invites comment on likely compliance costs, competition and other impacts, it fosters the view that the Commission still doesn't understand the businesses it regulates. Why would the Commission choose not to *show-off* its knowledge and encourage engagement by presenting what it does know to contribute to the quality of this consultation process?

4.11 For example:

- Other than in relation to ASX Guidance Note 29 (Proposal F7), CP 200 doesn't address differential impacts on Market Participants. Market Participants are generally exempt from the typical Base-Level and other Financial Requirements set out in PF 209 (i.e. the Conditions of their AFS Licence), yet this isn't even mentioned in Section C; and
- Questions such as B3Q3 (regarding PI and Fraud Cover) and B3Q13 (EDR and IDR) and the costs associated with the proposals are incredibly naive. The Commission doesn't choose to volunteer the fruits of its monitoring of PI/Fraud Cover availability generally for the purposes of RG 126 (Retail Compensation Arrangements).

4.12 Despite the above, the Commission is nevertheless of the view that in developing the proposals *"...we have carefully considered their regulatory and financial impact..."* and on the information currently available to the Commission, the proposals *"...strike an appropriate balance..."* (Paragraph 99). If a Financial Services Licensee was to make such a representation in such a significant document, based solely on the premises set out in CP 200, the Commission would be right to test whether the representation was misleading or deceptive. Why not lead by example and hold to the standards expected/required of AFS Licensees?

4.13 One wonders how consultations with Stakeholders other than AFS Licensees and their representative bodies (e.g. Consumer Groups) could have relied upon the Stakeholder having an informed and objective understanding of the current and proposed regulatory regime. If the Commission is being less than transparent with AFS Licensees, how lacking is the material being put before Consumer Groups, FOS and the Office of Best Practice Regulation?

4.14 CP 200 requests *"...Any information about compliance costs, impacts on competition and other impacts, costs and benefits..."* (Paragraph 102) so that these matters can be taken into account if a Regulatory Impact Statement is to be prepared (Section I), which is required if the Commission's proposed regulatory options have more than

"...minor or machinery impact on business..." (Paragraph 100). It should already be clear to the Commission that a RIS will be required.

4.15 The Commission has *"...reviewed the growth and development of the MDA Sector, and the operation of our guidance and relief, including whether..."* guidance and relief (Paragraph 14):

- facilitated competition and innovation;
- was inconsistent with guidance and requirements for comparable Financial Products; and
- contained sufficient mechanisms to promote confident and informed consumers and investors.

4.16 Yet at Paragraph 23 of CP 200, in summary, all the Commission advises is that it has identified some areas where guidance and conditions of relief need revision to resolve ambiguities to ensure it:

- is consistent with other relevant guidance relief; and
- promotes confident and informed consumers and investors.

There is no discussion of the likely impacts on competition in CP 200 yet the Commission states (Paragraph 99) that on the information currently available to it, the proposals will promote efficiency and foster competition and innovation, will enable existing MDA Operators to continue to expand and develop their businesses, and will facilitate the entry of new, competent and appropriately resourced MDA Operators. Why doesn't CP 200 address (or at least acknowledge) the obvious? That increased capital adequacy costs and barriers to entry will tend to encourage aggregation and increase concentration risk, promote the commercial interests of more capitalised (and typically larger) organisations and will tend to limit service differentiation and innovation as a consequence.

5. COMPLIANCE PROGRAMS & SURVEILLANCE ARE THE KEY

5.1 The review and research conducted in relation to MDA Services (Paragraphs 14 to 19), in particular the internal arrangements and compliance performance of MDA Operators, appear to have resulted in little or no Licensing/Banning Order or other form of Enforcement Action. The question arises "Why not?". Only Conflicts Management, Resourcing/Outsourcing and use of certain unlimited recourse products are noted as material concerns.

5.2 The proposals to increase capital adequacy requirements seem to serve an assumption that the greater the capitalisation, the greater the protection to clients and the business. Due account has not been taken of those third-parties (e.g. Market Participants, Custodians etc) who provide support services AND hold an AFS Licence. They, in turn, are also subject to significant licensing, capital adequacy and regulatory reporting/surveillance/enforcement requirements in their own right. Nor has due account been taken of the different ways client assets are actually held. The Commission has this information.

5.3 The proposals to increase disclosure/explanation in relation to particular Financial Products are likely to be shown to be ineffective. The effectiveness of disclosure in the Retail context, after long trial, has been found not to have been as effective as hoped. The conventional wisdom has shifted, yet the hope here is that special disclosure for Financial Products with complex attributes will be effective. Whether or not these proposals are adopted, the keys to an effective regulatory regime are nuanced Surveillance and targeted Compliance Programs. The processes, duties and record-keeping applicable to Retail Personal Advice would make a *"...reasonable*

basis..." for a MDA 'investing' solely in unlimited recourse products extremely difficult to justify.

6. SECTION B – RESOLVING TEMPORARY *NO-ACTION* POSITIONS

6.1 We don't service AFS Licensees for whom the Proposals in relation to Switches on Regulated Platforms (i.e. Proposals B4, B5, B6 and B7) are relevant, and therefore we aren't in a position to provide useful feedback.

6.2 We service a number of AFS Licensees (particularly ASX Market Participants) who "benefit" from the Commission's No-Action stance (issued on 8 December 2004) in relation to Family Accounts. Our view is that the Commission's analysis and proposed position are flawed fundamentally. Our view is that the No-Action stance in relation to Family Accounts has never been necessary for the purposes of the regulation of MDA Services under CO 04/194.

6.3 Although the wording of the Family Accounts No-Action Letter (Paragraph 31) was worded generically (i.e. its offer of no enforcement action was directed to AFS Licensees generally, not just ASX Market Participants or SDIA/SAA Members), it was particularly relevant to ASX Market Participants because staff and their related Family Accounts were obliged by the ASX Business/Market Rules at the time to deal through the ASX Market Participant, and the staff member may have authorisation from a spouse or other third-party to deal on their Account. This prohibition on dealing elsewhere has eased over the years, but it remains a common requirement as a matter of internal compliance policy at many ASX Market Participants because it strengthens mechanisms monitoring staff dealings.

6.4 Although the Commission reports that the No-Action Letter stated that the No-Action position was taken because of some confusion among certain SDIA Members (Paragraph 32) about whether the Commission's guidance applied to Family Accounts, our recollection was that even though specific relief for SDIA Members was requested to put the matter beyond doubt, the majority of SDIA Members were not confused and disagreed with the interpretation adopted as the Commission's stance (i.e. these arrangements amounted to a MDA, and there was a need for No-Action relief). The Commission did confirm that further submissions would be sought from the SDIA and that the No-Action Letter was issued as an interim measure, but noted that *"...this does not imply that ASIC's policy is likely to change..."* (Paragraph 34).

6.5 The basis for the necessity for the No-Action position was that *"...if a Representative of an AFS Licensee undertakes Discretionary Trading on behalf of a Family Member, that trading would generally be part of the Financial Services Business conducted by the Representative's Principal (i.e. the Licensee). As a result, these accounts would be considered MDAs and subject to the requirements in our guidance and class order, including Licensing requirements. ..."* (Paragraph 33).

6.6 If in fact the service is a Discretionary Account Service provided on commercial terms by the AFS Licensee as part of its Financial Services business to family members or staff, who qualify as a Retail Client, then the service and the AFS Licensee (if their AFS Licence authorises Retail Services) should comply with the regulatory requirements for Retail MDA Services.

6.7 However, the two fundamental presumptions driving the necessity for a No-Action Letter are incorrect. Firstly, any and all third-party dealings by a Representative should not be presumed in the first instance to be part of the AFS Licensee's business.

This presumption sets an erroneous and inconsistent precedent in the application of long-standing "Licensing Principles". And secondly, any and all such dealings should not be assumed to be discretionary.

6.8 Just because a Director, Employee or other type of Representative (Section 910A CA) happens to place dealing instructions on behalf of a third-party, the presumption should not be that the person is in the business of doing so, requiring the coverage of an AFS Licence with the necessary Authorisations. If they aren't in the business of doing so (i.e. they are acting solely in a private capacity), then no Licence (or Licence coverage) is required. Whether or not they are in the business of doing so (given there is no Licensing Exemption for incidental dealing) depends on application of the "business-test" (i.e. repetition, the commercial terms, how they hold themselves out etc). Merely exercising authority (e.g. Power of Attorney) to deal on someone else's behalf, and to bind them to any resultant transaction executed within the scope of that authority, does not amount to conducting a Dealing Business, even if the holder receives some benefit, commercial or otherwise. Holding and exercising dozens of such authorisations would be a different matter. Then there is the matter of how the person holds themselves out (or how they reasonably appear) to the public or their family. In summary, just because a person who happens to be a Representative places order instructions on behalf of third-parties does not mean they are conducting a Financial Services Business. Particularly so where the range of third-parties happens to be limited to certain members of the family.

6.9 AFS Licensees are bound by:

- the requirements of Financial Services (and other relevant) Laws;
- relevant industry practice standards; and
- the reasonable service expectations of the client,

as they go about providing their Financial Services. "Licensing-Principles" are drawn from the Corporations Act and ASIC guidance. In the case of ASX Market Participants, the Corporations Act and Market Integrity Rules subject Family Accounts to Staff Order Authorisation and Client Order Precedence obligations. Industry Practices (and AUSTRAC requirements) impact authorisation of a third-party to operate (e.g. instruct dealings on) someone else's Account. Family Accounts would usually benefit from concessionary rates of brokerage. The reasonable service expectations of Family consulting and/or using a Family Member who is a Representative to place their transaction instructions will depend on the circumstances, their role within the AFS Licensee and how they hold themselves out.

