ASIC
Australian Securities & Investments Commission

REPORT 496

Response to submissions on CP 200 Managed discretionary accounts: Update to RG 179

September 2016

About this report

This report highlights the key issues that arose out of submissions received on Consultation Paper 200 *Managed discretionary accounts: Update to RG 179* (CP 200) and details our responses to these issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Contents

A Overview

1 ASIC is responsible for regulating managed discretionary account (MDA) services provided to retail clients.

2 An MDA service comprises some or all of the services and functions involved in providing an MDA. An MDA is a facility, other than a registered managed investment scheme (registered scheme) or an interest in a registered scheme, with the following features:

(a) a person (client) makes contributions;

(b) the client portfolio assets are managed on an individual basis by another person (MDA provider) at the MDA provider's discretion (subject to any agreed limitation); and

(c) the client and the MDA provider intend that the MDA provider will use the client portfolio assets to generate a financial return or other benefit for the client.

3 There are a wide variety of arrangements that can constitute an MDA. Industry uses different terminology to refer to services that may have the relevant features of an MDA. For example, products more commonly known by industry as a separately managed account, individually managed account or a unified managed account may fall within the definition of an MDA.

4 We consider that an MDA generally falls within the definition of both a 'managed investment scheme' under s9 of the Corporations Act and a 'facility for making a financial investment' under s763B of the Corporations Act.

5 We regulate MDAs as a financial product. If you enter into a contract with a client to provide an MDA, we treat you as the issuer of a financial product. However, we recognise that MDAs also involve a range of functions and services, such as offering and trading in financial products, operating a custodial or depository service, and giving personal advice.

6 ASIC's guidance and requirements for MDAs are set out in Regulatory Guide 179 *Managed discretionary account services* (RG 179) and Class Order [CO 04/194]—which is being replaced by ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968.

7 We apply a tailored regulatory regime to MDA providers, giving relief from the managed investment scheme provisions in Ch 5C of the Corporations Act, and the financial product disclosure provisions in Ch 6D and Pt 7.9 of the Corporations Act. We do this on the basis that MDA providers have more limited functions than responsible entities of registered schemes.

8 To benefit from our relief, MDA providers must comply with the AFS licensing and conduct requirements in Pts 7.6–7.8 of the Corporations Act—and some additional conduct requirements designed to promote protection for investors and financial consumers.

Consultation process

9 In Consultation Paper 200 *Managed discretionary accounts: Update to RG 179* (CP 200), we proposed to modify some areas of our guidance and conditions of relief to resolve ambiguities in the current requirements, to ensure that our regulatory requirements for MDAs are consistent with those that apply to comparable financial products, and to promote confident and informed investors and financial consumers.

10 In particular, we set out our proposals in CP 200 on:

(a) revoking two outstanding, ASIC-issued, no-action letters on MDAs for family members and MDAs operated on regulated platforms;

(b) consolidating ASIC's no-action position on MDAs for family members into our relief instrument and imposing limited conditions on the operation of these accounts;

(c) requiring MDA providers to meet enhanced financial resource requirements;

(d) requiring MDA providers that provide custodial and depository services, and external MDA custodians, to meet enhanced financial requirements;

(e) modifying our relief instrument to impose specific conditions when an MDA provider has a discretion to invest retail clients' portfolio assets in products or arrangements where recourse is not limited (e.g. contracts for difference);

(f) requiring disclosure about how clients may terminate their MDA contract;

(g) requiring disclosure about the operation of outsourcing arrangements in particular circumstances; and

(h) updating our guidance to reflect the changes in the law that have been implemented as part of the Future of Financial Advice (FOFA) reforms.

11 This report highlights the key issues that arose out of the submissions received on CP 200, and our responses to those issues.

12 This report is not intended to be a comprehensive summary of all the responses we received. It is also not meant to be a detailed report on every question from CP 200. We have limited this report to the key issues.

13 For a list of the non-confidential respondents to CP 200, see the appendix. Copies of these submissions are available on the ASIC website at www.asic.gov.au/cp under CP 200.

14 We have now released our final guidance in the updated RG 179 and a new legislative instrument—ASIC Corporations (Managed Discretionary

Account Services) Instrument 2016/968—which has been registered on the Federal Register of Legislation.

15 We will assess whether there is a need for further guidance or regulation after observing how industry complies with the updated requirements, and in light of our regulatory experience and any case law on these obligations.

Responses to consultation

16 We received 37 responses to CP 200 (including 22 confidential responses) from industry associations, MDA providers, banks, financial advisory firms and legal practitioners. We are grateful to these respondents for taking the time to send us their comments.

