
**EXPLANATORY STATEMENT for
ASIC Corporations (Managed Discretionary Account Services) Instrument
2016/968**

and

ASIC Corporations (Repeal) Instrument 2016/969

Prepared by the Australian Securities and Investments Commission

Corporations Act 2001

The Australian Securities and Investments Commission (**ASIC**) makes the *ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968* under subsections 601QA(1), 741(1), 926A(2), 951B(1), 992B(1) and 1020F(1) of the Corporations Act 2001 (**the Act**).

Subsection 601QA(1) of the Act provides that ASIC may exempt a person from a provision of Chapter 5C of the Act; or declare that Chapter 5C applies to a person as if specified provisions were omitted, modified or varied.

Subsection 741(1) of the Act provides that ASIC may exempt a person from a provision of Chapter 6D; or declare that Chapter 6D applies to a person as if specified provisions were omitted, modified or varied.

Subsection 926A(2) of the Act provides that ASIC may exempt a person or a financial product or class of persons or financial products from all or specified provisions of Part 7.6 of the Act (other than Divisions 4 and 8); or declare that Part 7.6 of the Act (other than Divisions 4 and 8) applies in relation to a person or a financial product or class of persons or financial products as if specified provisions were omitted, modified or varied.

Subsection 951B(1) of the Act provides that ASIC may exempt a person or a financial product or class of persons or financial products from all or specified provisions of Part 7.7 of the Act; or declare that Part 7.7 of the Act applies in relation to a person or a financial product or class of persons or financial products as if specified provisions were omitted, modified or varied.

Subsection 992B(1) of the Act provides that ASIC may exempt a person or a financial product or class of persons or financial products from all or specified provisions of Part 7.8 of the Act; or declare that Part 7.8 of the Act applies in relation to a person or a financial product

or class of persons or financial products as if specified provisions were omitted, modified or varied.

Subsection 1020F(1) of the Act provides that ASIC may exempt a person or a financial product or class of persons or financial products from all or specified provisions of Part 7.9 of the Act and may declare that Part 7.9 of the Act applies in relation to a person or a class of persons as if specified provisions were omitted, modified or varied.

ASIC makes the *ASIC Corporations (Repeal) Instrument 2016/969* under paragraphs 601QA(1)(a), 741(1)(a), 951B(1)(a), 1020F(1)(a) and 1020F(1)(c) of the Act.

Under subsection 33(3) of the *Acts Interpretation Act 1901* (as in force as at 1 January 2005 and as applicable to the relevant powers because of section 5C of the Act), where an Act confers a power to make, grant or issue any instrument (including rules, regulations or by-laws), the power shall be construed as including a power exercisable in the like manner and subject to the like conditions (if any) to repeal, rescind, revoke, amend, or vary any such instrument.

1. Background

A managed discretionary account (MDA) means a facility, other than a registered scheme or an interest in a registered managed investment 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.

There are a wide variety of arrangements that can constitute a MDA. The financial services industry uses different terminology to refer to a service that may have the relevant features of a MDA. For example, products more commonly known by industry and investors as a Separately Managed Account, Individually Managed Account, Investment Advisory Program or a Managed Discretionary Portfolio Service may fall within the definition of a MDA.

We consider that a MDA generally falls within the definition of both a managed investment scheme under section 9 of the Act and a facility for making a financial investment under section 763B of the Act.

Shortly after the commencement of the financial services regulatory regime it became apparent that applying the regulatory requirements for managed investment schemes to the regulation of MDA's did not reflect the risks associated with the operation of MDA's. This is because MDA providers have more limited functions than responsible entities of registered schemes.

Accordingly, in ASIC Class Order [CO 04/194] ([CO 04/194]) ASIC adopted a tailored regulatory regime for MDA providers, exempting them from the managed investments provisions in Chapter 5C of the Act; and product disclosure provisions and fundraising in Chapter 6D and in Part 7.9 of the Act. Simultaneously we imposed some disclosure obligations on MDA providers to ensure that clients receive adequate information when determining whether to enter into a MDA; and imposed requirements on MDA providers and external MDA custodians to ensure client money is adequately protected and potential conflicts of interest are managed.

Our regulatory approach sought to allow for flexibility in the structuring of MDAs by ensuring that our requirements for MDA Providers are appropriate and therefore tailored to take into account the nature of the financial products and services involved in providing the MDA.

Under the *Legislative Instruments Act 2003* (Legislative Instruments Act), legislative instruments cease automatically, or ‘sunset’, after 10 years, unless action is taken to exempt or preserve them. To preserve its effect, a legislative instrument must be remade before its sunset date. [CO 04/194] was scheduled to sunset on 1 October 2016.

2. Purpose of the instruments

Our overriding objectives when regulating MDAs are to help promote investor and financial consumer trust and confidence in the provision of MDAs, and to apply the minimum appropriate regulation to the provision of MDAs by MDA providers. This is consistent with the framework for the regulation of financial products and services under the Corporations Act.

ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968 is designed to help us achieve that objective.

ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968 will continue the relief provided by [CO 04/194] in a new legislative instrument that reflects current drafting practice, with some changes.

The primary changes are as follows:

- (a) relief has been provided to financial services licensees, who are market participants, where they provide MDA services only to immediate family members. These licensees are not required to have a licence authorisation to provide MDA services, subject to some conditions;
- (b) giving relief to providers of MDA’s through a regulated platform, so that where a platform does a task, for example providing transaction reports to clients, the licensee is not also obliged to do that task, subject to some conditions;

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- (c) increasing disclosure received by consumers about fees charged within the MDA, the investment strategy and termination of the MDA; and
 - (d) restricting MDA providers from investing client assets in non-limited recourse products unless they have obtained appropriate consent, prior to investing.