6.10 Even though anyone or entity involved in the Financial Services business of an AFS Licensee is deemed to be a Representative, not every Representative is duty bound by their role to provide Advisory, Dealing and other Financial Services to Retail/Wholesale Clients directly. Every family learns from, and may rely on, the employment experience of its Members, but that experience and insight must not be assumed, in the first instance, to be relied upon as one and the same as the professional experience and insight of the employing AFS Licensee.

6.11 Representatives who are NOT involved in providing Client Advisory (including Research) and/or Dealing Services at work can't be assumed, in the first instance, to be doing what they do for their Family Account(s) as part of their Principal's Financial Services Business. Only Advisers, Analysts and Dealers are deemed sufficiently competent by their AFS Licensee to perform these roles. If the Representative is employed in the Back-Office (e.g. in the Scrip/Settlements Department) or has an administration role in the Middle Office, and doesn't have the title of Client Adviser or Institutional Dealer, then anything they facilitate on a Family Account can rightly be presumed, in the first instance, to be private activity.

They aren't competent to provide Advisory and/or Dealing Services. In such circumstances, the Family Account would be allocated to be the responsibility of a particular Adviser or Dealer (whose identity would be disclosed on the Confirmation despatched for each transaction).

6.12 Family Members would very rarely be qualified as a Wholesale Client. Whether Wholesale or Retail, the Family Member would receive, complete and return the relevant New Client Account Application pack to open the Account in their own name. The Adviser/Dealer for the Account would be specified. The pack includes (in case it's required) a third-party authorisation for signature, if the Family Member wishes to permit their spouse or anyone else (in addition to themselves) to operate their Account. Representatives who aren't an Adviser or Dealer do not have direct, immediate access to Order Screens for order placement. However, they may source and relay Research and other advice from within the AFS Licensee.

6.13 Advisers and Dealers do represent their AFS Licensee at the Financial Service interface with Retail/Wholesale Clients. Those providing Retail Advisory Services are obliged to maintain RG 146 Accreditations. Dealers who service only Wholesale Clients are required to remain competent (as Retail Advisers also are) but may not maintain RG 146 Accreditations. Dealers discuss and even report their opinions on stocks and the Market to Family Members, but in a private capacity. There aren't accredited to provide Retail Advice in a professional capacity. The Family Accounts would usually be allocated to a Retail Adviser. The same applies for a Retail Adviser, and even though they do maintain RG 146 Accreditations, their Family Accounts would usually be allocated to another Retail Adviser.

6.14 The Commission's stance is based on concerns about the implications (and potential abuse of) of authority being granted to operate the Family Account(s). The Commission hasn't expressed concerns about 'advice' (usually twinned to 'dealings') provided in a private capacity. The concerns motivating the Commission's pursuit of CO 04/194 (and prior stances in relation to Retail Discretionary Account Services) were that dealings should be suitable for the Account holder, and therefore the Commission made Retail Personal Advice a fundamental, integral element of a Retail MDA Service. To be consistent, given the Commission's concern is centred on the 'advice' apparently provided by the Representative to a Family Member, the No-Action stance should be extended to cover any and all advice provided by a Representative to a holder of a Family Account. Such Advice should be construed as part of the Financial Services Business of the employing AFS Licensee, even if any consequential dealing decisions are made by the Family Member and effected by the Family Member with their own AFS Licensed Adviser. The focus on the apparent exercise of dealing discretion is too limited to address the Commission's concern to protect Family Members (particularly in the context of relationship breakdown).

6.15 The most efficient means to enhance these protections is to focus on the general use of third-party authorisations, and on the content of (e.g. warnings and notification obligations included in) third-party authorisations and related processes.

6.16 Those members of the immediate family who aren't legally competent (i.e. under 18 years of age, or non compos mentis) may only engage in dealings by means of a legally competent parent/guardian. Even if that parent/guardian happens to be a Representative of an AFS Licensee, the Representative should only be classified as an ordinary client of the Principal, and not as a provider of Dealing Services as a Representative. In essence, a parent is dealing on their own account (i.e. Representative A/C Child or Dependant), which is exempt from the definition of Dealing Service (Section 766C CA). The child, in their own right and although a

trusteeship exists, can't be a client of the Principal and therefore he/she can't be a third-party.

6.17 If the Representative deals on behalf of a legally competent spouse, the presumption in the first instance should be that the dealings are done in a private capacity (as a person authorised by the client, but not in their capacity as a Representative of the Licensee). Like any third-party authorised to place dealing instructions on someone else's Account, the Representative may deal in the name of his/her spouse (i.e. use the spouse's account). That third-party authorisation is documented, usually explains the associated risks/obligations, and is signed by both the Account holder and the authorised party. The Representative, in their private capacity, may be authorised to deal as they please or may only be acting as directed by the spouse. There may or may not be exercise of discretion on the part of the Representative in their private capacity.

6.18 **Analysis of this scenario cannot exclude the significance of spouse status in tax and marital law.** Marital law recognises property-in-common, despite who appears on the legal title (or who has beneficial ownership). And the tax law permits a household to arrange affairs on the basis of marginal rate differences.

6.19 The Commission's concerns could similarly arise from dealings on behalf of the Family's Family Company or Family Trust.

6.20 Our comments in relation to Proposals B1, B2, B3 and B4 are as follows.

6.21 If the Commission chooses to maintain its presumption in the first instance that merely because a Representative, regardless of his/her role within an AFS Licensee's business, has third-party authority to deal (and may select Financial Products dealt) on a Family Account he/she is operating a MDA on behalf of the AFS Licensee, and chooses to pursue Proposals B1 to B4, the Proposals should apply to all AFS Licensees, not just Market Participants. The logic of the Commission's stance should be applied universally.

6.22 The Commission should expect the following sorts of consequential action by impacted AFS Licensees. If the AFS Licensee doesn't have Authorisation as an Retail MDA Operator, given the significant costs associated with the Variation Application and compliance with CO 04/194, the Commission should expect the AFS Licensee to warn staff not to act on any Family Account on a discretionary basis, even if the staff member has third-party authorisation to operate the Family Account. The AFS Licensee may go as far as rescinding and rejecting all staff-held third-party authorisations to operate a Family Account (or any other Account, even under a Power of Attorney), and oblige the Family Member to use an 'independent' Adviser/Dealer with the AFS Principal directly, in which case they would still be subject to Order Authorisation and Client Order Precedence obligations, but would be likely to lose the benefit of concessionary rates of brokerage. Given the Commission's apparent presumption that all Representatives are effectively described as competent to provide MDA Services to a Family Account, some AFS Licensees would transition the Family Accounts to Wholesale Client status, thereby avoiding the need for relief under CO 04/194 or the No-Action stance.

6.23 Those Authorised only to provide Wholesale Services will NOT contemplate the cost and administration of certain 'Retail' obligations just to facilitate staff being able to deal on a Family Account. In this context staff have to qualify as 'Wholesale' to use the Principal's services, or are already required to use the services of another AFS Licensee Authorised to provide Retail Services.

6.24 If a Representative of a Wholesale-Only AFS Licensee operates their own and Family Accounts at a third-party Retail AFS Licensee, that doesn't amount to a MDA Service provided by that other AFS Licensee, but the Commission's concerns to protect the interests of the spouse (estranged or otherwise) won't be addressed.

6.25 If a Representative of an AFS Licensee providing Retail Services is required (or 'encouraged') to deal through another AFS Licensee providing Retail Services (given the Commission's stance), then that third-party AFS Licensee isn't providing a MDA Service and, again, the concerns motivating the Commission won't be addressed.

6.26 The more that staff dealings can be facilitated (and welcomed) in-house the more effective the supervision and compliance controls in place within the employing AFS Licensee, which are designed to prevent (or minimise) the possibility of front-running, misusing information about client interests/dealings, insider trading etc. The strategy being pursued by the Commission will result in a weakening of these compliance mechanisms, and won't serve effectively to protect Family Members (or, for that matter, any Account holder who grants third-party authorisation to operate their Account) from abuse by those holding the authority.

6.27 Fraudulent (or unauthorised) conduct by Representatives is already covered by RG 126 in relation to Financial Services generally. Better protections are afforded Retail and Wholesale Clients of ASX Market Participants, whose PI Insurance coverage must also cover Wholesale Services, and the ASX Settlement/Clearing Rules oblige the Participant to restore holdings and entitlements which have been transferred without authorisation.

7. SECTION C – UPDATING FINANCIAL REQUIREMENTS FOR MDA OPERATORS

7.1 The case for the 'Proposed New Financial Requirements' is made on the basis that, firstly, the Commission has recently reviewed, imposed higher capital adequacy requirements or is in the process of consulting on the financial requirements for:

- Responsible Entities and IDPS-Operators;
- Operators of Custodial/Depository Services; and
- MIS Property Holding Arrangements,

and secondly, that financial requirements for MDA Operators should be increased to ensure they are harmonised with requirements that have applied to Responsible Entities since November 2012, and what's proposed in relation to MIS Property Holding Arrangements.