17 Additionally, we met with a number of industry associations to discuss our proposed guidance.

18 Respondents were generally supportive of ASIC's program to review the guidance and the relief instrument for providing MDA services, although several respondents raised concerns about specific aspects of our proposals.

19 Sections B–H of this report set out in more detail the issues raised during consultation, and our responses to those issues.

B Resolving the two outstanding no-action positions

Key points

This section outlines the key issues raised in submissions on Section B of CP 200, and gives details of our response to those issues.

It covers our proposed guidance on:

- MDAs for family members; and
- regulated platform MDAs.

MDAs for family members

20 In CP 200, we proposed that ASIC revoke the no-action letter on MDAs for family members and modify our legislative relief to exempt AFS licensees from the requirement to obtain licence authorisations to deal in MDAs and provide advice on MDAs if the only MDAs they operate are MDAs for family members or the family members of their representatives.

21 We argued that the policy position—previously in place through the no-action letter—should remain because this would avoid imposing regulatory requirements applying to MDAs on AFS licensees that only operated MDAs in this limited 'family account' sense.

22 Respondents agreed with our proposal to remove the no-action letter and generally supported our approach. Respondents who did not support ASIC's approach were split between two groups: those who argued that there should be no exemption; and those who suggested that the provision of MDA services for family accounts was a private arrangement and should not be regarded as a financial service subject to the provisions of the Corporations Act.

23 A number of respondents disagreed with the definition of 'family', as proposed in CP 200. Many respondents suggested that the proposed definition—limiting family to a spouse and non-adult children—was too restrictive and should be expanded to include parents and other immediate family. One suggestion was for ASIC to adopt the definition of 'certain family relationships' contained in s9AA of the Corporations Act.

24 Some submissions suggested that, if we were worried about our relief being misused, we could take greater comfort in limiting the proposal to market participants.

25 On the limited conditions that we proposed to apply to the family account exemption, a number of respondents were against the requirement to obtain

professional indemnity and fraud insurance to cover family accounts. This opposition resulted from the difficulty in obtaining professional indemnity insurance to cover family members, and in obtaining insurance that covered activities that did not fall within the AFS licensee's authorisation.

ASIC's response

We consider it appropriate to give relief where the MDA services provided are limited to MDAs for family members of market participants. This is consistent with the relief offered under the no-action letter.

It is a condition of our relief that the market participant must maintain adequate policies and procedures about monitoring and supervision to ensure that all discretions exercised under the MDA are within the powers agreed by the family member. The ASIC market integrity rules contain rules about management and supervision. Supervision of trading activities happens on a daily basis and in real time.

We consider that restricting the no-action position to market participants limits the potential for this relief to be misused.

We think that relief is appropriate because of the alignment of interests and high level of trust that generally exist between spouses and their non-adult children.

Following feedback, and consultation with the insurance industry, we are not proceeding with the proposal that those who operate MDAs for family members require professional indemnity and fraud insurance.

We consider some limited conditions are required to protect the interests of family members. These are reflected in our relief instrument.

We have defined 'family member' as 'spouse or non-adult child', which is consistent with the definition of 'immediate family' under the ASIC Market Integrity Rules (ASX Market) 2010. We are therefore using a definition that our stakeholders are already familiar with. This also corresponds with the rationale for the relief—that is, the alignment of interests and trust that exists between immediate family members.

Regulated platform MDAs

26 In CP 200, we proposed to revoke the no-action letter for MDAs provided on a regulated platform (also known as 'limited MDAs'), and to modify our guidance to specify that these arrangements would be regulated as MDAs and that AFS licensees that undertook this activity would need to obtain the relevant licence authorisations. We proposed that providers of regulated platform MDAs should comply with the same requirements as other MDA providers—with some exceptions, where certain functions were performed by the regulated platform.

27 Our proposal to require regulated platform MDAs to meet the AFS licensing requirements of MDAs generated many comments, both for and against the proposed changes.

28 Some respondents agreed that these providers should be subject to the same AFS licensing requirements as other MDA providers. They felt that this approach would ensure a level playing field for all MDA providers. Respondents also submitted that this would provide legal clarity.

29 However, a number of respondents felt that our proposals may contribute to a reduction in the number of regulated platform MDAs, which may limit consumer choice—we note that many of these responses also cited the proposal for increased financial resource requirements: see Section C.

30 Several respondents suggested that we should implement a two-tiered system for obtaining the relevant AFS licence authorisations: the first for providing full MDA services and the second for providing an MDA on a regulated platform.