ASIC Corporations (Repeal) Instrument 2016/969 is made to repeal the relief provided by [CO 04/194].

3. Operation of the instrument

ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968

Part 1—Preliminary

Section 1 – Name of the legislative instrument

This section provides that the title of the Instrument is the ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968.

Section 2 – Commencement

This section provides that the Instrument commences on the day after it is registered on the Federal Register of Legislative Instruments.

Section 3 – Authority

This section provides that the Instrument is made under subsections 601QA(1), 741(1), 926A(2), 951B(1), 992B(1) and 1020F(1) of the Corporations Act 2001.

Section 4 – Definitions

This section provides definitions that inform the content of the instrument.

Definition of “Act”

Act means the *Corporations Act 2001*

Definition of “client contributions”

Client contributions are defined to mean contributions of money or money’s worth made by a client by either:

- (a) paying or giving ownership of property to the MDA provider or an external MDA custodian; or
- (b) giving the MDA provider or an external MDA custodian power to undertake transactions relating to property through a power of attorney, an arrangement for the MDA provider, an external MDA custodian or their agent to be a signatory on an account of the client or otherwise.

Definition of “client portfolio assets”

Client portfolio assets are defined to mean, in relation to a client, financial products, money or other property that is:

- (a) client contributions of the client; or
- (b) borrowed or raised for the purposes of the MDA service provided to the client; or
- (c) derived directly or indirectly from financial products, money or other property referred to in paragraph (a) or (b).

This clarifies that property borrowed or raised for the purposes of the MDA service provided to the client, forms part of the client portfolio assets.

Definition of “external MDA adviser”

External MDA adviser is defined to mean, a financial services licensee authorised to provide financial product advice to retail clients who directly contracts with a retail client to prepare or review an investment program where:

- (a) the investment program is, or is intended to be, included in a MDA contract; and
- (b) the MDA contract is between that retail client and another person, who is a MDA provider.

Definition of “external MDA custodian”

External MDA custodian is defined to mean a financial services licensee who:

- (a) is authorised to provide custodial or depository services and to deal on behalf of retail clients; and
- (b) directly contracts with a retail client to provide custodial or depository services for MDA services provided to that client by another person who is a MDA provider.

Definition of “family member”

Family member is defined, in relation to a person to mean a spouse or a non-adult child of the person.

This definition assists in interpreting the relief provided in section 13. The definition replicates the definition of “immediate family” contained at Rule 1.4.3 of the *ASIC (ASX Markets) Integrity Rules 2010*.

Definition of “investment program”

Investment program is defined to have the same meaning as in subsection 912AEB(4) of the Act (as notionally inserted by section 15 of this instrument).

Definition of “market participant”

Market participant is defined to mean a participant in a licensed market. This definition assists in interpreting the relief provided in section 13.

Definition of “MDA contract”

MDA contract is defined to mean a written contract between a MDA provider and a retail client setting out the terms and conditions on which the MDA provider provides a MDA service to the client.

This definition clarifies that a MDA contract must be in writing and must set out the terms and conditions under which the MDA must be provided. It makes clear that a MDA contract is only entered into, for the purposes of the instrument, where there is a retail client.

Definition of “MDA provider”

MDA provider is defined to mean a person who holds an Australian financial services licence that authorises:

- (a) dealing by way of issue in either or both of:
 - (i) interests in managed investment schemes that are limited to a right to receive MDA services; and
 - (ii) miscellaneous financial investment products that are limited to a right to receive MDA services;
- (b) dealing in all the financial products that may be acquired with client portfolio assets under the MDA contract; and
- (c) except where an external MDA adviser has contracted directly with each retail client to whom the MDA provider provides MDA services to provide financial product advice relating to the investment program—providing personal advice to retail clients in relation to the MDA; and
- (d) except where an external MDA custodian has contracted directly with each retail client to whom the MDA provider provides MDA services to hold each client portfolio asset that is a financial product or a beneficial interest in a financial product—providing custodial or depository services in relation to those client portfolio assets.

MDA provider replaces the previously used term in [CO 04/194] of “MDA operator”, making clear that a MDA provider issues a financial product that is the MDA.

Definition of “MDA service”

MDA service is defined to mean a service provided by a MDA provider with the following features:

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- (a) a person (client) makes client contributions; and
 - (b) the client agrees with the MDA provider that the client portfolio assets will:
 - (i) be managed by the MDA provider at its discretion, subject to any limitation that may be agreed, for purposes that include investment; and
 - (ii) be held by the client unless a beneficial interest but not a legal interest in them will be held by the client; and
 - (c) the client or the MDA provider intend that that the MDA provider will use client contributions of the client to generate a financial return or other benefit for the client (even if no such benefit is in fact generated).

This definition largely replicates the previous definition in [CO 04/194]. Note that previously a prohibition on pooling was part of the definition; this is now a condition of the relief contained at s912AEC of the Corporations Act as inserted by section 15.

Definition of “miscellaneous financial investment product”

Miscellaneous financial investment product is defined to mean a facility:

- (a) through which, or through the acquisition of which, a person makes a financial investment as defined in section 763B of the Act; and
- (b) that is not otherwise a financial product under section 764A of the Act.