7.2 The rationale for the change, in essence, is that these proposed requirements will *"...assist..."* achieve the regulatory objective of ensuring MDA Operators maintain adequate resources to operate MDAs effectively and compliantly, AND ensure regulatory requirements for MDA Operators are similar to the requirements for comparable investment arrangements, including Registered MIS and IDPS.

7.3 The Commission's case is justified qualitatively and solely on the basis of the desirability of harmonisation (Paragraph 54). The Commission either can't or has chosen not to detail a case in quantitative terms which would support its view that current arrangements (and current levels of equity within their business) are not adequate, or will soon become inadequate, for all MDA Operators to operate their MDA effectively and compliantly (Paragraph 52). The Commission goes on to make the point (generally applicable to all AFS Licensees) that implementation of the new requirements won't prevent MDA Operation failure, but will facilitate orderly transfer or wind-up of the business if that becomes necessary (Paragraph 53).

7.4 Given the Commission's supposed interest in not harming or curtailing competition and innovation without good reason, how is it that the range of MDA Service Models, and related financial requirements (and equity position) aren't, haven' and considered in summary? The fact that so many don't provide their MDA Service in the guise of a Registered MIS or IDPS is ignored. The fact that a number of MDA Operators who are Market Participants, few in number but nevertheless so significant in terms of MDA Funds Under Management, haven't been addressed directly (given the Standard Licence Conditions for Capital Adequacy defer to the requirements of the relevant Market Integrity Rules) is truly remarkable.

7.5 Put yourselves in the shoes of SME MDA Operators who do not use (and do not need to use) Responsible Entity/IDPS structures, and who have an unproblematic Compliance/Audit record. Is it any wonder that they view ASIC as acting in an untransparent manner? Not only is the Commission lazily relying, yet again, on a one-size-fits-all regulatory solution, but harmonisation just happens to benefit the larger MDA Operators who use RE/IDPS structures. Clearly, any increase in capitalisation requirements will raise barriers-to-entry, and tend to foster a concentration risk and reduced incentive for service innovation.

7.6 Those who've operated compliant businesses to date, who have very defined and discrete MDA Service-Models, and who are growing organically/judiciously, and who aren't reasonably likely to breach their current compliance obligations going forward, are nevertheless being asked to recapitalise in a 'difficult' economic and Market environment, and by 1 July 2014. ASIC's desire for harmonisation not only appears careless and partisan, but the short transition deadline of 1 July 2014 reinforces that perception. The deadline suggests ASIC is ignorant of, or simply disregards, the commercial disadvantage that SME MDA Operators may face as a consequence during the re-capitalisation transition period.

7.7 The Commission reports that 193 AFS Licensees (as at August 2012) had Authorisations to operate a MDA Service or advise on MDAs (Paragraph 11). Around 50 (approximately 25% of those AFS Licensees) have only obtained their Authorisations since 1 January 2011 (an 18 month period). These numbers are not large. A successful Variation/Application requires considerable work, and the Proofs serve as evidence that the complex compliance arrangements necessary to comply with CO 04/194 and RG 179 have been built. The Commission expresses concern with the prospect of further growth driven by the FoFA Reforms. This is likely to eventuate, but the Commission has the benefit of reviewing the MDA Service-Model for each AFS Licensee seeking Authorisation. The Commission can focus its surveillance resources on the riskier Service Models.

7.8 The Commission had the opportunity to present in summary the results of its Surveillance and Compliance Programs, Breach Reporting history and Financial/Procedural Audit history of all these AFS Licensed MDA Operators. It could have summarised the range of Net Equity/NTA held by MDA Operators using RE/IDPS or Non-RE/IDPS structures (the latter include Market Participants). An indicative capitalisation-deficit would assist Treasury, the Minister and OBPR (and would facilitate an objective and transparent consultation process).

7.9 The Commission has chosen not to summarise the prevalence of use of (and how proportionate the use of) Market/OTC traded Derivatives and other 'sophisticated' products in relation to MDAs.

7.10 The public-record of the compliance failures on the part of MDA Operators, and Licensing/Banning-Order Action against MDA Operators, does not reflect any urgent

need for increased regulation. Other than to highlight Conflicts Management and Outsourcing, the Commission can not, or has chosen not to, present an objective case for change based on a record of significant, systemic compliance weaknesses.

7.11 MDA Operators have the choice of providing their MDA Services as a Responsible Entity and structuring their MDAs as a Registered MIS. Some use an AFS-Licensed Custodian. Many do not. Most manage MDA Portfolios invested in direct (rather than managed) investments, such as Market-traded (or to be traded) Securities and Derivatives, where the holdings are in the name of the MDA Client (i.e. legal and beneficial title remains in the name of the MDA Client, the exemplar of individually managing and not pooling MDA Client holdings). Yet the Commission's views aren't nuanced as a consequence. All the responsibilities and duties of a RE/Trustee in relation to a Trust are not applicable to a MDA Operator that does NOT operate their MDA Service as a Registered Scheme. Remember that the Commission's own Licensing Arrangements can recognise a MDA Service as a Miscellaneous Financial Facility, distinct from a MIS. Those who are Authorised to provide the former can't be expected to accept the Commission's simplistic, qualitative case for harmonisation.

7.12 By not presenting the current financial requirements which would apply to different (and currently compliant) MDA Service arrangements and models, the Commission hasn't allowed less technically informed readers (e.g. Consumer groups, OBPR) of CP 200 to make an informed view of the need for re-regulation. Those who offer a MDA Service(s) and who aren't a Responsible Entity or a Market Participant are currently subject to the Base-Level Financial Requirements and the Surplus Liquid Funds Requirements (i.e. flat $50,000 SLF where the MDA Operator has the discretionary power to dispose of client holdings to a 'collective' value exceeding $100,000). How is it that there was no mention of the option of increasing the SLF Requirements (given the amount has not been adjusted for inflation in 20 years)?

7.13 Harmonisation may make sense where the MDA Operator is a Responsible Entity already and subject to the special establishment and administrative obligations which apply to operating a Trust/MIS, but how is it that the current requirements (for Market Participants and AFS Licensees who aren't a RE/Market Participant) are deficient where MDA Client holdings are registered in the MDA Client's name, CHESS Sponsored by an ASX Market Participant (i.e. the transactions in ASX traded Securities are transacted through an ASX Market Participant and the holdings held in Participant/Issuer (usually the former) Sponsored form, and settlement is subject to the efficiencies and protections of the Licensed CS Facility, ASX Clear)? How is it that the current level of resourcing is inadequate in relation to this MDA Service model? How is it that it suggests a lack of commitment to their business (Paragraph 55)?

7.14 The functions of a MDA Operator (depending on their Service Model and Holding arrangements for MDA Client assets/property) and a Responsible Entity differ significantly (Paragraph 54). The particular similarities are not that both are typically responsible for managing investments, but that they make discretionary investment decisions. Both manage investments, but so do providers of investment/portfolio management services who do so on a non-discretionary basis (in real-time, in a consultative partnership with the client).

7.15 The current additional requirements (e.g. special PI Insurance requirements) which apply to MDA Operators exceed those which apply to non-discretionary services even though arrangements for holding and settling with MDA Client property are the

same. All that is different is that the MDA Operator doesn't seek/receive transaction instructions from the MDA Client before putting them into effect.

7.16 ASX Market Participants are subject to the Liquid Capital requirements of the Market Integrity Rules. Where that Market Participant is also an ASX Clear Participant, the Liquid Capital requirements of the ASX Clear Operating Rules apply (in accordance with Condition 12 of PF 209). Those ASX Market Participants who aren't an ASX Clear Participant are subject to being required to at least have minimum Core Liquid Capital of $100,000 and their ratio of Core + Non-Core Liquid Capital to their Total Risk Requirement is to exceed 1:2 to avoid reporting to ASIC. Their Total Risk Requirement includes their Operating Risk Requirement, and (if they have holdings in their own name – i.e. House Account positions) the Position Risk Requirement. Not being a Clearing Participant, their Counterparty Risk Requirement would usually be 'ZERO'. ASIC also has power to impose a Secondary Risk Requirement where Exposures are Unusual or Non-Standard. Returns are lodged with ASIC monthly. Audited Returns are lodged annually. A breach triggers penalties including a fine of up to $1,000,000. How is it these methodologies of allocating Liquid Capital to categories of financial risk are deficient for the purposes of addressing the risks faced by MDA Clients using the MDA Service model typically offered by an ASX Market Participant? How is it that this level of financial resourcing is inadequate? How is it that this level of resourcing suggests the MDA Operator is not committed to their business (Paragraph 55)?

7.17 Concerning Proposal C1, the Commission's case for harmonisation is not made? It is based on an analysis which doesn't take into account all the information available to the Commission, and adoption of such a simplistic one-size-fits-all 'regulatory solution' will ensure competition and innovation will be unnecessarily curtailed. Simply pursuing *"...more must be better..."* is a nonsense. Those who are Responsible Entities providing/hosting MDA Services should meet the requirements applying to Responsible Entities. Those that don't should be required to meet requirements which take into account the nature of the risks associated with the service arrangements, and the enforcement environment they face.

7.18 We note that MDA Operator revenue (for the purposes of Proposals C1 and C2) is not defined to be limited just to MDA Service revenue. Providers of MDA Services may operate significant other service streams within their Financial Services business(es).