31 A number of respondents stated that implementation of the new arrangements, including AFS licence applications and ongoing compliance measures, would increase costs for regulated platform MDAs. They submitted that the increased costs would ultimately be passed on to clients. However, as one respondent submitted, these costs were already borne by MDA providers who had obtained the relevant authorisations on their licence rather than relying on the no-action letter to implement an unlicensed MDA.

32 Most respondents agreed with our proposal to exempt the providers of regulated platform MDAs from certain reporting requirements, where these requirements were met by the operator of the regulated platform.

33 In CP 200, we said that, during the transition period, when we assess applications from MDA providers who are relying on the no-action letter to obtain the relevant AFS licence authorisations, we would take into consideration the experience gained by the licensee under the no-action letter for regulated platform MDAs.

34 Respondents requested that we provide guidance on how we would assess previous experience. Some respondents also asked for guidance on what services could be provided by a financial adviser without the need for an AFS licence authorisation to provide MDA services (i.e. a deal by issue authorisation).

35 One industry association suggested that MDA providers operating under a limited power of attorney should be excluded from the AFS licensing obligations, where the trading discretion was confined to the time or price at which transactions could be effected.

36 Respondents generally felt that a two-year transition period was adequate, although a number of respondents stated that this would depend on the final form of our guidance.

ASIC's response

We consider it appropriate to revoke the regulated platforms no-action letter and require providers of regulated platform MDAs to comply with AFS licensing and other requirements that are similar to those that apply to other MDA providers, except for the requirement to provide transactional reports and auditor reports.

AFS licensees that have operated regulated platform MDAs will be able to rely on this experience when applying for the licence authorisation to provide MDA services.

Recognising the experience gained under the no-action position will not automatically guarantee that we grant applicants the relevant AFS licence authorisation. Among other things, AFS licensees will still be required to demonstrate that they:

- have relevant skills and training;
- will maintain adequate risk management systems;
- will be able to comply with the legislative instrument; and
- are of good fame and character.

We consider that this approach strikes the right balance:

- Requiring MDA providers to hold an AFS licence will ensure that all MDA providers are regulated by ASIC.
- Recognising the experience gained while operating under the no-action position will help to avoid these AFS licensees ceasing their MDA business.

We have provided guidance in the updated RG 179 on when an AFS licence authorisation to provide MDA services will be required.

In RG 179, we clarify that, if the trading discretion given to an MDA provider is confined merely to the time or price at which transactions may be effected, we do not consider that this arrangement constitutes an MDA.

C Updating financial requirements for MDA providers

Key points

This section outlines the key issues raised in submissions on Section C of CP 200, and gives details of our responses to those issues.

It covers our proposed guidance on:

- financial requirements for MDA providers that do not provide custodial and depository services; and
- financial requirements for MDA providers that do provide custodial and depository services.

Net tangible asset requirements

MDA providers that do not provide custodial or depository services

37 In CP 200, we proposed that MDA providers should meet updated financial requirements that are similar to the requirements that apply to responsible entities of registered schemes.

38 In particular, we proposed that MDA providers that do not provide custodial or depository services must at all times hold minimum net tangible assets (NTA) the greater of:

(a) $150,000;

(b) 0.5% of the average value of all the client portfolio assets of the MDAs operated by the MDA provider up to a maximum NTA of $5 million; or

(c) 10% of the provider's average MDA revenue with no maximum NTA.

39 In CP 200, we stated that it was desirable for MDA providers and responsible entities to be required to meet the same financial requirements because their functions were similar in many key respects. However, respondents to CP 200 argued that the requirements were unnecessary for MDA providers because, in an MDA, the client holds a direct legal or beneficial interest in the underlying assets. In a registered scheme, the client has an interest in the trust fund as a whole, rather than a specific beneficial interest in particular assets.

40 Respondents submitted that the consequences of business failure for MDA clients were limited, as it was simpler for them to re-assert control or ownership over the client portfolio assets. Respondents also nominated the

prohibition on pooling MDA assets for investment purposes, which is a condition of our relief, as a feature that reduces the risks for MDA clients compared with registered scheme members.

41 Respondents generally acknowledged the need to maintain adequate financial resources, although most submitted that the proposed NTA requirement was too high. Some respondents felt that smaller MDA providers would have difficulty meeting the NTA requirement, which they said would benefit larger MDA providers to the detriment of industry competition, as well as increasing barriers to entry for new entrants into the MDA market.

