26th April 2013

Ms Geraldine Lamont
Retail Investors Policy Officer
Financial Advisers
Australian Securities & Investments Commission
Level 5, 100 Market Street
SYDNEY NSW 2000

By email: mdareview@asic.gov.au

Dear Ms Lamont

ASIC Consultation Paper 200: Managed discretionary accounts – update to RG 179

Thank you for the opportunity to make comments in response to ASIC Consultation Paper 200 (CP 200).

The Australian Financial Markets Association (AFMA) is the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets and provides leadership in advancing the interests of all market participants. These markets are an integral feature of the economy and perform the vital function of facilitating the efficient use of capital and management of risk. Market participants perform a range of important roles within these markets, including financial intermediation and market making.

AFMA represents over 130 members, including Australian and international banks, leading brokers, securities companies, state government treasury corporations, fund managers, wealth managers, traders in electricity and other specialised markets and industry service providers.

As you are aware, AFMA provided some initial comments to ASIC in December 2012 prior to the release of the consultation paper. For the sake of completeness I have included those comments again below for consideration.

Our comments relate to specific issues identified in CP 200 and we have not replied to every question or proposal in the paper.

1. ASIC Class Order [CO 04/194]

1.1 Investment program review conditions

In accordance with paragraph 1.19 of the class order, the MDA operator must ensure that it or an external MDA adviser gives each retail client personal advice about whether the MDA contract for that client is suitable in light of the client's personal objectives, needs and relevant personal circumstances at least once every 13 months.

Paragraph 1.20 says that if the MDA operator gives the personal advice, it must comply with Division 3 Part 7.7 in relation to that advice and provide a Statement of Advice for the advice that complies with … Subdivisions C and D.

There is an analogous requirement in paragraph 1.21 if an external MDA adviser gives the personal advice.

Some AFMA members have noted that it is not clear, where there is no change in circumstances or alteration to the strategy, whether a new SOA must be given to the retail client. Clarification of this requirement would be useful.

We also note there is a discrepancy between the timing of investment program reviews stipulated in RG 179 and the class order. For instance, RG 179 provides that the MDA operator must ensure that the investment program is reviewed in light of the client's relevant circumstances at least once every 12 months – see paragraph 179.44. Paragraph 1.19 of the class order refers to 13 months. In a practical sense the 13 month timeframe is preferred as it would mean there is consistency in timing of reviews for all MDA operators, irrespective of whether the MDA adviser is internal or external.

1.2 Client reporting conditions – annual reporting and audit

(a) Annual reporting to clients

Paragraph 1.29 of the class order requires an MDA operator to give to each retail client to whom it provides MDA services the information set out in paragraphs 1.29(a) to (d).

This reporting requirement is effectively pegged to 30 June each year because of the definition of "reporting period".

However, our members have noted that some systems operate on a calendar year rather than a financial year (and internal systems may be different depending on the financial year end of a particular institution in its home domicile), and that performance reporting is often based on a calendar year.

It is preferable that there is a requirement to report to clients every 12 months to allow for differences in reporting systems, rather than linking the requirement to the end of the Australian financial year.

(b) Audit

In accordance with the requirements set out in paragraph 1.31 of the class order, two audits are required – one is client facing in relation to controls and performance statements, and the other is ASIC facing and relates to the licensee's financial year.

AFMA members are aware that a number of waivers have been granted by ASIC to allow these audits to occur at the same time. We suggest that the class order should be amended so that both audits are required to be completed with 3 months of the end of the licensee's financial year.

2. Proposal B2 – definition of "family"

Proposal B2 on page 15 of the consultation paper says that [ASIC] proposes to explicitly define 'family' as 'the spouse and/or children (as defined in section 995-1 of the *Income Tax Assessment Act 1997*) of an AFS licensee or its representatives.'

AFMA considers this definition to be overly restrictive, in light of the policy objectives that ASIC wants to achieve.

At a minimum, it would seem appropriate to limit the relief to "immediate family" which, under Wikipedia, Investopedia and businessdictionary.com definitions, would include parents, siblings, grandparents, in-laws, civil unions and cohabitating partners (to the extent these latter two are not already covered by the Tax Act definition), as well as the spouse and/or children of the licensee or its representatives.

3. Custodians

Some AFMA members consider that it would be beneficial to reduce the current obligations imposed on custodians, and instead move those obligations (where appropriate) on to the MDA operator. In doing this, ASIC should reiterate that an MDA operator will continue to be permitted to outsource any of its obligations (but not liability as we acknowledge this is not possible) to any persons it considers necessary. This would provide further flexibility in structuring various MDA offerings which currently may not be possible.

4. Proposal C4 - consistency with financial requirements for providers of custodial and depository services

Proposal C4 suggests that MDA operators responsible for holding client portfolio assets must meet the same NTA requirements as custodians/responsible entities.

