7 May 2013

Ms Geraldine Lamont
Retail Investors Policy Officer, Financial Advisers
ASIC
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SYDNEY, NSW, 2000

Email: mdareview@asic.gov.au

Dear Ms Lamont,

AFA Submission – Consultation Paper 200 – Managed discretionary accounts: Update to RG179

The Association Of Financial Advisers Limited ("**AFA**") has been serving the financial advising industry for over 65 years. Its aim is to provide members with a robust united voice, continually improve practices and focus firmly on the exciting, dynamic future of the financial advising industry. The AFA also holds the client to be at the centre of the advice relationship and thus support policies that are good for consumers and their wealth outcomes.

With over six and half decades of success behind it, the AFA's ongoing relevance is due to its philosophy of being an association of advisers run by advisers. This means advisers set the agenda, decide which issues to tackle and shape the organisation's strategic plan.

Thank you for the opportunity to provide feedback on Consultation Paper 200.

The operation of MDA's is a reasonably specialized area that we expect only impacts a limited number of advisers. We note the coverage in paragraph 11 of the number of licensees who are authorised to operate an MDA and the growth rate. It would be beneficial, in reviewing this consultation paper to have an appreciation of the number of advisers who provide MDA services and the number of impacted clients. It would also be beneficial to have more information on any issues with client experiences and client losses that have been occurred with respect to MDAs. There are undoubtedly increased risks involved with these MDAs, however it would be helpful to see an articulation of these risks.

We have received feedback with respect to concerns about these proposals from our members who utilize MDA's. In particular, smaller licensees have expressed deep concerns about the proposed capital requirements. In their view the percentage of invested assets requirement, will make it extremely difficult for many who currently operate MDA's to continue. The strong argument from them is that an MDA is very different from an MIS, so an equivalent capital requirement is not appropriate.

Resolving the Two Outstanding No-Action Positions

We are obviously aware that the Two No-Action positions are not universally known around the industry and are not publically available. There is no doubt that this is an ineffective way of providing guidance to the industry. Thus we support the incorporation of these no-action positions in the regulatory guidance.

With respect to family accounts, our position is as follows:

- We support the proposal that licensees would be exempt from having MDA authorization if they are only providing these services to family members. There is a different commercial involvement and relationship that occurs in the context of family members, and it is important that this is recognized (B1Q1).
- We do not support the need for any additional limitations on this position (B1Q2).
- We believe that it would be appropriate to add the parents of an adviser into the classification of family (B2Q1).
- Whilst we accept that Professional Indemnity Insurance is desirable, we also note that there are potentially a number of issues with this, including the fact that where it is a service that is not covered by the license, then it may be problematic. PI insurers may not be comfortable to provide cover for a service that is not included in the licensees authorizations. We recommend that this requires further consideration (B3Q1)
- We support the need for proactive monitoring of family focused MDA activity (B3Q5).
- We believe that due to the different nature of the adviser/client relationship, that IDR/EDR procedures and liabilities are complex. There is also an important consideration for the position of licensees, in that they would not be liable for any losses that the adviser experiences in their own portfolio, so they might question liability that would arise out of losses in the portfolio of a family member of an adviser (B3Q8).
- We support the family member providing formal acknowledgement of the specific considerations in the MDA arrangement (B3Q16).
- We support the proposal with respect to the management of a situation where the spouse of an adviser separates from the adviser. This is potentially a problematic situation and there needs to be appropriate protection for the spouse (B3Q18).

With respect to switches on regulated platforms, our position is as follows:

- We recognize the business requirement to enable timely re-adjustment of a client's portfolio, particularly in circumstances of model portfolios. The no-action position provided some genuine benefits in this regard, so we anticipate that there will be some concern that this no-action position is being removed and not replaced (B4Q1). We will await the feedback of other parties in the consideration of this matter.
- We support a transition period for the introduction of changes of this potential scale. It is quite possible that a number of businesses who are currently using this regulatory mechanism to rebalance their portfolio and therefore an appropriate transition period is necessary. We consider two years to be acceptable (B5Q1).
- We would support reduced requirements for an MDA operator who has all investments held through a regulated platform (B6Q1).

Updating Financial Requirements for MDA Operators

As stated previously, this is the issue that has generated the most concern from our members. We do not accept that MDA operators should be subject to the same financial requirements as the responsible entities of managed investment schemes. MDA operators and MIS schemes are very

different entities. Where an MDA operator does not act as a custodian and uses a regulated platform, the level of risk is significantly less (C1Q1 & C1Q2).