42 A large number of respondents submitted that the proposed NTA requirements did not reflect the lower risks faced by providers of regulated platform MDAs (or limited MDAs). They noted that, for MDAs operated on a platform, key administrative and custodial functions were undertaken by third-party providers, who must themselves meet financial requirements. Respondents anticipated that the proposed NTA requirement would result in a significant number of providers of regulated platform MDAs ceasing to provide these services. They suggested that a lower NTA requirement should apply to these providers.

43 Several respondents requested that the proposed definition of 'average MDA revenue' be limited to revenue from MDA services, as many MDA providers provide other services within their financial services businesses. They submitted that including these services would significantly increase the amount of NTA MDA providers were required to hold.

ASIC's response

We have not adopted, at this time, the proposed NTA requirements in CP 200 for MDA providers that do not provide custodial or depository services.

The feedback we received has highlighted the range of ways in which MDA providers operate, and we consider that further analysis is required before implementing changes to the financial resource requirements.

Further, the lack of clarity in the industry at present, caused by the no-action positions, makes it difficult for us to assess the impact of our proposals.

We will be reviewing the financial resource requirements over the next two years as additional MDA providers obtain the relevant AFS licence authorisations, and we can assess the impact of other changes to our MDA policy.

MDA providers that provide custodial or depository services

44 In CP 200, we proposed that MDA providers responsible for holding client portfolio assets should meet the same requirements as those that apply to responsible entities that hold scheme property.

45 In particular, we proposed that—unless the MDA provider arranges for the client portfolio assets to be held by an AFS licensee who is authorised to provide custodial or depository services other than as an incidental provider or a body regulated by the Australian Prudential Regulation Authority—MDA providers that provide custodial and depository services must at all times hold minimum NTA the greater of:

(a) $10 million; or

(b) 10% of the provider's average MDA revenue with no maximum NTA.

46 We proposed to exclude MDA providers who are responsible for holding client portfolio assets from the definition of 'incidental custodial or depository services', as defined in RG 166. This means that MDA providers would not be able to fulfil their NTA obligations by meeting the reduced minimum NTA requirements for providers of incidental custodial or depository services.

47 Many respondents did not provide detailed feedback on this proposal, but instead provided detailed feedback on our proposals about imposing tailored financial resource requirements on MDA providers that do not provide custodial or depository services. They then repeated, or re-emphasised, this feedback in response to our proposal on MDA providers that do provide custodial or depository services.

ASIC's response

We have not adopted, at this time, the proposed NTA requirements in CP 200 for MDA providers that provide custodial or depository services. This corresponds with our decision for financial resource requirements for MDA providers generally.

The financial resource requirements for MDA providers that provide custodial or depository services will be incorporated into our review of the financial resource requirements for MDA providers that do not provide custodial or depository services.

We note that AFS licensees undertaking custodial or depository services are currently required to meet the financial resource requirements, as set out in RG 166.

D Improving disclosure for MDA investors

Key points

This section outlines the key issues raised in submissions in Section D of CP 200, and gives details of our responses to those issues.

It covers our proposed guidance on:

- the investment program and investment strategy;
- disclosure of fees charged within an MDA;
- outsourcing arrangements (where these are used); and
- how an MDA contract may be terminated.

The investment program, MDA contract and advice about the MDA

48 In CP 200, we proposed to refine our conditions relating to the MDA contract, investment program and financial advice to make it clear that:

(a) the investment program forms part of the MDA contract;

(b) the investment program must contain an investment strategy;

(c) the investment strategy must contain sufficient detail to permit an opinion to be formed on the suitability of an investment program for each client; and

(d) the MDA provider, or an external MDA adviser, must provide personal advice about the MDA contract on an annual basis.

49 A majority of respondents were in favour of the clarifications proposed by ASIC.

50 Respondents suggested that we should provide additional information on the definition of ‘investment strategy’ and what the investment strategy should include.

51 All respondents agreed with our proposed guidance to clarify that personal advice about the MDA must state that the MDA contract, including the investment program, is appropriate to the client’s objectives, financial situation and needs (client’s relevant circumstances). An industry association further suggested that we should require explicit statements about the suitability of an MDA service, the specific contract and the investment program.

52 On the annual review, one industry association suggested that—where clients had declined to attend the review, or did not respond to an invitation to attend the review—the MDA services should be allowed to continue.

Another industry association suggested that the review should be every two years, rather than every year.

53 Some arguments against our proposals about the investment program, raised in submissions, were that:

(a) increased information provided to clients may prevent them from properly examining the MDA agreement;

(b) clients were not required to appoint advisers to invest in managed investment schemes, and therefore investors should be permitted to maintain an MDA investment without an adviser; and

(c) ASIC should not restrict the flexibility about where specific content should appear in disclosure documents for MDAs.