This definition assists in defining MDA provider. A MDA may be issued as an interest in a managed investment scheme or as a miscellaneous financial product.

Definition of “non-adult child”

This definition clarifies that by non-adult child, for the definition of family member, we mean a child who is under 18 years of age, and including adopted children, stepchildren or ex-nuptial children; or anyone who is a child within the meaning of the *Family Law Act 1975*.

Definition of “non-limited recourse product”

This definition provides that a non-limited recourse product is a facility that includes an obligation imposed on a person under an agreement to pay an amount to another person in the event of the occurrence or non-occurrence of something, where the rights of the other person in relation to the obligation are not limited to any property that the first person has paid or set aside as security for the payment, or property to be transferred by the other person to the first person on completion of the obligation under the agreement.

This definition is included to assist with explanation of conditions imposed by the instrument on the use of non-limited recourse products within MDAs.

Definition of “spouse”

This definition clarifies that spouse includes another individual with whom the individual is in a relationship that is registered under a law of a State or Territory for the purposes of section 2E of the *Acts Interpretation Act 1901*; and another individual who lives with another on a genuine domestic basis in a relationship as a couple.

Definition of “stepchild”

This definition defines stepchild as the child of a spouse.

Part Two—Exemption

Section 5 – MDA providers and external MDA custodians

Paragraph 5(1)(a) exempts MDA providers and external MDA custodians from complying with subsection 601ED(5) of the Act in relation to a managed investment scheme if the only interests in the scheme are rights to MDA services. This means MDA providers and external MDA custodians are not required to register their managed investment schemes.

Paragraph 5(1)(b) exempts MDA providers from complying with Parts 6D.2 and 6D.3 of the Act in relation to an offer to a client of securities to be held by the client where interest is held or proposed to be held on behalf of the client as part of the MDA services.

Paragraph 5(1)(c) exempts MDA providers from providing a Product Disclosure Statement in relation to both the MDA services and any equitable right or interest in a financial product arising because of a holding of the MDA services.

Paragraph 5(3)(a) provides that ASIC may exclude a person from relying on the exemption by providing notice in writing.

Paragraph 5(3)(b) provides that a person is excluded from relying on the exemption where they become aware they have reason to believe they have failed, other than in an immaterial respect, to comply with relevant provisions of the Act, as inserted by the instrument.

Section 6 – Persons involved in acquiring MDA services

Section 6 provides relief to persons other than the MDA provider or external MDA custodians so that they do not have to comply with Part 7.9 of the Act, in relation to a financial product that relates to a MDA service, where they have no reason to believe that a MDA provider may not rely on the exemption in paragraph 5(1)(c).

Section 7 – Dealers contracted by MDA provider

Section 7 provides that a licensee and an authorised representative of a licensee do not have to give a person a Financial Services Guide under subsections 941A(1) or 941B(1) of the Act in relation to a dealing in a financial product where the person is a client of a MDA provider and the licensee, or the authorised representative, has a contract with the MDA provider to deal on behalf of the client in client portfolio assets and the MDA provider does not do any dealing for the client.

This means that the licensee or an authorised representative does not have to give a Financial Services Guide to the client for individual investments the client is entered into as part of the MDA.

Subsection 7(3) provides that ASIC may exclude a person from relying on the exemption by providing notice in writing; and that a person is excluded from relying on the exemption where they become aware they have reason to believe they have failed, other than in an immaterial respect, to comply with a condition in section 8 of the Instrument.

Section 8 – Condition

Section 8 provides that a person who relies on the exemption in section 7 must not knowingly cause the MDA provider to fail to comply with sections 912AEA to 912AEG of the Act, as inserted by the instrument, in relation to the MDA service.

Section 9 – Issue of client portfolio assets

Subsection 9(1) exempts MDA providers from complying with the parts of Part 7.9 of the Act which would require a Product Disclosure Statement to be given to a client for financial products that are, or if acquired will become, client portfolio assets of the client. The exception to this is section 1017E, which places requirements upon the licensee when dealing with client money.

Subsection 9(2) provides that the exemption in subsection (1) does not apply to a person if ASIC excludes that person from relying on the exemption by providing notice in writing, and that notice has not been withdrawn. A person is also excluded from relying on the exemption where they become aware they have reason to believe they have failed, other than in an immaterial respect, to comply with a condition in section 10 of the Instrument, without having notified ASIC of that failing within 10 business days. An authorised representative who has reason to believe that the exemption in subsection (1) has ceased to apply to a licensee is excluded from relying on the relief, when acting on behalf of the licensee.

Section 10 – Conditions

Section 10 provides that a person who relies on the exemption in section 9 must not knowingly cause the MDA provider to fail to comply with sections 912AEA to 912AEG, as inserted by the instrument, of the Act in relation to the MDA service.

Section 11 – Exemption – Securities offers

Subsection 11(1) provides that a person does not have to comply with the securities disclosure and related provisions in Pts 6D.2 and 6D.3 of the Corporations Act for securities that if acquired would become client portfolio assets of the client in relation to MDA services provided by the MDA provider.

Subsection 11(2) provides that subsection (1) does not apply to a person if ASIC excludes that person from relying on the exemption by providing notice in writing, and that notice has not

been withdrawn. A person is also excluded from relying on the exemption where they become aware they have reason to believe they have failed, other than in an immaterial respect, to comply with a condition in section 12 of the Instrument, without having notified ASIC of those failures within 10 business days.

