



30 April 2013

Geraldine Lamont  
Retail Investors Policy Officer, Financial Advisers  
Australian Securities and Investments Commission  
Level 5, 100 Market St  
Sydney NSW 2000

Email: [mdareview@asic.gov.au](mailto:mdareview@asic.gov.au)

Dear Ms Lamont

**Re: Consultation Paper 200 Managed Discretionary Accounts: Update to RG 179**

The Financial Planning Association of Australia (FPA) welcomes the opportunity to provide feedback to the Australian Securities and Investments Commission (ASIC) on its proposed amendments to the regulatory guide on managed discretionary accounts (MDAs).

The FPA believes ASIC's desired outcomes of the proposed requirements for the new regulatory guide are unclear in CP200. The FPA would support the objectives of increasing consumer protection, enhancing efficiencies, and improving integrity in the system. It is these objectives that have guided the FPA's positions in response to ASIC's proposals in CP200.

The FPA's submission responds to the following proposals:

- Financial requirements for MDA operators;
- Revoking Class Order CO 04/194;
- Defining regulated platforms;
- Non-limited recourse arrangements;
- Fee Disclosure Statement obligations; and
- Conflicted remuneration.

The FPA would welcome the opportunity to discuss this further. If you have any questions, please contact me on 02 9220 4505 or [dante.degori@fpa.asn.au](mailto:dante.degori@fpa.asn.au).

Yours sincerely

**Dante De Gori**  
*General Manager Policy and Conduct*  
Financial Planning Association of Australia<sup>1</sup>

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<sup>1</sup> The Financial Planning Association (FPA) represents more than 10,000 members and affiliates of whom 7,500 are practising financial planners and 5,500 CFP professionals.



### ASIC's consultation process

The FPA understands ASIC's standard consultation process. However, given the feedback we have received and concerns raised by others via submissions and the media, the FPA strongly recommends ASIC consider further consultation on some of the more controversial issues relating to the updated regulatory guidance on MDAs.

As part of the process of further consultation, the FPA suggests ASIC provide a detailed list of the investor risks the Regulator is trying to minimise, mapped against the different MDA models operating in the market. This would clearly identify those models with lower versus higher risk outcomes, resulting in regulatory requirements matching the consumer risk and appropriately licensed MDA service providers. It will also assist consumer understanding of the risks of different types of MDAs and offer reassurance for PII insurers when determining cover and premiums.

The FPA understands that many of the recommendations put to ASIC in response to CP200, including the FPA recommendations below, are significantly different to those originally proposed by ASIC. To ensure the final regulatory guide delivers improvements in consumer protection, system integrity, and market efficiency, careful and thorough consideration must be given to all options by all stakeholders (not just ASIC) in determining the most appropriate regulatory environment for consumers and industry. This can only be achieved through further consultation.

#### FPA recommendation:

The FPA recommends ASIC undertake a thorough risk identification process and further consultation with all stakeholders prior to making a final decision on changes to its regulatory guide for MDAs.

### Level playing field

The FPA understands that it is ASIC's position that market participants and clearing participants are bound to comply with financial requirements under the market integrity rules of the market they belong to, and therefore should be exempt from complying with ASIC's regulatory requirements for licensees (in all their various forms) including for the MDA services such participants provide to retail clients. The FPA is concerned that CP200 is silent on this exemption creating a lack of transparency in the Regulator's consultation process and an unlevel playing field for industry participants.

Even though market participants are bound by certain financial requirements, there has been no consultation or confirmation from ASIC of the detail of these financial requirements; of the adequacy of these financial requirements in relation to the MDA service market participants provide to retail clients; what services the financial requirements relate to; whether some market participants receive exemptions from these financial requirements; or when the market participant financial requirements were last reviewed. To ensure appropriate consumer protection measures, there must be a consistent and transparent approach to regulating all participants who provide an MDA service to retail clients, based on the risks associated with the MDA function or service provided.

Market participants and clearing participants play a key role in the provision of MDA services to retail clients, and are usually responsible for trading directly to the market on behalf of clients and having



custodial arrangements. These are the high risk components of MDA services yet an exemption of the MDA regulatory requirements is afforded to just these providers.