54 One industry association supported our proposal to allow advice to be given by record of advice as an alternative to a Statement of Advice.

ASIC's response

We have adopted the proposed measures. The requirement for the MDA contract to include an investment program, which includes an investment strategy, is a pre-existing requirement in [CO 04/194].

We know that, in practice, MDA providers and advisers generally include specific statements about the investment strategy within the investment program. We have formalised this process by making it an explicit requirement under our relief instrument.

It is an existing requirement that an MDA provider, or an external MDA adviser, must give each client personal advice about whether the MDA contract and investment program are suitable in light of the client's relevant circumstances at least once every 13 months.

Fee disclosure

55 In CP 200, we proposed to clarify that the FSG and MDA contract should contain information about the fees and costs of the MDA in a manner that is consistent with Sch 10 of the Corporations Regulations.

56 Feedback on this proposal was mixed, with approximately half of the respondents agreeing with our approach. A number of the responses in support of the proposal stated that it would assist investors in making investment decisions.

57 Many respondents were against the proposal. One industry association stated that FSGs were generic and included a group of services. The client only paid for the services that were applicable, and this was determined after the FSG was given. This was supported by another industry association, which

stated that this proposal would be likely to lead to sweeping statements about fees, rather than meaningful descriptions of fees that may apply.

58 A number of responses favoured the use of the words 'consistent with Schedule 10' as they stated that not all MDA fee structures lent themselves to the format of Sch 10.

59 Some responses suggested that this proposal would not lead to investors making more informed investment decisions because such investment decisions were made on all the relevant information as a whole, including the strategy and performance of an MDA.

ASIC's response

We have adopted the proposed measures.

Our relief in ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968 will require disclosure that is consistent with Sch 10 of the Corporations Regulations, as modified in relation to managed investment schemes.

The relief instrument makes explicit requirements about fee disclosure that are already implicit in our requirements for the content of the FSG.

We think it is important that fee information is also included in the MDA contract because this sets out the terms that govern the relationship between the MDA provider and the client.

Outsourcing arrangements

60 In CP 200, we proposed to require the FSG for an MDA to provide a description of the operation of outsourcing arrangements that apply to the MDA, where relevant.

61 Approximately three-quarters of respondents agreed with our approach. Respondents believed that it should be clear which functions were delivered under which AFS licence authorisations.

62 Where respondents disagreed with this proposal, the underlying rationale was that:

(a) it was not necessary to give details of the outsourcing arrangements, as long as individual providers took responsibility for their outsource providers; and

(b) it would be inefficient to alter the FSG every time there was a change in outsourcing arrangements, and the arrangement could be adequately explained in the SOA.

63 One response argued that there should be no requirement to disclose outsourcing arrangements in the FSG when only administrative functions (rather than advice and transactional functions) were outsourced.

ASIC's response

We have adopted the proposal to require additional disclosure about outsourcing arrangements in our relief instrument.

Under [CO 04/194], MDA providers were required to give additional disclosure where external MDA advisers and custodians were used. MDA providers were also required to make any disclosures that might reasonably be expected to influence the investors' decision.

As such, we believe that the requirement to give details of outsourcing arrangements provides clarity but does not alter pre-existing obligations.

We also note the broad support for the proposal.

Terminating the MDA

64 In CP 200, we proposed that the FSG and the MDA contract should contain certain information, including:

(a) how the client may communicate an instruction to terminate the MDA contract;

(b) the length of time required for termination to take effect;

(c) how the client portfolio assets will be disposed of, or transferred to the client, if those assets are not held directly by the client; and

(d) the requirement to develop a policy outlining the steps for termination of an MDA contract and disclose that policy to investors.

65 On this issue, all respondents but one agreed with the proposal to require disclosure of how clients may terminate the MDA contract. While a majority of these agreed that the information should be contained in both the FSG and the MDA contract, a substantial number (including two industry associations) submitted that the information should only be contained in the MDA contract, and not in the FSG. They argued that termination of the contract was complex and the FSG was not the appropriate place to provide these details.

66 Nearly all respondents submitted that the additional disclosure would assist retail clients in better understanding the operation of an MDA contract. In addition to this, two submissions (including one from an industry association) suggested that AFS licensees should give clear details of any applicable notice periods and ensure that the contract contained a clause stating that the MDA provider would comply with client termination instructions in a timely manner.

67 Most respondents, including industry associations, agreed with our requirement to develop and disclose a policy outlining the steps the MDA provider would take to terminate an MDA contract.