We would also like to express our concern about the NTA requirement of 0.5% of the value of client MDA assets. For a business with client MDA assets of $200m, that generates fees of 1.5% ($3m), the NTA requirement would be $1m on the client assets test and $300k on the revenue test. Clearly the client assets test is a significantly higher barrier than the revenue test and this seems to be a problematic outcome.

For smaller licensees who are MDA operators, a client book of $200m would not be unusual, however $1m in NTA would pose a significant complication. There is an expectation that this requirement will make it extremely difficult for many licensees, particularly those who are small to medium in size. This is likely to lead to the need for many businesses to discontinue offering MDA services which will have a flow through implication in the disturbance to the impacted clients.

We do not have any problem with the definition of 'client's portfolio assets', however we are obviously concerned about the implications of this test (C2Q2). As explained above, we do not consider that the revenue test will be the key factor, although we make the point that the revenue definition is somewhat complex (C2Q2).

Improving Disclosure for MDA Investors

We are offer the following feedback on this section:

- We do not have any objection with the requirement for an investment strategy (D1Q1).
- We support the proposal with respect to disclosure of outsourcing arrangements (D3Q1).
- We support the requirement to fully disclose upfront the termination arrangements and process (D4Q1).
- We do not oppose the proposed requirement that where giving effect to a client's decision to terminate an MDA arrangement that this should be done in a timeframe that is no longer than is reasonably necessary (D5Q1). We do however question the intended meaning of "no longer than is reasonably necessary". How long might this be and what further guidance can be provided.

Other Modifications to Guidance and Relief

Our feedback with respect to this section is as follows:

- We support the need for greater controls around the type of products that can be provided through an MDA arrangement. In particular we have particular concerns about the availability of non-limited recourse products (E1Q1).
- Our initial preference would be to prohibit these products, however we consider it important to be very clear on what products might be covered under any potential prohibition. In our view further consultation would be necessary on which products are to be excluded (E1Q2).
- Some form of client consent is essential when clients are taking on higher levels of risk (E1Q5).
- We do not have any particular problem with the proposed definition of non-limited recourse products, however we feel that this requires further consideration to assess specific product types. The regulatory guide should give specific examples (E2Q1).
- We support the proposed increase in the period required for the notification of a significant breach from 5 business days to 10 business days. It makes complete sense to align this with the requirements under Section 912D.

Updated Regulatory Guidance

Our feedback with respect to this section is as follows:

- We do not accept the view that an MDA is a financial product. We would argue that it is a service with respect to the provision of financial products. This is a point where there is some disagreement within the industry.
- We support the provision of detailed guidance on the new requirements with respect to MDA operators (F1Q1).
- We support the requirement for MDA operators to comply with the full range of FoFA obligations.
- Management of conflicts of interest is critical in the context of the discretion that MDA arrangements provide to advisers. Thus stringent controls on conflicts of interest are appropriate.
- We support the intention to provide MDA specific regulatory guidance on the FoFA reforms (F3Q1)

Implementation and Transition Period

There are significant changes proposed in this consultation paper, so we support the need for appropriate transition arrangements. Our feedback is as follows:

- We accept that it is reasonable to expect that new MDA operators should comply with the new requirements, however we would raise the point that some people who are already in the process of applying (or may be at the time the regulatory guide is finalized), may have already spent a significant sum of money in seeking authorization, so these changes could cause significant disruption and potential loss if they were unable to proceed (H1Q1 & H1Q2).
- The transition period for existing MDA operators needs to be considered in the context of the scale of the change and the likely time to prepare. The Consultation Paper suggests that final guidance will only be released at the end of 2013. Thus in respect to existing MDA operators needing to meet the financial requirements and the other obligations, 6 months does not seem to be a reasonable period. I would suggest that they should have at least 12 months to prepare for the changes from the time of the finalization of the regulatory guide. This will also assist in managing the impact upon clients. If the licensee does not believe that they can meet the financial requirements, then they need time to find a solution or exit the MDA operator business.

Conclusion

We thank you for the opportunity to provide feedback on the regulatory approach to managed discretionary accounts. This paper involves significant change, some of which will have a major impact upon the businesses of MDA operators. These implications need to be carefully considered.

Should you have any questions, please do not hesitate to contact me on 02- 9267 4003.

Yours sincerely,

Philip Anderson

Chief Operating Officer