7.19 Concerning Proposal C2, it shouldn't proceed given our stance in relation to Proposal C1.

8. SECTION C – UPDATING FINANCIAL REQUIREMENTS – CONSISTENCY WITH PROVIDERS OF CUSTODIAL AND DEPOSITORY SERVICES

8.1 Again, proposals C3 (External MDA Custodians) and C4 (MDA Operators) would result in very significant change, yet the need for change is unsubstantiated (other than expressing the view in Paragraph 59 that Retail Investors in MIS place significant reliance on arrangements made by REs, IDPS Operators and MDA Operators for safe custody of their assets) and it falls to MDA Operators to rebut the need for change when the responsibility for making the case for reform/re-regulation rests with the Commission.

8.2 Simply deeming any holding arrangements for MDA Client property as always equivalent to a full-blown Custody/Depository Service is breathtaking in its disregard for efficient regulatory outcomes, which protect users of financial services appropriately and sufficiently, while fostering competition and innovation. Doing so

ignores one of the fundamental Licensing principles; namely, how the person/entity is holding themselves out.

8.3 Concerning Proposal C3, if the External MDA Custodian (the terminology 'manufactured' by CO 04/194) holds itself out as being in the business of providing stand-alone Custodial Services, then it will be Authorised to do so by virtue of its AFS Licence, and will meet applicable Capital Adequacy requirements, and rightly so. If such a Custodian acts (or offers to act) as an External MDA Custodian, then the MDA Client will be just another client among however many individual and professional investors using its Custody Services.

The typical duties of a MIS Custodian are more extensive than needed to support a MDA because of the CO 04/194 prohibition on pooling MDA Client property. If each MDA Client is separately identified and administered as a beneficial owner, then the identification and valuation of MDA Portfolio holdings, and settlement of MDA Portfolio transactions, is a very linear exercise. In the interests of both regulatory and service efficiency, arrangements which lessen the risk to the MDA Client should be recognised and encouraged. If the only Custodial Service provided is limited to the typical MDA Portfolio arrangements, then the proposals set out in CP 194 should not apply.

8.4 The more the Custodial Services deployed as part of a MDA Service diverge from the usual stand-alone Custody Services, the less relevant are the current and proposed Capital Adequacy requirements for Custodial/Depository Services, and the greater the legitimacy of retaining the exemption for incidental Custodial Services.

8.5 The deficiencies of CO 04/194 include the presumption (where legal title doesn't remain with the MDA Client) that a MDA Operator will also be the Custodian of MDA Portfolio property unless a third-party AFS Licensee with the necessary Authorisation is appointed as the External MDA Custodian. Having construed operation of all Retail MDAs as operation of a Registerable MIS, CO 04/194 adopted the logic of being Authorised to operate a Registered Scheme(s), which bundled Authorisation to issue MIS Interests and to provide Custodial Services for the property of the MIS.

All those Authorised to provide a Retail MDA Service are assumed to be an Issuer of 'MDA Services' and (where legal title to the holdings isn't in the name of the MDA Clients) Custodian of MDA Portfolio property. If the MDA Operator doesn't 'hold' MDA Portfolio property (i.e. in circumstances where legal title isn't in the name of the MDA Clients), an External MDA Custodian does and has to meet the particular requirements prescribed by CO 04/194. This analysis, by assuming MDA Clients will almost always be restricted to beneficial ownership of their MDA Portfolio holdings, doesn't appropriately recognise holding arrangements where the MDA Client remains the legal owner of their MDA Portfolio property (i.e. holdings are registered in the name of the MDA Client, not a Custodian or Nominee Service A/C MDA Client). Where legal ownership remains with the MDA Client, the MDA Operator is exercising control and administration of the MDA Portfolio holdings, not their custody (even where the mailing address for the MDA is the MDA Operator). This is typically the case for MDA Services provided by ASX Market Participants where MDA Portfolio holdings are registered in the name of the MDA Client and any Corporate Actions are accounted for by the settlement and clearing systems operated by ASX Settlement and ASX Clear. Even where discrete beneficial ownership remains with the MDA Client, the purpose of doing so is to maximise administrative and settlement efficiency. Corporate Actions are accounted for in the same way.

These holding arrangements are very much incidental to the discretionary-management focus of the MDA Service.

8.6 For the sake of efficient regulation, the definition of *"...average revenue..."* should exclude revenue derived from Financial Services other than 'Custodial' Services.

8.7 For the sake of efficient regulation, the definition of average revenue should exclude revenue flowing to outsourced service providers who are Authorised by an AFS Licence to provide that service. Where provided by an unlicensed entity, even though the External MDA Custodian would remain responsible for the outsourced services, the direct protections of the Licensing environment rest with the External MDA Custodian.

8.8 In relation to Proposal C4, and for the same reasons as presented above, MDA Operators should NOT be automatically excluded from the definition of a provider of 'incidental custodial or depository services'. The Commission's analysis should walk through the range of typical MDA holding arrangements. Where the MDA Client's holdings remain discretely registered in the name of a Custodian or Nominee Company, and beneficially owned by the MDA Client, this should remain recognised as an 'incidental' Custodial Service. These Custodian Service elements aren't separately accessible, other than by establishing a MDA with the MDA Operator.

9. SECTION D – IMPROVING DISCLOSURE FOR MDA INVESTORS – INVESTMENT PROGRAM, MDA CONTRACT & ADVICE

9.1 Whatever 'refinements' are made to CO 04/194, the related Regulatory Guide (will it remain RG 179?) must reflect those refinements and be consistent. It must also unpack the logic behind all of the 'refined' CO 04/194.

9.2 Proposal D1 relates to 'refinements' to the CO 04/194 Conditions relating to the MDA Contract, the Investment Program and the obligation to only provide Personal Advice in relation to MDA Services provided by the MDA Operator. There are indeed many ambiguities inherent in the MDA Contract/Investment Program requirements of CO 04/194, yet the Commission hasn't seen fit to list them. Why is it the Commission chooses not to demonstrate its understanding of CO 04/194? Again, it falls to MDA Operators and other interested parties to highlight the problematic. Why wasn't a re-draft CO 04/194 included with CP 200?

9.3 The starting point should be the rewriting of CO 04/194 in its entirety. A plain English text will maximise its utility to users, and would facilitate better presented MDA Services. CO 04/194 has been amended a number of times during its life, and these opportunities could have been used to make CO 04/194 more clear, and to better integrate the content requirements for the FSG, MDA Contract and Investment Program.

9.4 We have no objection to an explicit requirement for the Investment Program to include an Investment Strategy, but it should not be given significance beyond any other Relevant Personal Circumstance (Proposal D1(b)). A MDA Client's Relevant Personal Circumstances include the Investment Objectives. The Investment Objectives can be, or express, an Investment Strategy. 'Investment Strategy' will have to be defined and addressed consistently across the content requirements for FSG, MDA Contract and Investment Program. An Investment Strategy is a sophisticated concept and (to be useful) will require care in its presentation and explanation.

9.5 Although CO 04/194 already requires it, we have no objection to the proposed clarification that Personal Advice about the MDA must address the suitability of the MDA Contract including the Investment Program.

9.6 Many other clarifications or refinements of CO 04/194 are required. To the extent the FSG must refer to certain aspects of MDA Contract and Investment Program content, more flexibility should be afforded to the MDA Operator (or External MDA Adviser, in the case of the Investment Program) regarding where the specified content appears. And although the Investment Program has always been, and is to remain, included as a Term & Condition of the MDA Contract, being a SoA, it has a different (and therefore, dual) purpose.

9.7 The Investment Program, whether prepared by the MDA Operator or not, must comply with (and include a statement to the effect it complies with) SoA dispatch/supply and content requirements. The latter oblige the SoA to be badged as such. Why specify this statement when the Investment Program must be titled a SoA and meet content requirements for a SoA?

9.8 The Investment Program must be reviewed at least once every 13 months, triggering a SoA in compliance with Subdivisions C and D of Division 3 of Part 7.7 CA (Conditions 1.19, 1.20 and 1.21 of CO 04/194). The Annual Reporting requirements (linked to the Financial Year ending 30 June) specify the inclusion of a SoA or particular statements regarding a SoA previously provided (Condition 1.31(d) of CO 04/194). It should be made clear the interaction between the Annual Review and the Annual Reporting. This should be described in the FSG.

9.9 Although the linkage of Annual Reporting to June 30 is practical given the Tax Year, many AFS Licensees balance at a date other than 30 June. There should be commentary on this scenario.

10. SECTION D – IMPROVING DISCLOSURE FOR MDA INVESTORS – FEE DISCLOSURE

10.1 Proposal D2 presumes MDA Service model arrangements are equivalent to RE/MIS arrangements, which is not the case. A reporting solution designed with typical RE/MIS arrangements specifically in mind is likely to be unnecessarily complex and out of context for the purposes of a vanilla MDA Service. Indeed, adopting the same format will foster the expectation that the MDA Service is a Registered MIS.

10.2 Any new specifications should allow removal of other provisions regarding presentation of fees/costs. The disclosure obligations for the purposes of FSGs, SoAs/RoAs, including oral disclosures, are extensive and detailed.