68 However, the majority of respondents disagreed with the proposal to disclose the details of this policy in the FSG. Instead, they suggested the information should be provided in the MDA contract. It was stated by a number of respondents that including this information in the FSG would lengthen and complicate the FSG, which was contrary to its purpose. Further to this, an industry association suggested that some MDA providers operate a number of different policies, each with different policy requirements regarding termination, and these would not be compatible with the FSG.

ASIC's response

We have adopted the proposal to require details on terminating the MDA to be included in the MDA contract.

However, we are not requiring this information to be included in the FSG. We agree that including termination details in the FSG would lengthen and complicate the document. We consider that, because termination of the MDA is a contractual issue, disclosure in the contract will be sufficient.

To operate their MDAs effectively and efficiently, MDA providers should have policies and procedures in place to ensure the orderly exit of clients from MDA contracts.

E Other modifications to our guidance and relief

Key points

This section outlines the key issues raised in submissions in Section E of CP 200, and gives details of our responses to those issues.

It covers our proposed guidance on:

- investing in arrangements where recourse is not limited; and
- MDA clients that become *non compos mentis* or 'of unsound mind'.

Investing in arrangements where recourse is not limited

69 In CP 200, we proposed to modify [CO 04/194] to impose specific conditions on MDA providers where the providers have discretion to invest in financial products or investment strategies with non-limited recourse.

70 Responses on this issue were generally supportive of the need to impose specific conditions on MDA providers.

71 Of those agreeing with the need for specific conditions, the majority supported the MDA provider being required to include a specific risk warning in the FSG, and in each client's investment program, outlining the risks to the client as a result of the MDA provider investing in a non-limited recourse arrangement.

72 Respondents suggested that ASIC should provide guidance on the issues that the specific risk warning should cover—but not provide standardisation, because disclosure would need to be tailored to take into account the product or arrangement being used.

73 A number of respondents disagreed with the proposal that investment by MDA providers in non-limited recourse products or arrangements under an MDA should be restricted to wholesale investors. They argued that ASIC had no right to effectively ban retail access to such products.

74 Our other proposals in this section did not receive many comments. The comments we received were generally supportive.

ASIC's response

Our solution has been to adopt a compromise position whereby MDA providers must seek prior written consent from the client if they are going to invest their client portfolio assets in a non-limited recourse product. This consent must be separate to the MDA contract, and will require the client to be shown a worked example demonstrating the amount they could lose on the product. Once granted, the consent will be valid for future transactions in non-limited recourse products of the type agreed to in the consent.

We will also require the worked example and the additional risk disclosure to be contained in both the FSG and the MDA contract.

We consider non-limited recourse products or arrangements to be riskier than financial products with quantifiable maximum recourse. We also consider that investing in non-limited recourse products or arrangements through an MDA creates additional risks for investors. This is because, unlike other investors, MDA clients do not need to consent to each transaction before the MDA provider invests in such products on their behalf.

In light of the additional risk and the potential significant adverse impact on investors, we consider it appropriate to give retail investors the opportunity, before entering into a transaction, to assess the riskiness of the products or arrangements, and the skills and experience of the MDA provider in dealing with these products (e.g. the ability of the MDA provider to continuously monitor investments and respond spontaneously to protect the investor's interests).

75 In CP 200, we consulted on whether other classes of investment products or strategies—in addition to contracts for difference and over-the-counter derivatives—should be subject to the conditions applied to products with non-limited recourse arrangements.

76 Responses to this question were mixed, with some suggesting that the scope was already wide enough, while others suggested that more classes of investment should be subject to the conditions. Suggestions included:

(a) any margin loan;

(b) financial products that have a component of leverage; and

(c) unlisted products, such as private equity instruments, where exiting a position can be costly.

77 One suggestion was for ASIC to provide guidance on which products would be covered by the definition of 'non-limited recourse product or arrangement' and allow MDA providers to assess whether particular products fell within the definition. One industry association suggested a 'carve out' so that the restriction on derivatives did not extend to the use of covered calls.

78 The majority of respondents were supportive of the proposed definition of 'non-limited recourse product or arrangement'. However, a few submissions (including one from an industry association) argued that the proposed definition was too restrictive and should not be included. Respondents argued that clients were protected by annual personal advice and the investment parameters. It was suggested that, if the restriction were applied, it should only apply to products where losses were open-ended, or unquantifiable.

79 No responses provided an alternative definition, although some asked for examples to be provided to demonstrate which products the definition would cover.

ASIC's response

Given our focus on investor and financial consumer protection, we have defined 'non-limited recourse product' broadly. We consider that, in doing this, we provide greater certainty to MDA providers about their obligations and is easier to supervise.