Section 12 – Conditions

Section 12 provides that a person who relies on the exemption in section 11 must not knowingly cause the MDA provider to fail to comply with sections 912AEA to 912AEG, as inserted by the instrument, of the Act in relation to the MDA service.

Section 13 – Market participants who provide MDA services to family members only

Section 13 exempts a financial services licensee, who is a market participant, from:

- (a) the requirement to register a MDA under subsection 601ED(5) of the Act;
- (b) the requirement to obtain an MDA-specific licence authorisations on their AFS licence and related provisions in Part 7.6 of the Act;
- (c) the financial services disclosure provisions in Part 7.7 of the Act; and
- (d) the requirement to prepare a Product Disclosure Statement under Part 7.9 of the Act,

with respect to the provision of a MDA that is provided to a family member of the licensee or a representative of the licensee.

The MDA for a non-adult child will terminate immediately when that child turns 18.

Section 14 – Conditions

Section 14 imposes conditions on the family accounts exemption provided in section 13.

Paragraph 14(1)(a) requires licensee to obtain written consent from an adult family member as to the discretions exercised under the MDA. The family member must acknowledge that confirmation of transactions will be sent to a nominated address and transactions that the licensee conducts for the client will be supervised as if the client were an employee of the licensee. In practice this provision will only apply to spouses, as the relief is not available for the provision of MDAs to adult children.

Paragraph 14(1)(b) requires that disclosures be made to the spouse, in writing, about: whether they will have access to dispute resolution schemes; that the licensee is required to have adequate internal and external dispute resolutions arrangements to deal with complaints; and about access to compensation.

Paragraph 14(1)(c) requires the market participant to maintain adequate policies and procedures about internal controls and supervisory arrangements for family accounts.

Subsection 14(2) provides that a licensee relying on the family account relief must not invest the client portfolio assets of the family member in: interests in unregistered managed investment schemes; interests in schemes that are not managed investment schemes because they are schemes in which all the members are body corporates that are related to one another and to the body corporate that promotes the scheme; and non-limited recourse products.

Subsection 14(3) provides that a spouse may consent to investing in non-limited recourse products where they give consent in the manner specified in the instrument.

Subsection 14(4) provides the information that must be provided to a client when obtaining their written consent for the purposes of subsection 14(3).

Subsection 14(5) provides that written consent given under section 9 of the *Electronic Transactions Act 1999* will be consent for the purposes of subsection (3).

Subsection 14(6) provides that if the licensee invests the client portfolio assets in non-limited recourse products or keeps non-limited recourse products as client portfolio assets in accordance with subsection (3), it or an external MDA adviser must give the client personal advice about whether the non-limited recourse product is suitable in light of the client's relevant personal circumstances at least once every 13 months.

Subsection 14(7) provides that a licensee, operating in reliance on section 14 must not consent to a variation of the requirement that the MDA cease when a non-adult child turns 18.

Part Three—Declaration

Section 15 – Requirements for the provision of MDA services

Section 15 modifies Part 7.6 of the Act so that it applies (other than Divisions 4 and 8) in relation to a financial services licensee as if it were modified or varied by inserting the following sections in their relative order in Division 3 of Part 7.6.

Section 912AE – Requirements for the provision of MDA services

Section 912AE provides that sections 912AEA to 912AEG, as inserted by this instrument, apply to a financial services licensee that holds an Australian financial services licence to deal in MDA services, however described, on their Australian financial services licence, to a retail client.

The exact wording of section 912AE is used because some financial services licences describe MDA services in different ways.

Section 912AEA – Financial Services Guide

Section 912AEA provides the requirement for a Financial Services Guide to be provided to a retail client before they enter into a MDA contract.

Subsection 912AEA(1) provides that, before entering into a MDA contract to provide MDA services to a person as a retail client, a licensee must give the person a Financial Services Guide that complies with Division 2 of Part 7.7 and include the prescribed information and statements outlined in paragraphs 912AEA(1)(a) to (k).

This information and statements required are in ASIC's view required to aid financial consumers in making informed decisions before entering a MDA.

Subsection 912AEA(2) makes it a requirement that the Financial Services Guide contain information about fees and costs in relation to the MDA services that complies with Part 2 of Schedule 10 of the *Corporations Regulations 2001*, as if certain assumptions, outlined in paragraphs 912AEA(2)(a) to (c), applied.

Subsection 912AEA(3) provides that the information and statements required to be included, for the purposes of subsection (1) only need to be included to the extent that they are reasonably required for the purposes of the MDA client making a decision about whether to participate in the MDA service. Further, the information and statements required to be included only needs to be included if the information is actually known to the licensee or a director of the licensee.

Section 912AEB – MDA contracts

Section 912AEB sets out the requirements for a MDA contract entered into between a licensee and a retail client.

Subsection 912AEB(1) provides that, a licensee must ensure that each MDA service it provides to a retail client is provided under a MDA contract that meets the requirements outlined from paragraphs 912AEB(1)(a) to (c). This includes: information specifying the nature and scope of discretions; prominent warnings that identify the key areas of difference between acquiring a financial product directly and through a MDA service; and termination information.

In particular paragraph 912AEB(1)(c) details the information required to be included in the MDA contract about termination. This includes disclosures about:

- (a) how the instruction to terminate must be communicated;
- (b) how long it will take for the termination to take effect, which is not more than is reasonably necessary; and
- (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.