11. SECTION D – IMPROVING DISCLOSURE FOR MDA INVESTORS – OUTSOURCING ARRANGEMENTS

11.1 'Outsourcing Arrangements' must be defined. It should not cover any and all external service arrangements. Disclosure should not replicate a Privacy Statement/Policy. A FSG should describe sufficiently the Financial Services provided by the AFS Licensee, including the use of third-parties to execute and settle transactions. We fail to see why what's proposed isn't proposed to providers of Retail Services generally.

11.2 While there's some merit in disclosing summary detail about third-parties involved in MDA Service delivery, how they are monitored is not sufficiently useful to justify in an already sizeable New MDA Client Pack. The MDA Client shouldn't be

'encouraged' or confused about whether they can access the third-party directly as part of their usual MDA arrangements.

12. SECTION D – IMPROVING DISCLOSURE FOR MDA INVESTORS – TERMINATING THE MDA

12.1 Concerning Proposal D4, only summary/general information should be specified for the purposes of the FSG. The detail should be left to the MDA Contract. There should be sufficient flexibility for the MDA Operator to design a termination transition which is appropriate to the complexity of the arrangements, holdings and strategy applicable to that MDA. There may be Derivative positions, holdings of Foreign Products, which may need time to be unwound or to provide direct access. Explanatory material should not be provided in a Contract (e.g. MDA Contract).

12.2 Proposal D5 is redundant. As a matter of regulatory principle, the period should be reasonable. Stating in the MDA Contract that it should be so adds nothing.

12.3 Regarding Proposal D6 in relation to development of a termination policy, such a proposal is redundant. Policies and procedures must cover the footprint of the activities of a Financial Services business, including special compliance conditions (e.g. the Conditions of CO 04/194). This is a requirement of the General Obligations, and the Procedural Audit requirements of CO 04/194 would reinforce the need for a documented Policy/Procedure. Specifying formulation raises the question of whether Policies might not have to be formulated for all services, which is not the case.

12.4 Regarding Proposal D6 in relation to FSGs, it is a nonsense for the FSG to disclose detail of such policy information. It contradicts the purpose and content (i.e. clear, concise and effective text) requirements for FSGs. Special text distorts the focus of the FSG, which can give mixed signals to readers. The focus must be the Termination Clause in the MDA Contract.

13. SECTION E – OTHER MODIFICATIONS – ARRANGEMENTS WHERE RECOURSE ISN'T LIMITED

13.1 Proposal E1 presents three options for addressing concerns in relation to non-limited recourse arrangements. The 'regulatory solutions' proposed aren't that imaginative.

13.2 CO 04/194 already requires disclosure of significant risks in accordance with the standard of disclosure expected in a FSG and SoA; namely, that the information be presented and worded in a clear, concise and effective manner, and to the level a person would reasonably require when deciding whether to acquire Financial Services (i.e. the MDA Services) as a Retail Client. Why should additional black-letter regulation be required? How is it that simply expecting certain additional detail by means of Regulatory Guide commentary would be insufficient?

13.3 CO 04/194 also requires the Investment Program to have a *"...reasonable basis..."* in order to ensure the operation of the MDA Contract (in accordance with the discretions granted and investment strategy to be pursued) remains suitable personally for the MDA Client, given their Relevant Personal Circumstances. The Best-Interests duty will come into play on 1 July 2013 at the latest. Why should additional black-letter regulation be required? So much is already (and will continue to be) expected of an Adviser providing Retail Personal Advice in relation to such sophisticated and risky products. While distinction must be made between limited, proportionate use of such products and their sole use for the purposes of a MDA, it would be difficult for the MDA Operator/External MDA Adviser to establish a *"...reasonable basis..."* for disproportionate use of these sorts of products.

13.4 Given the nature of this particular class of Derivative Products, and given CO 04/194 appears to exempt the MDA Operator (and External MDA Adviser?) from having to provide a PDS for the Product, the existing regulations nevertheless provide ample scope for the Commission to achieve its preferred outcomes by means of Surveillance and Compliance Programs. FOS and PI insurers (i.e. Market mechanisms) would reinforce these preferences. Given the requirements for providing Retail Personal Advice, Conflicts Management and Retail Compensation Arrangements, the Commission (and FOS) has more than sufficient scope to influence the 'popularity' of the use of such non-limited recourse products.

13.5 In our view, banning is a clumsy and blunt solution. Can the Commission be sure that use of these products, however limited, would always be inappropriate? How is it there can be no distinction between discrete use of such products versus sole use of such products for the purposes of a MDA? We prefer facilitation of informed choice. Much of the responsibility in this regard must fall on the AFS Licensee and the individual Adviser, but some must fall on the Retail Client. Specifying an additional and specific Risk Warning in the FSG and Investment Program may simply further discourage the Retail Client from reading the FSG and MDA Contract/Investment Program. And the Commission's approach to how the text should be presented, may be at odds with the style and approach of the material in use at the MDA Operator (External MDA Adviser?), requiring a rewrite or (if not rewritten) making the material less internally consistent. Despatch of a new or Supplementary FSG can be a very costly exercise.

13.6 Regulatory Guide commentary (the Commission's interpretation of the standard of conduct expected of AFS Licensees and Representatives acting in an efficient, fair and honest manner) could simply encourage (and recognise the benefits of) providing the PDS (and any subsequent Supplementary PDS) for the more complex and risky products to the MDA Client (as part of the New MDA Client Pack). There could also be consideration of requiring Confirmations for all transactions conducted on a MDA being provided to the MDA Client directly (as ASX Market Participants are obliged to do – see ASX Guidance Note 29). This allows the MDA Client to monitor dealings and performance.

13.7 Requiring express consent prior to each and every transaction in such products is at odds with the discretionary-service model. It dilutes the reasonable service expectation that the Retail Client will not be consulted on transaction matters 'within-scope' of the MDA Contract. There's also the matter of how time-sensitive dealings in such Products can be. The MDA Client could have an existing position which the MDA Operator wishes to close-out/liquidate. Not being able to contact the MDA Client for consent could prove catastrophic, and if so, the MDA Operator could rightly face the wrath of the MDA Client for not acting to protect them given the MDA Operator was appointed to apply a Discretionary Services Model.

13.8 Concerning Proposal E2, we have no comment on the definition of 'non-limited recourse product or arrangement' proposed by the Commission. The bounds of the definition must be clear (i.e. in plain, precise and meaningful English). Particular classes of Derivatives can be very difficult to describe. The Commission must do its utmost to ensure the definition actually targets the Products in question, minimising any collateral damage to another category of Product(s).

14. SECTION E – MDA CLIENTS THAT BECOME OF UNSOUND MIND

14.1 Proposal E3 proposes a 'regulatory solution' specific to those licensed as a Trustee Company providing traditional Trustee Company Services. We haven't provided our

compliance and risk management support services to this sector, and so won't comment on the detail of Proposal E3.

14.2 However, the Commission's Regulatory Guide commentary should address the use of General/Enduring Powers of Attorney to operate a MDA, and to instruct the MDA Operator on behalf of the beneficiary of the MDA. Powers of Attorney tend to merely reflect the discretions authorised by the MDA Contract, but are better recognised by Banks, Registries and others. Documentation and reports should be able to be dispatched to a competent and authorised party where the beneficiary is of unsound mind or has diminished mental capacity, or is becoming so.

15. SECTION E – OTHER MODIFICATIONS – BREACHES OF THE CONDITIONS OF RELIEF

15.1 Proposal E4 should have been put into effect when Section 912D(1B) was amended to extend the self-reporting deadline. Harmonisation with the reporting period applying to the reporting of 'significant breaches or significant likely breaches' is appropriate. The 5 Business Day period was adopted originally for CO 04/194 because it was the deadline at the time. The longer period may delay commercial/regulatory intelligence reaching the Commission, but we don't see this as diminishing the protections available to MDA Clients or the avenues of action available to the Commission to any material extent.

15.2 The wording of Conditions 1.33, 2.15, 4.8, 5.7 and 6.6 of CO 04/194, which relate to breach notification should reflect the Commission's guidance on Self-Reporting (i.e. RG 78, Form FS80). Regarding the level of detail to be reported, the CO 04/194 expectations regarding updating the Commissions in relation to progress of a breach and its remediation should be made clearer. The wording *"...or would have known... if it had undertaken reasonable enquiries..."* needs revision to avoid confusion.

15.3 It seems extraordinary to us that Proposal E5 be put out for consultation. It is a matter of current enforcement policy and procedural fairness. Regulatory Guide 98 stands, and can be referred to for guidance on these matters. Why reiterate any of the content of Regulatory Guide 98? Doing so adds to the Commission's administrative task. An update to RG 98 may require the Commission's guidance on MDAs to be so updated.

16. SECTION E – OTHER MODIFICATIONS – PROVIDING MDA SERVICES TO WHOLESALE CLIENTS

16.1 We agree that CO 04/194 be amended and refined to be made clear, concise and effective. To the extent users haven't been certain about the application of CO 04/194 to MDA arrangements provided to a 'Wholesale Client' says something about the quality of the drafting of CO 04/194, and RG 179. RG 179.25 and RG 179.28 (but not as well as they could) explain that the jurisdiction of the relief and its Conditions are limited to Retail Clients. RG 179.60, RG 179.61 and Note 2 to RG 179.11 are more explicit.