We have defined 'non-limited recourse product' as follows:

> Non-limited recourse product in relation to a person means a facility held by, or on behalf of, the person which includes an obligation:
>
> (a) requiring the person that is the client (first person), or the person holding the facility on behalf of the client (first person), to provide consideration to another person in the event of the occurrence or non-occurrence of an act, matter or thing (including the occurrence of a date); and
>
> (b) in relation to which obligation, the rights of the other person are not limited to the following:
>
> (i) rights to property (if any) that the first person has paid or set aside as security for the performance of the obligation; and
>
> (ii) rights to set off the obligation of the first person to provide the consideration against a liability (if any) of the other person to the first person.

MDA clients that become *non compos mentis* or of unsound mind

80 In CP 200, we consulted on a proposal to modify the reporting requirements in our relief so that, when a licensed trustee company is acting as an attorney under an enduring power of attorney and is providing an MDA service to a client under our relief, if the client subsequently loses legal capacity as a result of becoming of unsound mind, the trustee company would be required to:

(a) maintain and prepare the ongoing disclosure documentation required under the MDA relief and retain a copy for seven years; and

(b) give the documentation to the next of kin of the client; or

(c) where there is no next of kin, or it is not appropriate or practicable to give the documentation to the next of kin, the documentation may be provided to a guardian, administrator or manager of the client.

81 Most responses did not engage with this issue although the proposal received some support.

82 One submission against the proposal (from an industry association) stated that the proposal was inconsistent with the MDA client granting a power of attorney to a third party to receive disclosure on their behalf. It was argued that the MDA provider should not send disclosure documentation to parties who have no legal right to make a decision about the documents.

83 This response also suggested that the issue of clients becoming of unsound mind should be addressed more broadly across the whole financial services regime, and not just in relation to guidance on MDAs.

84 It was submitted to us that an attorney under an enduring power of attorney is also subject to common law fiduciary duties to the incapable donor and a number of duties under the Powers of Attorney Acts in each state and territory to, among other things:

(a) act honestly, diligently and in good faith;

(b) not use the position for profit;

(c) avoid acting where there is or may be a conflict of interest;

(d) not disclose confidential information gained as the attorney under the power unless authorised by law; and

(e) keep accurate records and accounts.

85 It was further submitted that, where an MDA provider is also the holder of the power of an enduring power of attorney and the MDA client becomes of unsound mind, the MDA ceases.

86 Responses did not highlight the potential costs of this proposal; however, it was suggested that there may be some costs involved in duplicating disclosure documents.

ASIC's response

We are not proceeding with this proposal.

We do not accept the argument by industry that an MDA issued under an enduring power of attorney will cease if the client becomes of unsound mind. It does not necessarily 'fall away'. While an MDA may cease when issued under a general power of attorney—depending on the individual circumstances, this will not necessarily be the case for enduring powers of attorney.

If a client becomes of unsound mind, the obligation to give them the disclosures required by the legislative instrument or the Corporations Act may continue unaffected, depending on the circumstances. Where this occurs, the requirement under the relief to give the client disclosures, such as annual reports, cannot be met by the disclosure being 'given to' or retained by the MDA provider, even if the provider is acting under an enduring power of attorney.

Despite our view that clients involved in MDA arrangements assume a large amount of risk if they become of unsound mind, we understand from industry that this is an issue which will arise in limited circumstances and, if relief is sought, should be considered in the context of the specific MDA services described in an application for individual relief.

F Other modifications to our guidance and relief

Key points

This section outlines the key issues raised in submissions on Section F of CP 200, and gives details of our responses to those issues.

It covers our proposal to clarify our guidance on the scope and application of our relief for MDAs. It also covers our proposed guidance on:

- conflicts of interest;
- FOFA reforms and MDAs; and
- ASX Guidance Note 29.

Clarification of our guidance

87 In CP 200, we proposed to revise RG 179 to provide additional regulatory guidance on the scope and application of our relief for MDAs. We proposed to:

(a) make it clearer what arrangements are captured by our guidance on MDAs;

(b) clarify in our guidance that, for an arrangement to meet the definition of an MDA, the client and the MDA provider *intend* that the MDA provider will use the client contributions to generate a financial return, or other benefit;

(c) clarify that we consider MDAs to be financial products, which also involve the provision of financial services;

(d) provide guidance on what AFS licence authorisations are required for different MDA activities; and

(e) clarify that, as well as meeting professional indemnity and fraud insurance requirements, MDA providers must meet the requirements imposed on all AFS licensees in Regulatory Guide 126 *Compensation and insurance arrangements for AFS licensees* (RG 126).