Subsection 912AEB(2) provides that the licensee must ensure that each MDA contact obliges the licensee to do the things outlined from paragraph s912AEB(2)(a) to (e). This includes performing obligations honestly and with a degree of care and diligence that a reasonable person would exercise; acting in the best interests of the clients; not taking improper

advantage of information obtained; complying with the investment strategy and compensating the client for any loss caused by an act or omission of any agent or other person engaged in connection with the MDA.

Subsection 912AEB(3) mandates that the licensee must comply with the requirement to have and maintain written policies, setting out the steps it will take to ensure that if the contract is terminated, the client portfolio assets will be dealt with as required to be dealt with under the contract and the obligations subsection (2) mandates. This means that should a licensee not comply with these obligations they will be both liable to the client under the MDA contract and able to be held accountable by ASIC for breaching the Act.

Subsection 912AEB(4) requires the licensee to ensure each MDA contract contains an investment program prepared by the licensee or an external MDA adviser.

Subsection 912AEB(5) requires the licensee to ensure that the investment program includes a number of items prescribed from paragraph (5)(a) to (d).

Subsection 912AEB(6) requires licensees to ensure the investment program:

- (a) is appropriate for the client;
- (b) sets out, in as much detail as a retail client would reasonably require to clearly understand:
 - (i) any significant risks associated with the nature and scope of the licensee's discretions under the MDA contract and the strategies that are to be applied in exercising those discretions; and
 - (ii) whether and, if so, how the client may give instructions to the licensee that affect the licensee's discretions under the MDA contract; and
 - (iii) details of when and by whom the suitability of the MDA contract to the client's relevant personal circumstances will be reviewed as required by this section; and
- (c) is worded and presented in a clear, concise and effective manner; and
- (d) unless there is a separate Statement of Advice that meets those requirements, complies with the requirements for a Statement of Advice in Subdivisions C and D of Division 3 of Part 7.7 of the Act.

Subsection 912AEB(7) requires the licensee, in circumstances where the investment program has been prepared by an external MDA adviser, to have no reason to believe that the investment program does not comply with the requirements for a Statement of Advice; and to have no reason to believe that any statement in the Financial Services Guide given by the licensee about the investment program prepared by the external MDA adviser is misleading or deceptive or likely to mislead or deceive.

Subsection 912AEB(8) provides that, for each MDA contract entered into with a retail client, the licensee must ensure that it or an external MDA adviser gives personal advice as to the

contract's suitability for the client before entering the contract and every 13 months thereafter. This allows for an annual review to be conducted while providing some flexibility.

Subsection 912AEB(9) provides that if an external MDA adviser gives personal advice to a person before the MDA contract is entered into the licensee must review the advice and must not enter into a contract if it has reason to believe that the MDA service is not appropriate to the client's relevant personal circumstances.

Section 912AEC – Asset holding

Section 912AEC establishes the requirements for a licensee, or external MDA custodian, holding client assets as part of providing MDA services.

Subsection 912AEC(1) provides that the licensee must ensure that client portfolio assets of a client are not pooled with any other property to enable an investment to be made or to be made on more favourable terms.

Subsection 912AEC(2) provides that the licensee must do all things necessary to ensure that if they hold a client portfolio assets, they hold these assets on trust for the client. If they engage a custodian to hold client portfolio assets, they must ensure that all assets held by a custodian or sub-custodian are held so that the client has a beneficial interest in the assets. Alternatively the licensee or the custodian or sub-custodian may hold assets under the client money or client asset provisions of Divisions 2 and 4 of Part 7.8 of the Corporations Act. Except for certain amounts held as margin, money and assets held under Divisions 2 and 4 of Part 7.8 client portfolio assets must be held on trust for the client under *Corporations Regulations 2001* regulation 7.8.01(5) and 7.8.07(2).

Subsection 912AEC(3) provides that subsection (2) does not apply where the client portfolio assets are located outside of Australia, in a place where there is no legal concept of a trust and where certain other requirements, detailed in the subsection are met.

Subsection 912AEC(4) provides that the licensee must have reasonable procedures in place for giving instructions to custodians or custodial staff in relation to client portfolio assets.

Subsection 912AEC(5) provides that a licensee must ensure that any person it directly or indirectly engages to hold client portfolio assets does so in a way that the assets are, as far as practicable, clearly identified and held separately from the property of the MDA provider, the holder of the assets and any other person other than the client, except in relation to:

- (a) Australian or foreign currency;
- (b) a deposit-taking facility of a body carrying on a business of accepting money on deposit, including rights under that facility;
- (c) securities (as defined in s92(1) of the Corporations Act); or
- (d) derivatives.

In these cases it is permissible to use omnibus accounts subject to certain conditions, outlined in subsection (6).

Subsection 912AEC(6) sets out a series of requirements that the licensee, or any person it directly or indirectly engages to hold client portfolio assets, must do if client portfolio assets of a client are not held separately from property in which the licensee or the person holding the client portfolio assets has an interest in, separately from the property of any other person other than the client and other clients of the MDA service. These requirements relate to the need for policies and procedures to be put in place, and records to be kept, to negate risks from client portfolio assets not being held separately and to ensure the licensee complies with its duties to each client.

Subsection 912AEC(7) provides that the licensee must do all things necessary to ensure that if it holds client portfolio assets, it, and where a custodian holds the assets, the custodian, has an organisational structure that supports compliance with the requirement to ensure that client portfolio assets are held separately from property in which the licensee or the other person holding the assets has an interest and from the property of any other person other than the client and other clients of the MDA service, with the exceptions explained at subsection (5).