16.2 The Commission has seen fit, finally, to address all the logical consequences of 'MDA Services' being construed as a Financial Product. If a 'MDA Service' is a Financial Product, it must be so in both the Retail and Wholesale contexts. Any person or entity in the business of providing MDA Services, even if strictly limited to Wholesale Clients, should (in logic) be required to have the relevant MDA Service Authorisation. Yet, in our experience, the Commission's guidance and Licensing System doesn't contemplate (and the latter doesn't allow for) an AFS Licensee that is

licensed to provide Wholesale-Only Services being Authorised to operate a MDA (or Discretionary Portfolio Management) Service. In the Wholesale context, the usual Financial Product Advice and Dealing on behalf of Another Authorisations covering relevant Products are sufficient to operate a Wholesale MDA. Beyond that, the Licensing environment should also allow an AFS Licensee to be Authorised to advise on, or deal in, Wholesale/Retail MDA Services provided by another AFS Licensee(s). Regulatory Guides 2 and 3 only address the Retail MDA Operator's own MDA Service.

16.3 Note 1 to RG 179.28 does not require Wholesale-Only MDA Services to be Authorised under an AFS License. It is addressing a scenario where Retail MDA Services are provided AND discretionary services are provided to Wholesale Clients by the same AFS Licensee. RG 179.28 was the place to highlight again and explain why an AFS Licensee only Authorised to service Wholesale Clients wasn't required to seek Authorisation for its various Financial Services to cover Wholesale 'MDA Services'.

16.4 The fact that the Commission's guidance (including the guidance of RGs 2 and 3) hasn't addressed all the obvious consequences of construing 'MDA Services' as a Financial Product has weakened the standing of the analysis which led to the focus and scope of the relief required by CO 04/194.

17. SECTION F – UPDATED REGULATORY GUIDANCE – CLARIFICATIONS

17.1 The Commission has had ample opportunity to revise and clarify RG 179, during the last decade, in the face of all the queries it must have received regarding Authorisation requirements and the Compliance Arrangements for Retail MDA Services. Likewise, Regulatory Guide 2, should have been revised to better address the Authorisations necessary to operate a MDA Services business (see RG 2.73, 2.89, 2.100 and 2.213).

17.2 The fact that RGs 179 and 2 have remained deficient since publication says something about the final authorisation process prior to their release. Far fewer deficiencies would survive if relevant staff at the Commission put themselves in the shoes of the less-expert reader of the document. You expect those Authorised to provide Retail Services to road-test certain key documents (e.g. FSG, SoA formats) to measure their effectiveness in communicating key information. Why doesn't the Commission do the same? The Commission does have the staff with sufficient practical experience to point out weaknesses or gaps in the final draft of a Regulatory Guide. Representatives of industry bodies could likewise assist maximise the effectiveness of the final draft of a RG (particularly example-scenarios).

17.3 Concerning Proposal F1, all revised guidance relevant to MDA Services specifically should be presented in RG 179 or its successor. The new guidance must be the subject of meaningful consultation PRIOR to release.

17.4 On the matter of PI and Fraud Insurance (Proposal F1(e)), the successor to RG 179 should make it clear that RG 126 is the primary source of guidance. RG 126 should specify the thresholds/benchmarks specific to Retail MDA Services (i.e. how the usual thresholds/benchmarks for Retail Financial Services have to be re-calibrated where Retail MDA Services are provided).

18. SECTION F – UPDATED REGULATORY GUIDANCE – CONFLICTS OF INTEREST

18.1 If a separate Regulatory Guide is justified (e.g. like the one published for Research Providers), then it should be limited to MDA Service issues and scenarios. It should rely on RG 181 and not have to reiterate the text of RG 181. Its text shouldn't be finalised until the FoFA environment (i.e. all the necessary Corporations Regulations and any other relevant relief) have come into effect.

18.2 In logic, 'special' conflicts faced or potentially faced by an External MDA Adviser should also be addressed in the Appendix.

18.3 The scenario (provided on page 56 of CP 200) is not as helpful as it appears in that the investment time-horizon for the MDA may be much longer-term, in which case the quantum (or degree) of 'conflict' is significantly reduced. Questions of degree are a relevant consideration.

18.4 Regarding the range of options available to control conflicts, the suggestion (at Paragraph 115(b)) that a Compliance Officer approve all investment decisions is a surprise. MDA Service Managers are competent and best placed to assess the degree of conflict in the context of the Investment Programs for MDAs, using the MDA Operator's compliance procedures. Compliance should be left to review the compliance performance of the MDA Services team and their supervision by Management.

19. SECTION F – UPDATED REGULATORY GUIDANCE – FoFA REFORMS & MDAs

19.1 Concerning Proposal F3, our view is that as much as possible of CO 04/194 should be dismantled to the extent the FoFA Reforms impose the equivalent or substantially similar obligation. The Commission should be prepared to justify why special, additional requirements should apply to particular aspects of Retail MDA Services given the prospect of the significant requirements of the FoFA Reforms. To the extent the Commission provides guidance to MDA Operators and External MDA Advisers concerning the impact of the FoFA Reforms on MDA Services, all that should appear in RG 179 or its successor.

19.2 Concerning Proposal F4, our view is that the premier document should be RG 179, not RG 175, given that Retail Personal Advice is such a fundamental element of a Retail MDA Service. The guidance should address the fact that the Personal Advice is episodic, but the actions (and duty) to enact the Personal Advice are ongoing.

19.3 Regarding Proposal F5, given that the FoFA Reform relating to Fee Disclosure has been enacted to address the failures of disclosure obligations to date, there should be due recognition of the documented disclosure required by CO 04/194 to date. Consideration should be given to exempting the MDA Operator from the Fee Disclosure Statement requirements to the extent they comply with the Conditions of CO 04/194.

19.4 Concerning Proposal F6, serious consideration should be given to exempting those Authorised to provide Retail MDA Services from Renewal Notice requirements. MDA Clients have received, and will continue to receive, statements about fees at establishment and annually. Given the reporting requirements of CO 04/194, the FoFA Reforms are unnecessary. Both regimes should not apply unmodified to Retail MDA Services provided by a MDA Operator.

20. SECTION F – UPDATED REGULATORY GUIDANCE – ASX GUIDANCE NOTE 29

20.1 We agree that the ASX guidance be incorporated in RG 179, but if requirements such as Confirmation despatch to the MDA Client are to be retained, this requirement should not just be applied to ASX Market Participants.

21. SECTION G – GUIDANCE & RELIEF TO BE RETAINED

21.1 This is the opportunity to review RG 179 and CO 04/194 in their entirety for the sake of regulatory efficiency, for clarity and consistency, and against the requirements of the FoFA Reforms. To the extent the FoFA Reforms have caught up with the Conditions of CO 04/194, for the sake of regulatory and compliance efficiency as much reliance as possible must be placed on the FoFA Reforms as they apply generally to all episodes of Retail Personal/General Advice. CO 04/194 should only address Conditions justified as specific to Retail MDA Services. Its text should not replicate or reiterate the FoFA Reforms.

21.2 Concerning Proposal G1(a), Paragraph 1 of CP 200 (copied from RG 179.5) is misleading and should not be used. It chooses not to refer to the discretionary authority granted by the client, to be exercised by the Adviser/Manager in pursuit of the client's particular investment program. Rely on the definition of MDA Service used in CO 04/194, and RG 179.11.

21.3 The content requirements for the FSG, MDA Contract and Investment Program must be reviewed to ensure that particular information is presented in the appropriate place. It should be clear that as the Investment Program is part of (i.e. includes terms and conditions of) the MDA Contract, information prescribed for the MDA Contract may appear in the Investment Program (Proposal G1(b), (c) and (d)).

21.4 Condition 1.11 of CO 04/194, which prescribes special FSG content, includes redundant text about the level of detail of information prescribed. This should be left to the CA provisions prescribing FSG content. The significant risks associated with investing through the particular MDA Service include those associated with the demographic of Financial Products likely to be used for the purposes of the client's MDA. It is nonsense to prescribe reference to the Investment Program being in compliance with *"...Division 3 of Part 7.7..."*, and that the FSG complies with CO 04/194. These simply aren't meaningful to Retail Clients, as the Commission would well know. It would also be very helpful if the special FSG content requirements addressed the scenario of an Authorised Representative's FSG. Further, there should be allowance for the External MDA Adviser 'preferred' by the MDA Operator (or the MDA Client) to change without a Supplementary (or new) FSG. The External MDA Adviser should consider the risks associated with the MDA's strategy/objectives (Condition 1.11(ii) of CO 04/194), and the guidance relating to Scaled Personal Advice. Perhaps a demarcation of the responsibilities of the MDA Operator and External MDA Adviser should be expressly permitted?

21.5 Condition 1.12 of CO 04/194, which prescribes MDA Contract content, should never have prescribed statements to the effect of Condition 1.12(a), (b), (c) and (d), given the General Obligations applying to AFS Licensees (e.g. to always act efficiently, honestly and fairly). Why prescribe a statement that the MDA Contract comply with the Conditions of CO 04/194? It's redundant, and unnecessary for the purposes of the protections afforded the MDA Client and the triggers available to the Commission for Enforcement/Licensing Action. Why is condition 1.13 qualified?