The FPA questions how allowing market participants to be 'exempt' from the regulatory requirements for MDA providers raises standards for all participants, enhances consumer protection, ensures integrity in the system, and provides fairness and equity for all participants. It appears that ASIC is reviewing requirements for financial planners and licensees but not participants who provide high risk MDA services. This creates an unlevel playing field for industry participants, and an uncertain and confusing regulatory environment for consumer which will ultimately reduce consumer protection.

**FPA recommendation:**

The FPA strongly recommends an obligation on ASIC to review the regulatory requirements for all MDA service providers, including market participants and clearing participants.

### **MDA licensing structure and regulatory and financial requirements**

Managed discretionary accounts serve a purpose for investment consumers. MDAs offer efficiencies to planners and clients alike which help control costs while providing investment diversification opportunities. Ensuring the effective operation of the MDA market, while protecting consumers, is paramount. This can only be achieved by developing an appropriate licensing structure for MDAs.

There are many different forms of MDA services with varying degrees of consumer risk. The FPA believes ASIC's proposed regulatory changes, particularly in relation to financial requirements, do not sufficiently or appropriately consider the diversity of the arrangements within the MDA market.

As such the FPA believes a one-size-fits all approach to regulating the MDA market, as proposed in CP200, is inappropriate. The FPA does not support imposing the same regulatory requirements on an MDA provider who holds no client assets under a custodial arrangement and does not trade in derivatives, as those imposed on a custodian MDA provider who trades directly to the market on behalf of clients.

The FPA does not support a 'blanket' type approach to financial requirements for those operating in the MDA space. Such an approach does not consider the many varieties of MDAs in the market, or more importantly, the different MDA custodial arrangements that are already in place and serve as a protection mechanism for consumers.

A one-size-fits-all approach to financial requirements will significantly reduce market competition by eliminating smaller participants and giving an unfair advantage to the larger dealer groups able to meet such requirements. This goes against ASIC's stated strategic objective to ensure fair and efficient financial markets. It will force many small licensees to operate the service under the licence of a big dealer group.

The proposed NTA requirements are a significant increase and will not be achievable for any but the large dealers. It will have a considerable impact on small licensees, will substantially reduce competition, and have a cost impact on the remaining operators and their clients.



In response to ASIC's CP200, the FPA conducted a member survey to gain a better understanding of the MDA arrangements our members offer to their clients. 75 percent of respondents offer MDAs services where the assets are held in custody by another party, namely a regulated platform.

Many financial planners who operate MDAs use an external custodian to hold all of the clients' assets. The custodian already has a significant financial obligation. Requiring non-custodians to meet strenuous financial requirements is an unnecessary duplication, will drive all small operators out of the market, and offers no additional consumer protection. Financial requirements should be imposed on those entities that hold the custodial arrangements for the client's assets.

Financial planners also offer MDA services provided via a platform which has an external custodian. The platform provider and custodian are already subject to financial requirements. Imposing financial requirements on the MDA provider, in this instance the financial planner, is again a duplication and will simply result in increased pricing to retail clients.

A licensed custodian holds all client assets completely independent of the AFSL managing the portfolio under the limited discretionary arrangement. That custodian must maintain \$5M NTA at all times. No client funds can be deposited into or drawn from the regulated platform without express client consent. The AFSL managing the portfolio must also maintain adequate PII cover at all times from a base of \$2M under RG126. They must also maintain base solvency under RG166.

Anecdotal evidence shows that most licensees operating MDAs under the 'no action letter' are small businesses, the majority of whom do not hold client assets under custodial arrangements. Requiring those entities that currently operate under the 'no action letter' to maintain NTA requirements, as proposed by CP200, would force such licensees to stop offering discretionary services to clients. The proposal to apply the new financial requirements to those currently operating under the Class Order relief imposes Responsible Entity (RE) type requirements on operators offering lower risk MDAs. The cost of holding this level of capital would likely send many MDA operators, and financial planners out of business which would have a devastating effect on clients.

The FPA understands the role of NTA and Responsible Entity (RE) type requirements for providers or issuers of product who deal direct with the market. However, small businesses operating and managing small lower risk MDAs who are not dealing directly with the market or holding client assets in custodial arrangements do not represent the same consumer risk as those acting at the same capacity of RE's.

The FPA is unclear of the consumer risk ASIC is trying to overcome by mandating financial requirements on entities that do not hold custodial arrangements or deal directly with the markets. The FPA questions the purpose of the proposed NTA policy as it is unlikely to be sufficient as a compensation scheme for potential MDA client losses. For this purpose, it also duplicates the existing professional indemnity (PII) insurance and dispute resolution requirements.