Subsection 912AEC(8) provides that the licensee must do all things necessary to ensure that if it holds client portfolio assets, it, and if a custodian holds those assets, the custodian, segregate custodial staff from staff performing other functions in a way that minimises the potential for conflict, if a conflict of interest exists or may exist.

Subsection 912AEC(9) provides that the licensee must do all things necessary to ensure that if it holds client portfolio assets, it, and if the custodian holds the client portfolio assets, the custodian, has a documented policy, approved by directors or a governing body or a delegate of the directors or a governing body, designed to ensure that custodial staff are not influenced by any conflict of interest.

Subsection 912AEC(10) provides that the licensee must do all things necessary to ensure that if it holds client portfolio assets, it, and if a custodian holds those assets, the custodian, undertake reasonable checks to find out and document if there has been any attempt to inappropriately influence custodial staff, and to take reasonable action in the event this happens.

Subsection 912AEC(11) provides that the licensee must do all things necessary to ensure that if it holds client portfolio assets, it, and if a custodian holds those assets, the custodian, structure their business in a way that minimises the risk of conflicts of interest arising. For example, the instrument requires that custodial staff not be responsible for investment or trading decisions.

Subsection 912AEC(12) provides that the licensee must, for its custodial staff ensure that, and for custodial staff of any custodian, it does all things necessary to ensure that the custodian ensures that custodial staff have the necessary capacity and resources to perform core administrative activities.

Subsection 912AEC(13) provides that the licensee must comply with subsections (7) to (12) as if any sub-custodian were the custodian, except to the extent that, in relation to client portfolio assets outside this jurisdiction, it is not practicable for the licensee to do all things necessary to ensure that the sub-custodian does a particular thing.

Subsection 912AEC(14) requires the licensee to keep, for 7 years, records demonstrating its compliance with subsections (2) to (13).

Subsection 912AEC(15) provides that the licensee must set out in writing and implement a reasonable process, for determining whether it ought to engage a custodian and for monitoring custodial performance. The process for determining whether to engage a custodian must involve the application of a reasonable written policy approved by directors or a governing body or a delegate of the directors or a governing body, which addresses potential conflicts of interest.

Subsection 912AEC(16) provides that the licensee must not permit a custodian or sub-custodian to be involved in discretionary decisions concerning a deposit account, except in the circumstances provided for in the subsection.

Subsection 912AEC(17) provides that the licensee must ensure that it keeps records of client portfolio assets in a way that enables the holding of those assets to be conveniently and properly audited by an auditor of the MDA service and to do all things necessary to ensure that any custodian or sub-custodian keeps such records in relation to any asset that is held by the custodian or sub-custodian.

Subsection 912AEC(18) provides that the licensee must review the appropriateness of written policies and processes it is required to have under subsection (15) and any written processes it relies on to comply with subsection (16) at least once every 13 months; and if directed by ASIC in writing, arrange for a report on the effectiveness and reasonableness of the processes or policies to be prepared and given to ASIC.

Subsection 912AEC(19) provides that where a licensee engages a custodian to hold client portfolio assets the licensee must ensure that, whether the licensee holds a beneficial interest in the client portfolio assets or not, they have a written agreement with the custodian that meets the requirements of paragraphs 912AEC(19)(c) to (e). These requirements relate to the ongoing review and monitoring of the work performed by the custodian. They also relate to ensuring the liability of the custodian is not excluded from direct loss.

Paragraph (19)(e) provides the licensee must not permit the granting of a security interest, mortgage, lien or other encumbrance in favour of the custodian or its associates unless the licensee reasonably believes, that any conflict which may arise because of that interest will not materially increase the risks that the custodian will fail to meet its obligations and the licensee must keep the written record of reasons for 7 years after the security interest has ceased.

Subsection 912AEC(20) provides that if a MDA contract between the licensee and a retail client does not include provisions that require the licensee to consider exercising, or to exercise, a right that relates to client portfolio assets, the licensee must fulfil those duties as provided in the MDA contract.

This means that should a licensee not comply with these obligations they will be both liable to the client under the MDA contract and able to be held accountable by ASIC for breaching the Act.

Subsection 912AEC(21) provides that if a MDA contract does not include provisions that require the licensee to consider exercising, or to exercise, a right that relates to client portfolio assets, the licensee must give to the client, as soon as practicable after receipt, a copy of all the communications sent to the licensee that are relevant to the exercise of the right; and to take reasonable steps to implement any instructions given by the client about how the right relating to the assets is to be exercised.

Subsection 912AEC(22) provides that the licensee must not invest client portfolio assets in interests in unregistered managed investment schemes; interests in schemes that are not managed investment schemes because they are schemes in which all the members are body corporates that are related to one another and to the body corporate that promotes the scheme; and non-limited recourse products.

Subsection 912AEC(23) provides that the prohibition against investing in non-limited recourse products does not apply where the client gives prior consent to investing in non-limited recourse products where they give consent in the manner specified in the instrument. The requirement to give consent is a requirement to give consent for each 'type' of non-limited recourse product. For example separate consents are required for investing in contracts for difference and foreign exchange contracts. There is not the possibility to give 'blanket consent' for all investments in non-limited recourse products.

Subsection 912AEC(24) provides the information that must be provided to a client when obtaining their written consent for the purposes of subsection 912AEC(23).