21.6 Conditions 1.15 to 1.18 address Investment Program content. It is unnecessary (and a source of confusion) to include the reference to *"...Retail Client..."* in Condition 1.15. Concerning content specified for an Investment Program prepared by the MDA Operator, Conditions 1.16(a), (b) and (d) are redundant. The longstanding, general SoA-content requirements address these matters. Condition 1.16(c)(iii) is also redundant. The Insufficient/Inaccurate RPC Information Warning either applies or doesn't, and each Annual Review necessarily requires consideration of whether this Warning is triggered. The greatest source of confusion is caused by Condition 1.16(e). A *"...separate SoA..."* needs to be better explained, and it is a nonsense (on two grounds) to require a statement of compliance with Subdivisions C and D of Division 3 of Part 7.7 CA. Firstly, these references are meaningless to a Retail Client, and secondly, compliance with Subdivision D requires the document to be badged as a *"...Statement of Advice..."*. Conditions 1.20 and 1.21 avoid this confusion. Concerning Conditions 1.17 and 1.18, there are grounds for specifying particular responsibilities for the External MDA Adviser, not just the MDA Operator.

21.7 The Asset Holding Conditions (Conditions 1.22 and 1.23 of CO 04/194) should also expressly contemplate (and encourage) lesser-risk arrangements where legal title is retained by the MDA Client.

21.8 The prohibition on investing MDA Client property in most Unregistered Schemes should be reviewed. The prohibition shouldn't be justified on the basis it closes a loophole for potential abuse. Certain opportunities in Unregistered, Wholesale-Only MIS may be appropriate for achieving certain investment exposures. CO 04/194 allows the MDA Client to be treated as eligible to receive Securities Offers not requiring a Disclosure Document through the MDA Operator (see Section 6 of CO 04/194). Section 5 of CO 04/194 similarly allows PDS to be avoided. Why not permit greater access to Unregistered Schemes? How many layers of protections should reasonably be required?

21.9 Concerning Proposal G1(h), there should be as much reliance on RG 126 as possible. Any special requirements for MDA Operators should be justified on a detailed objective basis, and take into account the nature of the MDA Service arrangements (e.g. the range of Financial Products to be dealt in, and where they'll be transacted and settled), which have different PI/Fraud risks.

21.10 Concerning Proposal G1(j), prescribing maintenance of adequate documented measures is redundant. The Audit of documented measures to ensure compliance with CO 04/194 is unnecessary. In our view, the procedural Audit isn't justified. The Audit of the accuracy of Client Reporting has practical value.

21.11 Concerning Proposal G1(l), given the Commission's policy on Secondary Services, Condition 4 of CO 04/194 should be deleted.

21.12 We have no view on Proposal G2.

21.13 Concerning Proposal G3, we don't accept that all MDA Service models fall within the definition of MIS, and must be registered. Relief should only apply to those whose arrangements trigger the definition of MIS. We agree relief should continue in relation to PDS and Disclosure Document requirements. The heading to Condition 6 of CO 04/194 ('Securities Offers') is far more meaningful than the heading to Condition 5. The latter should be headed ('Offers of interests in a (registered?) MIS').

21.14 Guidance must follow the logic of construing 'MDA Services' as a Financial Product to its natural conclusion. While current guidance in RGs 2 and 3 focuses on the

coverage of Advisory and Client Dealing Services, the logical need for Authorisation to Deal by Issuing MDA Services should be highlighted. Then there's the matter of providing Advice and Client Dealing Services in relation to a MDA Service operated by another AFS Licence holder. And finally, how is it that a Managed Discretionary Account (or Discretionary Portfolio Management) Service provided by an AFS Licensee only Authorised to provide service to Wholesale Clients isn't recognised as a separate category of Financial Product for Authorisation purposes (see Section 16 above)?

22. SECTION H – IMPLEMENTATION & TRANSITION PERIOD

22.1 Proposal H1 presents the Commission's usual approach to implementing new requirements. Existing operators may be subject to a Transition Period. Those yet to secure the necessary AFS Licence, or a Variation of Service/Product Authorisations, in order to provide the particular Financial Service are usually required to meet the new requirements immediately they come into effect. However, it may be fairer to allow those whose AFS Licence/Variation Applications have been received by ASIC, BEFORE the date the new requirements come into effect, should be assessed under the 'old' requirements and allowed to take advantage of the Transition Period. The revised Class Order and Regulatory Guide should be released at the same time.

22.2 Proposal H2 requires existing MDA Operators (including those relying on a no-action position) to comply by 1 July 2014, which may amount to 12 months or less as a Transition Period depending on the time-line of consultation processes. Although the Commission should be aware of the number of existing operators needing to re-capitalise, that statistic isn't provided, and those needing to do so may suffer considerable commercial disadvantage when attempting to source various sources of funding because of the short Transition Period.

23. SECTION I – REGULATORY & FINANCIAL IMPACT

23.1 The text of this Section bears all the hallmarks of a template. Given the content of CP 200, we doubt seriously that the Commission has considered carefully the regulatory and financial impacts on (and the impact on competition and innovation of) its proposals. This is confirmed by the apparent doubt about whether a Regulation Impact Statement might be required. The proposals go far beyond a *"...minor or machinery impact..."*.

23.2 We have reviewed the equivalent text in Consultation Papers 164 (Additional Guidance about how to Scale Advice), 182 (FoFA: Best Interests Duty and related Obligations – Update to RG 175), 183 (Giving Information, General Advice and Scaled Advice) and 189 (FoFA: Conflicted Remuneration).

23.3 In each case, the Commission confirms that, before settling on a final policy, it will comply with the Australian Government's Regulatory Impact Analysis requirements by:

- considering ALL feasible options, including examining the likely impacts of the range of alternative options which COULD meet the Commission's policy objectives;
- if regulatory (including guidance) options are under consideration, notifying the OBPR; and
- if the Commission's proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulatory Impact Statement.

23.4 In our view, the consultation processes conducted in recent years to develop the text of legislation, regulations and guidance have demonstrated the Commission has not given due consideration to all feasible options which could be pursued to achieve its policy options, and hasn't given equal weight to its obligations under Section 1(2) of the ASIC Act. The RIS (FoFA: Best Interests Duty and related Obligations) published in December 2012 has only fuelled concerns that the RIA/RIS process is a matter of form rather than substance. This RIS only addressed guidance developed by the Commission in relation to the Best Interests Duty (i.e. Div 2 of Part 7.7A) and was published coincidentally with release of the final Commission's guidance (DATE?), before any possible feedback from OBPR. This RIS restricted its commentary to, and provided limited and selective statistical data focussing on the impacts on Financial Advisers (paragraph 23 of RIS), to the exclusion of other categories of significant providers.

23.5 We note that RIS haven't been published for Regulatory Guides 245 (Fee Disclosure Statements) and 246 (Conflicted Remuneration), yet this guidance has more than a minor or machinery impact (including some positive impacts) on AFS Licensees providing Retail Advisory Services.

23.6 The situation the Commission has faced as a consequence of the FoFA Reforms is that its GUIDANCE (which is necessary) could/should be subject to the RIA/RIS process. The situation with MDA Services is entirely different. The product 'MDA Service' is entirely the construct of the Commission, and regulated by means of a Legislative Instrument, not direct Legislation or Regulation. A review of CO 04/194 and related guidance must therefore trigger a parallel RIA/RIS process, which includes testing the original analysis which found Retail MDA Services to be a Registerable MIS, in accordance with the OBPR's "Best Practice Regulation Handbook".

23.7 Among the functions and powers set out in Section 1(2) of the ASIC Act, when performing its functions and exercising its powers, the Commission *"...must strive..."* to:

- *"...administer... laws...effectively and with a minimum of procedural requirements..."*; AND
- *"...promote the confident and informed participation of investors and consumers in the financial system..."*; AND
- *"...maintain, facilitate and improve the performance of the financial system... in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy..."*.

These duties are to be given equal weight. One can't be pursued or addressed without pursuit of all the other mandates concurrently.

23.8 The progressive re-regulation of Retail Advisory Services since 1995 has been a necessary and complex enterprise. Retail Investor protection has been the mantra throughout, but the Commission's duties to consider cost impacts and minimise procedural requirements have not received the equivalent level of consideration, effort and profile. This is evident from the Commission's endorsement of particular regulations/instruments, and its guidance, during the last 20 years.

23.9 The Commission's public and media stance is very skewed to a focus on investor protection. And, as we understand it, behind the scenes the Commission's stance has had to be balanced by Treasury's sympathy for sustainable commercial outcomes which are effective.

23.10 The Commission's understanding of how Advisory Services (particularly Personal Advice) can and should be provided to a Retail Client presumes a more Financial Planning Service-Model relating to products which tend not to be Market-traded. Recognition of 'live' Market practicalities, and the reasonable, time-sensitive service expectations of Retail Clients requiring services in relation to Market-traded product, has been slow to emerge. Policy and guidance must be sufficiently nuanced to balance the realities of service environments, not to favour particular AFS Licensees, but to make this flexibility available to all AFS Licensees who may provide services (among others) in that environment.

23.11 CP 200 doesn't give comfort that the Commission has given due consideration to the general and special Compliance/Enforcement environments which may apply to MDA Operators. At the outset, there should have been justification of continuing the prohibition on General Advice in relation to Retail MDA Services. The protections of Retail Personal Advice are considerable, and should be kept in mind when making the case for re-regulation. Then there are the layers of general protections available by virtue of Licensing, Capital Adequacy, Retail Compensation Arrangements, Disclosure in all its guises, Warnings and the Licensing/Banning Order and Civil Penalty Powers. In addition, a special Compliance/Enforcement environment (e.g. Market Integrity Rules) may apply to the MDA Operator, all of which should be taken into account when shaping proposals for re-regulation (or de-regulation). Overlapping Retail Investor protections is by definition an inefficient outcome.

