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Australian Securities and Investments Commission
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Via email: rri.consultation@asic.gov.au

Dear Ms Hadisutanto,

Thank you for the opportunity to make a submission in relation to the proposed review of CP385 and draft RG181.

In this submission we make specific reference to issues that arise in areas of retail financial services which pertain to the creation, management and advice on managed accounts. These are generally offered as either as products, generally registered managed investment schemes (colloquially SMAs or Managed Portfolios) or services, as Managed Discretionary Accounts (MDAs offered under CI2016/968 and RG179).

The provision of managed accounts and the personal advice which relates to them is, perhaps obviously, intended to;

- create and manage portfolios of assets, which;
- are more likely than alternatives, to;
- enable an investor to achieve their specific investment objectives.

In commenting on the proposed revision of RG181, we will have reference to the provision of managed account products and services rather than other retail financial services.

Legislative Framework

The regulation of conflicts of interest should be considered in the broad context of other fundamental obligations relating to the provision of financial services. In particular, we want to reference;

- Obligations on all AFSLs to deliver services “Efficiently, Honestly, Fairly”
Corporations Act s912 A (1) (a)

- A requirement to “have in place adequate arrangements for the management of conflicts of interest that may arise.” s 912 A (1) (aa)
- The obligation on all AFSs to have adequate resources (financial, technological and human) s912A (1) (d)
- Best interest duty of advisers s961B
- A requirement to ensure that, in respect to the receipt of benefits, “consent is ‘clear’ if it is genuine, express and specific” RG246.44
- Advisers’ obligations to comply with the Code of Ethics, and in this context specifically Standard 3 “You must not advise, refer or act in any other manner where you have a conflict of interest or duty.”

This intersecting set of potentially conflicting obligations, those cited above and others, is specifically called out in the draft of RG181. In some cases the obligations are in conflict and the Code of Ethics is directly in conflict with other obligations. Streamlining the obligations would be advantageous

Operation of Managed Account Products and Services

AFSLs or their related entities may fulfill a number of roles in relation to the provision of managed account products or services. Generally, these include:

- Providing personal advice to retail or wholesale investors
- Acting as Responsible Entity for SMAs or Managed Portfolios
- Acting as MDA Provider
- Acting as portfolio manager
- Appointment of 3rd party portfolio or investment managers or asset consultants
- Broking or transaction execution services

For some organisations, they might also include custodial services or also acting as IDPS Operator or trustee of a superannuation fund through which an SMA is made available.

IMAP observes that principal drivers in the growth over the past decade of managed account services have been;

- An attempt to ensure that the “Efficiently” and “Fairly” obligations can be met in the provision of initial and ongoing personal advice in respect of investments. It is arguable that an ongoing investment management service cannot be delivered “Honestly” in the absence of “Efficient” and “Fair” structures such as managed accounts
- Substantial broadening of investment opportunities, such as ETFs, ESG options, infrastructure, private market investments. Adequate analysis of these requires a level of expertise and resourcing beyond many organisations and almost all individual advisers. This level of resourcing incurs substantial cost.

- Continuing refinement in the way individual investor objectives are defined, leading to increasing sophistication in the way portfolios are constructed. The simple “5 options” approach of the industry funds fails to meet the needs of clients seeking advice, particularly in retirement as personal circumstances become more complex
- Broader investment selection has also enabled the refinement of investment philosophy and the ability to express this through portfolio construction. Investors have been offered portfolios, for example, based on ESG principles, or a belief in either passive or active approaches to portfolio construction, or portfolios which explicitly provide for exposure to illiquid investments. Construction of portfolios to reflect specific investment philosophies requires coordination of advice (understanding an investor’s goals) and portfolio management
- Substantially improved technology has enabled the timely management of multiple client accounts concurrently in a way which can accommodate individual preferences.

Managed accounts have emerged as a preferred option for the delivery of ongoing Efficient, Honest and Fair investment services, **precisely** because they integrate each aspect of the chain which links advice, investment selection, portfolio construction, administration and custody and ongoing monitoring and reporting.

Managed accounts have allowed investors to receive portfolios more closely aligned to their personal circumstances and goals, in a way which was not possible when an adviser simply selected individual investments from an approved product list provided by a licensee. For example, they uniquely allow clients to uniquely accommodate existing assets, personal preferences, off platform or external assets or customise tax outcomes.

The provision of some of these roles or services within one organisation could lead to potential or real conflicts of interest. However, it is the ability to integrate advice and portfolio management that enables the delivery of a flexible, customisable service that more clearly meets the investor’s objectives.

Costs

Most conflict of interest issues focus on the costs to investors and the manner in which the interests of the organisation or adviser may be given precedence over those of the investor. These services create a cost which would be expected and unexceptional if charged by a third party but create the perception of a conflict if charged by a single organisation. It should be clear to investors what the costs of those services are to allow them to make an informed decision about their suitability and value.

The obligations contained in s912 A (1) (d) imply that services provided by an AFSL should be charged to recipients at a price which allows the AFSL to make an adequate return on those services to enable it to continue to deliver to a professional standard.

In response to the specific questions, we observe:

B1Q1: Is our guidance clear?

The guidance provided in RG181.28 – 41 lists a broad list of conflicts which may provide some guidance to organisations in formulating policy. There is unlikely to be little new in this list that an organisation which has considered its current services would not have already contemplated.

B2Q1: Is our guidance clear in draft RG181?

Again, for an organisation which has remained current in its understanding of the law and regulations, there will be little in the roadmap which they will not have already considered in regards to relevance to their own organisation and services.

B5Q1 / B7Q1 : Adequate Arrangements / Effective Management, Is our guidance clear?

The outlined steps are an adequate approach to the recognition and assessment of conflicts. However, as s912 A (1) (aa) recognizes, conflicts will emerge in the provision of financial services.

The draft RG181 references through the roadmap the other law and regulation to which AFSL's are subject. However, there is no section which attempts to reconcile the conflicting obligations which arise. The most glaring example is the contradictory position of the Adviser Code of Ethics and RG181.

In our view, the draft RG181 does not provide adequate guidance on the mechanisms or processes which an AFSL could employ to assess whether a conflict is appropriately managed. Table 3 most closely approaches this but could be extended.

These might include:

Assess

- Competitive assessment of pricing strategies
- Assessment of the nature and scope of services provided compared to alternatives
- Adequacy of resourcing, relative to alternative options

Respond

- Confirmation that clients are aware of and accept the proposed terms of supply (disclosure)
- Comparison of the proposed service with other equivalent services

Implement

- Comparison of investor outcomes achieved over time and costs incurred with equivalent services
- Independent ratings assessments

In addition, the draft RG181 does not provide guidance for scenarios where, in ASIC's view, a real or perceived conflict, having been identified, assessed and managed by an organisation would be regarded, by ASIC, as being appropriately managed.

It would improve RG181 if ASIC were to specifically cite examples where an AFSL whose service consisted of multiple services, for example advice + portfolio management or advice + MDA operations, for each of which an appropriate cost was charged, demonstrated appropriate conflict management through a combination of identification, controls, disclosure and ongoing management or other mechanisms.

We support the timely review of RG181 and look forward to participating further in the consultation.

Yours faithfully



Institute of Managed Account Professionals Ltd