Subsection 912AEC(25) provides that written consent given under section 9 of the *Electronic Transactions Act 1999* will be consent for the purposes of subsection (23).

Section 912AED – Insurance requirements

Section 912AED provides that the licensee must maintain at all times professional indemnity insurance and insurance covering fraud by its officers and employees that is adequate having regard to the nature of the activities carried out by the licensee; and which covers claims at the same time amounting in aggregate to whichever is the lesser of:

- (a) \$5 million; or
- (b) the aggregated average value of the client portfolio assets of all people to whom it provided MDA services as retail clients during a 12 months period ending no more

than one month previously or, if it has not been providing MDA services for 13 months, the amount that it reasonably estimates will be the aggregated average value of the client portfolio assets of all people whom it will provide MDA services to as retail clients during the first 12 months that it provides MDA services.

Section 912AEE – Compliance measures and audit

Section 912AEE provides that the licensee must have adequate, documented, measures to ensure compliance with the licensee's obligations relating to the provision of MDA services by it in accordance with the Act and to lodge, with ASIC, together with its annual financial statements, a statement from a registered company auditor as to whether the licensee has complied with the documented measures during the financial year and whether the documented measures complied with this section during the year.

Section 912AEF – Client reporting

Section 912AEF mandates information that the licensee must give to each retail client to whom it provides MDA services.

Subsection 912AEF(1) provides that the licensee must provide the retail client with information every three months, ending on each quarter day, about the particulars of all transactions entered into during the period, particulars of each of the client portfolio assets, the total value of the client portfolio assets and all revenue and expenses including fees and charges relating to the MDA services during that period.

Subsection 912AEF(2) outlines the methods by which the information required by subsection (1) may be given.

Subsection 912AEF(3) provides that where the client is given electronic access to the information during a reporting period, rather than a quarterly report, the information required by subsection (1) must remain readily accessible. The electronic facility must also make clear that only the information at the end of the quarter will be considered by the auditor.

Subsection 912AEF(4) provides that the licensee must provide documents, annually, with the following:

- (a) a summary of all the transactions carried out as part of the MDA, including information on the nature and purpose of the transactions;
- (b) the total management costs, and any other fees and costs associated with the MDA service, over the relevant reporting period, calculated on the same basis as required for disclosure in the FSG;
- (c) a copy of the annual review of the investment program; and
- (d) an annual audit report.

Subsection 912AEF(5) provides that an auditor may assume, when providing an opinion or statement required by subsection (4), that where there is an auditor's opinion that relevant procedures and controls implemented by an external MDA custodian were suitably designed and operated effectively, they may rely on that auditor's report, unless they are aware that the procedures and controls implemented by an external MDA custodian were not suitably designed and operating effectively.

Subsection 912AEF(6) provides that the obligations relating to transaction reporting do not apply if:

- (a) all the transactions effected under the MDA services provided to the client are effected by the licensee giving instructions to a regulated platform operator; and
- (b) all the client portfolio assets are held through one or more regulated platforms under a custodial arrangement between the regulated platform operator and the licensee or the client; and
- (c) the transaction reports have been provided to the client or the licensee by the platform operator; and
- (d) the licensee reviews the transaction reports and notifies the client if there are any errors or omissions.

Section 912AEG – Record keeping

Section 912AEG provides that a licensee must keep copies of certain documents relating to the provision of the MDA service, outlined in the section, for at least 7 years.

Section 912AF – Requirements for external MDA custodian

Section 912AF provides that sections 912AFA to 912AFE, inserted by this instrument, apply to external MDA custodians.

Section 912AFA – External MDA custodian to enter into a contract with each of the retail clients

Subsection 912AFA(1) provides that an external MDA custodian must ensure it has a written contract with each retail client to whom it provides custodial or depository services for MDA services.

Subsection 912AFA(2) provides that the MDA custodian must ensure that each MDA contact obliges the licensee to do the things outlined from paragraph s912AFA(2)(a) to (d). This includes performing obligations honestly and with a degree of care and diligence that a reasonable person would exercise; not taking improper advantage of information obtained; and compensating the client for any loss caused by an act or omission of any agent or other person engaged in connection with the custodial or depository services for the MDA services.

Subsection 912AFA(3) mandates that the external MDA custodian must comply with the provisions of the contract required by subsection (2). This means that should a licensee not comply with these obligations they will be both liable to the client under the MDA contract and able to be held accountable by ASIC for breaching the Act.

Section 912AFB – Assets holding

Subsection 912AFB(1) provides that the external MDA custodian must do all things necessary to ensure that if they holds client portfolio assets, they hold these assets on trust for the client. If they engage another person to hold the assets they must ensure that all assets held are held so that the client has a beneficial interest in the assets. Alternatively the licensee or the custodian or sub-custodian may hold assets under the client money or client asset provisions of Divisions 2 and 4 of Part 7.8 of the Corporations Act.

Subsection 912AEC(2) provides that subsection (1) does not apply where the client portfolio assets are located outside of Australia, in a place where there is no legal concept of a trust and certain other requirements, detailed in the subsection, are met.

Section 912AFC – Financial Services Guide for custody service

Section 912AFC provides that before providing custodial or depository services to a retail client for a MDA service, the external MDA custodian must provide to the client a Financial Services Guide that clearly explains the services for which it is responsible and for which the MDA provider is responsible.

Section 912AFD – Record keeping

Section 912AFD details the records the external custodian must keep: each contract it enters into under subsection 912AFA(1) and any Financial Services Guide provided to a client, and how long they must be kept for, 7 years.