Increasing the financial requirements of all licensees will not address the main consumer risks associated with MDAs. This can only be achieved through preventative measures such as proper supervision, adequate systems for operating MDAs, appropriate training and competencies, experience, thorough auditing, and comprehensive consumer education of the risks and structural considerations of MDAs arrangements.

The FPA believes ASIC needs to ensure the licensing structure is correct and effective and separately identifies the different types of MDA services provided, before it determines and mandates the



regulatory requirements. The licensing regime should have appropriate MDA categories and sub-categories based on the service or function provided and who in the MDA chain holds the custodial arrangements. These categories should consistently cover all MDA service providers, including market participants and clearing participants. For example, the following roles and functions:

- MDA adviser (category) – provides financial advice to retail clients, recommends the MDA, and develops the most appropriate MDA investment strategy for the client's needs and in line with the client's financial plan.
- MDA administrator (category)
  - non-custodial (sub-category)
  - custodial - holding client assets in custodial arrangements (sub-category)
- MDA operator (category)
  - MDA operator services including direct investment dealings with the market, often including transacting in shares and derivatives (sub-category).
  - limited MDA operator services with no direct trading (sub-category).
  - non-custodial (sub-category)
  - custodial - holding client assets in custodial arrangements (sub-category)

These brief descriptions (which are example descriptions only, not FPA recommended definitions) highlight the very different functions of each provider and the associated levels of risk. The FPA recommends ASIC's MDA definitions, authorisations, and financial requirements should match the function, custodial arrangements, trading activity and risk of the MDA service provided. This would allow ASIC to ensure the financial requirements match risk of the service provided under each category and sub-category of authorisation.

Each MDA service provider would adhere to the authorisation conditions relevant to the MDA functions / services they offer. The FPA believes the conditions of an MDA Adviser and non-custodian MDA operator authorisation should parallel the conditions of the existing Class Order CO 04/194, particularly when a regulated platform is used.

MDA providers should be allowed to seek authorisation for the services they provide to clients. For example, a financial planner should be allowed to be authorised to provide financial advice on MDAs as well as obtain a limited type of MDA operator authorisation if they provide lower risk non-custodian operator services which do not include derivatives or trading directly with the market.

In determining appropriate licensing authorisation categories and conditions, and NTA requirements, consideration should be given to (but not limited to):

- Custodian versus non-custodian
- Whether the operator holds client data
- If the operator handles the client payments / cash in relation to the MDA



- Appropriate competencies for the different functions within the MDA chain
- Ability to meet conflict of interest requirements in relation to MDA services offered
- Whether the provider trades in derivatives and shares
- Whether the provider makes decisions and transacts on behalf of clients directly to the markets.

The FPA also suggests the professional indemnity (PII) insurance arrangements in RG179 should reflect the risk of the MDA function and service offered. Therefore, the PII requirements in RG126 should be adequate for many MDA non-custodian functions, particularly where the provider does not make decisions or transact on behalf of clients directly to the markets or trade in derivatives.

The FPA recommends ASIC undertake further consultation to determine appropriate authorisation categories, conditions and financial requirements based around the function of the MDA service provided and the custodial arrangements.

**FPA recommendation:**

The FPA recommends ASIC re-structure its licensing authorisation criteria and requirements for MDAs based on the functions or services offered by the provider, the custodial arrangements within the MDA, and the types of financial products offered through the MDA.

The FPA recommends further consultation should be undertaken with all stakeholders should ASIC consider adopting this recommendation to ensure any changes to the MDA licensing arrangements, categories, conditions and NTA requirements, accurately reflect the consumer risks, while encouraging market competition.

The FPA does not support the adoption of the NTA financial requirements as proposed in CP200.

### **Removal of the regulated platform 'no action' letter**

Within CP200, B4 proposes to revoke the regulated platforms no-action letter, regulate instructions to regulated platform providers, including instructions to switch between investment options, as MDAs requiring specific AFS license authorisation. B5 proposes a 2 year transition period to allow those who are currently relying on the no-action position time to obtain the relevant AFS licence authorisations or to wind up their MDA business.