AFMA does not support this proposal as the arrangement under an MDA is different – there is no pooling of funds to access an investment (unlike a managed investment scheme), and the depository/custodial service that is offered by the MDA operator is only incidental as the service is typically a nominee service that is provided in conjunction with a broking activity. Further, the imposition of an onerous financial obligation on a MDA operator that has already appointed an external custodian is pointless and creates unnecessary duplication. There is no value-add to the end clients, particularly if the MDA operator is *merely* providing a nominee service.

We suggest that this proposal should be amended to more properly reflect the activity that is occurring and the service that is being provided. An alternative to consider might be NTA requirements based on a particular financial threshold.

5. Proposals E1– investing in arrangements where recourse is not limited

Responses to the questions in section E1 of the consultation paper are set out below. However, as an overarching comment, it is not at all clear that it is appropriate for ASIC to seek to effectively ban retail investor access to certain products in the context of an MDA merely because ASIC considers that the products may be "higher risk" (CP200.70) and because "it is appropriate to limit [an] operator's ability to use their discretion to invest in products that could generate additional liabilities for the client" (CP200.76). There does not appear to be any other basis for the proposal in E1(c) in the consultation paper apart from the above.

AFMA understands ASIC's intention in the proposal is to protect retail investors from suffering potentially significantly greater losses than the actual investment in an asset that is held in an MDA. Notwithstanding, whether or not a retail investor should have access to particular products in a particular circumstance is a matter of public policy that we respectfully submit is not within ASIC's remit to decide. The Corporations Act does not currently operate to prohibit retail investor access to particular products, but relies on the operation of the financial advice and disclosure provisions to ensure that an investor makes informed investment decisions and receives appropriate advice about products and the potential consequences of investing in those products. That regime will shortly be bolstered by the best interests duty as part of the FOFA reforms.

We do appreciate that the terms and conditions of a class order are within ASIC's remit, but consider, as a matter of principle, that an attempt to use class order conditions in the manner contemplated in the consultation paper is a mis-application of that power. There are already sufficient protections in place for retail investors to ensure that they understand the investment strategy in an MDA, including the nature of the products that the MDA operator might invest in.

E1Q1 Do you agree with our proposal to modify our conditions of relief to impose specific conditions when a client's MDA operator has discretion to invest in products or investment strategies with non-limited recourse? If not, why not?

See our comments above. In our view, the existing financial advice and disclosure regimes provide significant protection for retail investors.

E1Q2 Do you think option (a), (b) or (c) would be most effective in addressing the additional risks faced by retail clients when an MDA operator has discretion to invest in products or investment strategies with non-limited recourse? Please outline your reasons for preferring that option.

Of any of the options, option A is preferred because a key point of the MDA is to enable the MDA operator to perform the role of investing on behalf of their clients.

However, if there is a concern that this is not an adequate safeguard then there is a fourth option not included in CP 200 - namely, that the MDA operator could be required to both disclose the specific risks of investing in non-limited recourse arrangements (as contemplated under option A) AND seek specific consent to investing in those products either at the time the client opens the account or before such products are traded but NOT in each instance (as suggested in option B). This would seem to be a much more pragmatic and appropriate way forward than either option B or C, and would achieve ASIC's objectives.

E1Q3 Do you think option (a), (b) or (c) would be most effective in promoting confident and informed consumer and investor decision making and investment in MDAs?

See our comments above.

E1Q4 If you prefer option (a), do you think the wording of the risk warning should be standardised or should MDA operators be able to tailor the warning to suit their particular MDA offering?

MDA operators should be able to tailor their warnings according to their particular MDA offering. There are a number of risk mitigation tools available for all the financial products captured in this consultation and the operator should be able to clarify exactly how they intend to manage those risks.

E1Q5 Do you think any other measures need to be taken to address the risks faced by retail clients when higher-risk investments are included within an MDA? If so, what measures would be the most effective?

See the additional option suggested at E1Q2 above.

Any additional requirements that relate to the investor's ability to understand higher risk investments should be placed on the person who is giving personal advice to the client to enter into the MDA.

E1Q6 Do you think there are any other classes of investment products or strategies that should be subject to the same conditions outlined in this proposal? Please identify which investments or strategies, and why.

All financial products carry some element of risk. It is not appropriate to extend this proposal to encompass other products without any justification for doing so.

Any products that are included should only be caught if they fall within the specific definition of "non-limited recourse financial product or arrangement". Products or client accounts that have been structured specifically so the financial recourse <u>is</u> limited should not be included by default. By way of specific example – CFDs are expressly noted in the paper as an example of a ""non-limited recourse financial product or arrangement". With standard client accounts this is generally the case. However, accounts can be opened with CFD operators that are "limited risk" whereby every CFD transaction opened is expressly limited in the losses able to be incurred to the amount deposited by the client. If a product is structured in this manner then it should not be caught up in the proposed changes.

E1Q7 Will any of the three options impose costs on your business? If so, please identify the type of costs, their value and whether they would be one-off costs or ongoing.

It is not possible to quantify costs at this point in time. If the proposals were to go ahead as described in the consultation paper, licensees in certain sectors are likely to lose volume and clients.

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Please contact me on 02 9776 7997 or tlyons@afma.com.au if you have any queries about this submission.

Yours sincerely

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