Section AFE – Insurance requirements

Section 912AFE provides that the external MDA custodian must maintain at all times professional indemnity insurance and insurance covering fraud by its officers and employees that is adequate having regard to the nature of the activities carried out by the external MDA custodian; and which covers claims at the same time amounting in aggregate to the lesser of:

- (a) \$5 million; or
- (b) the aggregated average value of the client portfolio assets of all people to whom it provided custodial or depository services as retail clients for a MDA service during a 12 months period ending no more than one month previously or, if it has not been providing custodial or depository services for a MDA service for 13 months, the amount that it reasonably estimates will be the aggregated average value of the client portfolio assets of all persons to whom it will provide custodial or depository services

as retail clients during the first 12 months for which it provides those services for a MDA service.

Section 912AG Interpretation

Section 912AG assists with interpretation of the notional section 912AE to 912AFE.

Subsection 912AG(1) provides the circumstances in which a document will be taken to have been given to a person, in a variety of circumstances, including by giving it to an agent, in certain circumstances, proving it electronically or sending it via post.

Paragraph 912AG(2)(a) provides that that an email is sent when the email would be taken to be dispatched under section 14 of the *Electronic Transactions Act 1999* if it applied to that subsection.

Paragraph 912AG(2)(b) provides that a document is taken to be a copy of another document, regardless of minor differences, such as an absence of graphics of a promotional or decorative nature. This facilitates copies of documents that exist on websites.

Subsection 912AG(3) provides the circumstances in which case a person is deemed to engage another person, whether directly or indirectly.

Subsection 912AG(4) defines a number of the terms used in the notional subsections. Many of these definitions replicate the definitions of section 4 of the instrument or are defined by reference to a notional subsection which explains them.

Part 4 – Transitional

Section 16 – Arrangements for transitioning MDA services

Section 16 provides a transitional period for MDA providers and external MDA custodians who were previously relying on [CO 04/194]. For those entities they may still rely on [CO 04/194] until the earlier of the following:

- (a) the MDA provider and external MDA custodian (if any) in relation to the MDA service each having published a notice on its website that it will rely on this instrument in relation to the MDA service;
- (b) 1 October 2017.

Subsection 16(3) inserts notional section 912AGA into the Act.

Section 912AGA – Notice of reliance

Section 912AGA provides that if the application date for a MDA service occurs before 1 October 2017, the MDA provider and external MDA custodian (if any) in relation to the MDA service must publish and maintain on its website a notice that it will rely on ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968 in relation to the MDA service.

Subsection 16(4) provides that for both sections 16 and 17 a transitioning MDA service means a MDA service, the MDA provider for which has a financial services licence that has a condition requiring compliance with [CO 04/194] or part of [CO 04/194].

Section 17 – Licensing exemption for certain MDA providers

Section 17 provides a transitional exemption for any MDA provider who does not have a financial services licence authorising them to issue a MDA service. ASIC's view is that any person who enters into a MDA contract, other than an external MDA advisor, is issuing a MDA. Some licences issued by ASIC previously have not authorised financial services licensees, who may need authorisation to issue, to issue. Section 17 provides transitional relief for any financial services licensee who will need to vary their financial services licence.

ASIC Corporations (Repeal) Instrument 2016/969

ASIC Corporations (Repeal) Instrument 2016/969 repeals [CO 04/194].

4. Consultation

In 2013 ASIC released Consultation Paper 200 *Managed discretionary accounts – Updates to RG 179* (CP 200). CP 200 proposed that ASIC amend [CO 04/194] and its associated regulatory guidance, contained in ASIC Regulatory Guide 179: Managed discretionary account services. We received 36 submissions on CP 200 from a wide range of respondents.

The proposed amendments related to:

- (a) relief for financial services licensees where they provide MDA services only to family members;
- (b) relief for financial services licensees who provide MDAs through a regulated platform;
- (c) increased disclosure received by consumers about fees charged within the MDA, the investment strategy, termination of the MDA; and
- (d) restricting MDA providers from investing client assets in non-limited recourse products unless they have obtained consent, prior to investing.

ASIC also consulted on the appropriate financial resources to be held by MDA providers and external MDA custodians. These proposals were not related to this instrument, if ASIC had proceeded with these proposals they would have formed the basis for a separate instrument. ASIC did not proceed with these proposals.

In 2014, we deferred the implementation of the proposed new requirements for MDAs pending the outcome of the Government's Financial System Inquiry. Since that time we have liaised with industry, including holding roundtable meetings with industry representatives on ASIC's proposed approach to regulating MDA's.

Given that [CO 04/194] was scheduled to sunset on October 1 2016, rather than amend it we took the decision to remake it as *ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968*, incorporating the proposed amendments.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968

and

ASIC Corporations (Repeal) Instrument 2016/969

ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968 is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the Human Rights (Parliamentary Scrutiny) Act 2011.

ASIC Corporations (Repeal) Instrument 2016/969 is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the Human Rights (Parliamentary Scrutiny) Act 2011.

Overview

ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968 remakes ASIC Class Order [CO 04/194] with some amendments.

ASIC Corporations (Repeal) Instrument 2016/969 repeals ASIC Class Order [CO 04/194].

Human rights implications

The legislative instruments do not engage any of the applicable rights or freedoms.

Conclusion

These legislative instrument are compatible with human rights as they do not raise any human rights issues.

Australian Securities and Investments Commission