23.12 The efficiency and development of the economy relies on competition and innovation. The desirability of harmonisation is a valid consideration, but should also ring alarm-bells. Competition and developing service solutions to meet a need at the Retail Client interface are significant drivers of service innovation, and SME AFS Licensees have tended to be the most fertile environment for such development. Policy and guidance which happens to foster growth of barriers-to-entry and facilitate concentration, must trigger a forensic consideration of the likely impacts on the future incentives to innovate and compete.

23.13 If the Commission was able to demonstrate a detailed and practical understanding of service arrangements regulated and impacted directly by regulatory developments, it would reduce the incentive to over-interpret the law (as ASIC does itself). For instance, the Commission has had a long-standing concern about the conciseness and effectiveness of lengthy PDS, FSGs and SoAs. It should be remembered that FOS rely very heavily on ASIC guidance, and guidance should recognise the range of legitimate service arrangements and present practical explanations and solutions, and in a manner which doesn't raise further questions in the mind of the reader. Simplistic or incomplete guidance can skew FOS outcomes, and skew the risk-perceptions of PI Insurers.

24. CONCLUSION

24.1 CO 04/194 and RG 179 are long overdue for a considered review, as is the Commission's stance that any and all varieties of Retail MDA Service are a Registerable MIS.

24.2 Given that elements of CO 04/194 pre-saged the FoFA Best Interests Duty and Fee Disclosure Statement requirements, its review (in the interests of efficient regulation) is pressing given the FoFA Reforms come into effect (at the latest) on 1 July 2013.

24.3 However, the Commission must hasten slowly. The Commission's case for re-regulation isn't made. The detail presented in CP 200 is insufficient for an informed

assessment of the deficiencies of CO 04/194 (and RG 179) and the need for increased regulation. Harmonisation of certain Capital Adequacy requirements (across Responsible Entities and MDA Operators, and across Custodians and External MDA Custodians) is not as logical as it might first appear.

24.4 The Commission should be canvassing de-regulation of elements of CO 04/194 (e.g. allowing General Advice as a MDA Service-element in very particular circumstances).

24.5 Unless the Commission is prepared to state explicitly that no special 'MDA Services' Authorisation is required for Wholesale MDA Services, the logic of long-standing Licensing Principles and the Commission's Licensing System must allow MDA Services to be construed as a Financial Product for the purposes of Advisory, Dealing by Issuing and Dealing on behalf of Another Services in both the Retail and Wholesale contexts. In the case of an AFS Licensee Authorised to provide Retail MDA Services, nothing further should be required (in terms of Authorisation) as long as their AFS Licence also permits services being provided to Wholesale Clients. In the case of an AFS Licensee Authorised only to provide services to Wholesale Clients, coverage of MDA Services should be granted on request if the product Authorisations on their AFS Licence are sufficient for their MDA Service Model.

Authorised for Submission by

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INDUSTRY EXPERIENCE

I joined Johnson Taylor & Co Pty Ltd, a Member Organisation of the Australian Stock Exchange Limited (ASX) during August 1987 as a graduate trainee. I progressed through various back-office departments before joining the research department in February 1988. As an analyst, my brief was to assist establish long-term links with smaller listed companies and to expand the provision of 'corporate' stockbroking services to them as they matured. The aftermath of the October 1987 Market Crash eventually smothered the brief and I departed the firm late in 1989.

COMPLIANCE & RISK MANAGEMENT EXPERIENCE

I held the positions of Compliance Officer, Exchange Inspector and Manager, Membership (Melbourne & Hobart) at the ASX during the period January 1990 to October 1993. At that time, the Membership Department was responsible for enforcing compliance by Member Organisations with the ASX's Articles and Business Rules, and the Corporations Law (breach of which amounted to Prohibited Conduct under the ASX Articles and Rules). As Manager, I was also directly involved in developing regulatory policy, proposing and pursuing Business Rule amendments, and liaising with the ASC (which became the ASIC) on policy and disciplinary matters.

I left ASX to join Prudential-Bache Securities (Australia) Limited as Compliance Manager. Prudential-Bache Securities was related to Prudential Securities Inc., which is based in New York and has a presence throughout the world. My responsibilities required considerable knowledge of securities and futures business regulation in Australia, and an understanding of regulations applicable to major offshore markets. I left Prudential-Bache Securities in March 1995 to establish **Securities & Futures Compliance Services.**

CURRENT ACTIVITIES

Securities & Futures Compliance Services provides stand-by compliance and risk management support for small to medium-sized AFS Licence holders subject to any or all of the regulatory environments administered by ASIC, AUSTRAC and ASX Group. Although I'm not a Solicitor, I am a Compliance Specialist with many years of experience. My experiences as regulator and one of the regulated enable me to provide unique insights into compliance and risk management issues and how regulators are likely to perceive them, and unique perspectives in relation to the future of service models and business strategy.

Range of Clients

Clients include Stock/Futures Brokers, Funds/Portfolio Managers, MIS Operators (both Registered and Unregistered Schemes), Research providers and Corporate Advisers.

Range of Services

Services typically include **training** on compliance requirements and market practices; **review** of records and procedures against regulatory, industry and internal standards; **risk analysis** of services and supervisory/ procedural controls; **guidance** when facing regulatory/ disciplinary action or complaints/legal action; **administrative support** in relation to compliance matters generally (e.g. Authorised Representative Agreements, tailoring of the Compliance Policies & Procedures Manual and its ongoing update, development of Supervisory/Internal Reporting processes and Compliance Review Programs, assistance responding to regulatory Notices, support during regulatory inspections); and **explaining the**

compliance/risk implications of new service arrangements and business proposals, and new regulations.

More specifically, for those who provide stockbroking services, whether they be a Market Participant or not, I have assisted clients develop effective controls for the handling of Inside Information, the maintenance of Robust Information Barriers (also for Conflicts Management purposes) and for detecting conduct likely to amount to Market Manipulation/Rigging.

For those acting as Intermediary, and those captured by ASIC's expectations regarding the provision of Secondary Services, I have developed Agreements, client documentation and procedural controls to address those expectations.

I have developed proforma FSG, SoA/RoA formats and other 'Retail' documentation (e.g. Client Services Agreement, MDA Services Agreement & Investment Program), and assisted with their integration with Adviser/order management and client profiling systems typically used by Dealing Desks.

On the matters of service modelling and business strategy, I will take whatever opportunity I have to remind AFS Licensees (including Market and/or CS Facility Participants) that although their conduct (particularly in the 'Retail' space) is measured against the requirements of the law (and ASX Group Rules), industry practice and the reasonable service expectations of their clients, their regulatory environment does provide tools to control regulatory/commercial risk. For instance, where it is appropriate to do so, a client qualifying as a Wholesale Client should be treated as such. Also, AFS Licensees may choose to provide Personal or General Advice, or no advice at all. Revenue streams should reflect the difference in regulatory/commercial risk associated with particular service-streams. In the context of Market services, a reliance on transactional fees and not charging directly for Advisory Services does not synchronise risk with revenue. There must be matching for the service model to be sustainable.

Subscription Services and Specialist Roles

In addition to these project/issue specific support services, I provide **Compliance Alerts** and **Updates** on topical/difficult matters by subscription. I sit on the **Compliance Committee** at a number of Responsible Entities/Wholesale-Only Scheme Operators. I was also Company Secretary/Executive Officer of the Private Client Stockbrokers Association Limited (PCSA) until it was subsumed within the Securities & Derivatives Industry Association (SDIA), which recently changed its name to the Stockbrokers Association of Australia (SAA). I sit on the SAA's Compliance Committee.

And for the future? Change, change and more change

Financial services providers have experienced wave after wave of significant regulatory reform during the last 15 years. And more is to come. The period commenced with 'GOOD' Retail Advice reforms and the transition to a Single Responsible Entity for registerable MIS. Later there was the wholesale transition to the AFS Licensing regime and the reform of MDA Services. More recently we've faced the implementation of the Privacy Act, AML/CTF Act and reforms to Retail Compensation Arrangements, FOS and Short Selling We are facing Margin Lending, Credit Licensing and (in the case of ASX Participants) Capital Adequacy reforms, and the transfer of Market Supervision from ASX/NSX to ASIC. CFD/OTC Markets accessible to Retail Clients can expect considerable scrutiny in the short-term. CAMAC's report on its review of the Insider Trading legislation has been overlooked for some while now, but the Government can be expected to pursue those recommendations after the election. The continuing pressure on trail-commission arrangements will impact service models and business strategy. ASX Group has also pursued an intensive, wide-ranging reform agenda, often not in harmony with ASIC reforms (e.g. the ASX is extending its Responsible Executive and Management Structure requirements to ASTC Settlement Participants). More enforcement tools are available to your regulators, and they will be used.

Throughout these 15 years I have been both **radar** and **navigator** for clients, guiding procedural/system modification and the repositioning of business/service strategy. I have advised Professional Bodies on course/CPD content. I have made countless **submissions** to ASIC, Treasury, ASX Group and AUSTRAC for clients, industry bodies and on my own behalf, and I will continue to do so.