Almost half of the FPA member survey respondents currently rely on the CO 04/194 Class Order relief. Financial planners making switches or model portfolio changes do so by following the MDA client contract, investment strategy and financial plan, and under the authority of the client. Many utilise a limited MDA service to adjust the portfolio of clients who are geographically isolated.

Offering MDAs via a regulated platform provides flexibility and cost savings for clients with recognised bands for investment. This has allowed more clients to obtain relevant advice.

Revoking the Class Order relief (CO 04/194) will result in a one-size-fits-all approach to regulating all MDA services. Simple MDA services on a regulated platform offer a low risk and transparent option for



clients. Revoking the Class Order ignores the risk differentials and client benefits of such services as they will have to meet all the same obligations as a full scale and higher risk MDA service.

Imposing greater regulation and licence authorisations under a one-size-fits-all approach will increase the level of complexity and cost of advice for clients and licensees.

**FPA recommendation:**

The FPA recommends CO 04/194 is maintained. Alternatively, the 'no action' position afforded under CO 04/194 be incorporated into a function based regulatory approach for MDAs as described and recommended by the FPA above.

### **Defining regulated platforms**

ASIC proposes to define a 'regulated platform' as an IDPS, IDPS-like scheme or superannuation entity, under proposal B7, which would require all regulated platforms to meet the requirements of RG166: Licensing Requirements, including NTA requirements.

The FPA understands that some regulated platforms outsource the custodian arrangements for MDA operations. As previously mentioned, the FPA believes financial requirements should be commensurate with the risk of the service provided to consumers, particularly in relation to non-custodial arrangements.

The FPA questions whether the proposed regulated platform definition appropriately regulates such entities, particularly those offering non-custodial MDA administration services, as the proposed definition would impose the IDPS NTA requirements of RG166 on all regulated platforms.

The FPA is also concerned about the potential passing on to consumers of any increased costs associated with inappropriate regulation.

### **Investing in arrangements where recourse is not limited**

The FPA notes ASIC's proposal E1 to modify conditions of relief for MDAs with non-limited recourse arrangements. The FPA notes the high risk nature of such arrangements and believes that all MDA operators and MDA advisers must possess and maintain the appropriate competencies on derivatives in order to recommend and invest client assets within an MDA in non-limited recourse arrangements.

However, the FPA does not support the banning of MDA operators from investing retail client's portfolio assets within an MDA in non-limited recourse arrangements, as proposed under option c). As the definition of derivatives is very broad the FPA is concerned that full exclusion would significantly restrict the market.



The FPA does not believe option b) requiring client consent for each transaction, is appropriate either as it will significantly impact on the efficiencies such MDAs offer clients. It could also potentially expose the client to new risks, for example, if there was a market downturn and the MDA operator was unable to respond appropriately and in a timely manner (within the boundaries of the client's investment strategy) because the operator was unable to contact the client.

The FPA supports ASIC's proposal a) to enhance risk disclosures. While the FPA does not believe proposal a) goes far enough to provide adequate consumer protection, it is a more viable option than options b) and c).

The FPA recommends extending the proposed disclosure requirements to include a 'consumer understanding of the warning', and a requirement to prioritise conflicts of interest. The FPA believes this would be consistent with ASIC's regulatory approach and with the recommendations of the Parliamentary Joint Committee Inquiry into the collapse of Trio and Self Managed Super Funds.

**FPA recommendation:**

The FPA recommends the strengthening of disclosure and risk warnings (option (a)) in conjunction with a requirement to ensure consumer understanding of the warning, and to prioritise conflicts of interest for MDA operators investing retail client's portfolio assets within an MDA in non-limited recourse arrangements.

**Fee Disclosure Statement (FDS)**

The FPA supports the proposal to include guidance consistent with *RG245 Fee Disclosure Statement (FDS)* in the updated RG on MDAs. However, the FPA recommends ASIC clearly identify the entity responsible for providing the FDS as the MDA adviser, or the service provider giving the financial advice / MDA advice to the client, not the MDA operator.

**Conflicted remuneration**

The FPA supports the inclusion of the key elements of the Future of Financial Advice (FoFA) reforms in the updated regulatory guidance on MDAs. However, we note CP200 is silent on the conflicted remuneration FoFA requirements. The FPA assumes those providing MDA services to retail clients will be required to adhere to the requirements of RG246 Conflicted Remuneration.