88 This proposal received broad support from respondents, including industry associations.

89 Suggested topics for improved guidance included clarifying whether review requirements can be met with a record of advice, and giving guidance on different MDA arrangements involving multiple parties such as planners and investment specialists.

90 One suggestion was for ASIC to clarify the precise AFS licence authorisations required to offer MDA services, especially to retail clients, and to clarify what is not required for wholesale clients.

ASIC's response

We have implemented the proposals at paragraph 87.

Conflicts of interest

91 In CP 200, we proposed to provide more detailed guidance about our expectations for MDA providers in relation to managing conflicts of interest.

92 The overwhelming majority of respondents supported both the giving of guidance by ASIC in this area and the guidance proposed. There was a particular focus, in some responses, on ASIC giving examples to demonstrate the practical application of the obligations.

93 In relation to whether an MDA provider with a material conflict of interest should be required to disclose that conflict before entering into a transaction, responses were supportive but differed on when the interest should be disclosed. Some respondents suggested that any foreseeable conflict could be noted in the MDA contract or Statement of Advice, while one suggested that approval should be sought as the need arises.

94 One respondent said that, while the disclosure of material conflicts of interest was necessary, this was already covered by the FOFA reforms, and therefore guidance was not required in an MDA-specific context.

ASIC's response

We have provided additional regulatory guidance in RG 179 dealing with managing conflicts of interest as an MDA provider.

FOFA reforms and MDAs

95 In CP 200, we proposed providing specific regulatory guidance for MDA providers on the FOFA reforms, and the regulatory reforms relating to breaching conditions of relief. We asked respondents if there were specific areas on which they would like guidance.

96 The majority of respondents asked for guidance, stating that it would provide greater clarity for MDA providers.

97 While the majority of respondents agreed that ASIC should provide guidance for breaches of relief conditions, some were concerned that paragraphs 129–134 of CP 200—which outlined our proposed guidance—were confusing and possibly ambiguous in certain circumstances.

ASIC's response

We have decided not to proceed with this proposal.

While the proposal was designed to provide certainty for MDA providers, feedback suggested that the proposed guidance would create greater uncertainty.

Instead, we cross-refer, in the updated RG 179, to other ASIC regulatory guides that deal with FOFA.

ASX Guidance Note 29

98 In CP 200, we proposed to withdraw ASX Guidance Note 29—which contains guidance about MDAs for market participants—and incorporate that guidance in the updated RG 179.

99 Respondents were overwhelmingly in favour of this proposal, with only one of eight respondents disagreeing with the proposal.

ASIC's response

We have proceeded with this proposal.

We have incorporated ASX Guidance Note 29 into the updated RG 179 by integrating the information across the regulatory guide generally, rather than including it in a specific location.

G Implementation and transition period

Key points

This section outlines the key issues raised in submissions on Section H of CP 200, and gives details of our responses to those issues.

It covers our proposed guidance on the implementation and transition period for new and established MDA providers.

New MDA providers

100 In CP 200, we proposed that new MDA providers should comply with any revised regulatory guidance and conditions of relief from the date on which the guidance and relief instrument were released.

101 This proposal was supported by respondents to this issue.

Established MDA providers

102 In CP 200, we proposed to provide existing MDA providers with staged transition periods in which to comply with the new requirements in our relief instrument and our revised regulatory guidance.

103 Responses to these time periods were mixed. Most focused on the proposed transition periods for the updated financial resource requirements, which we are not proceeding with at this time.

ASIC's response

We recognise that the timing of any transition period has changed, following the delays in finalising the MDA policy.

Existing MDA providers must comply with the new requirements from 1 October 2017. If you are first authorised to provide MDA services on or after 1 October 2016, you must comply with the new requirements in our relief instrument and our revised regulatory guidance from the date of authorisation.

Established MDA providers currently relying on the no-action position on regulated platform MDAs must comply with the revised requirements from 1 October 2018.

Appendix: List of non-confidential respondents

- Association of Financial Advisers
- Australian Financial Markets Association
- Bailey Roberts Group
- Boutique Financial Planning Principals Group
- Colonial First State
- Financial Planning Association of Australia
- Financial Services Council (includes supplementary submission)
- Institute of Managed Account Providers
- McCullough Robertson
- MoneyPlan Australia Pty Ltd
- Pajeska Group Pty Ltd
- Puzzle Financial Advice Pty Ltd (includes addendum to original submission)
- Securities & Futures Compliance Services Pty Ltd
- Stockbrokers Association of Australia
- Westpac Group