Changes to MDAs coming – *ACT NOW to avoid the rush*

ASIC IS SET TO ANNOUNCE LONG-AWAITED CHANGES TO THE OPERATION OF MANAGED DISCRETIONARY ACCOUNTS (MDAS) BEFORE OCTOBER. ADVISORY FIRMS NEED TO BE READY.

WORDS
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Advisers operating a managed discretionary account (MDA) service have been on notice for over three years, so no one should be surprised when the regulator finally announces planned changes to lift the requirements on MDA operators and address key risks.

The truth is that the MDA sector, administration platforms and the financial services industry in general, have changed significantly in the 12 years since the Australian Securities and Investments Commission (ASIC) first introduced a regulatory regime and Class Order for MDA operators in 2004. Today, managed accounts are increasingly considered a mainstream investment management solution and many managed account solutions are made available using a MDA approach.

Among a raft of previously flagged changes, is the likely removal of a no action letter, which has allowed certain MDA arrangements to occur in regulated platforms such as wraps and master plans. It's possible this change will have the greatest impact on the industry.

Some may be surprised to learn that MDA arrangements for retail investors can, and do, exist where an adviser is not authorised to provide MDA services under their licence.

A large number of industry participants provide MDA services to retail clients using a no action letter issued back in 2004. This provision allowed certain MDA arrangements to occur in regulated platforms if a licensee's Financial Services Guide was amended and a contractual arrangement was implemented between the licensee and the client. This is commonly referred to as a Limited MDA arrangement.

TO BE, OR NOT TO BE, LICENSED

The no action letter came about because the industry argued that unlike "full service" MDAs, many advisers primarily used discretion to rebalance managed fund portfolios via a regulated platform which took care of administration, custody and reporting. It successfully argued that it wasn't clear whether they needed to be licensed or not.

If Limited MDA arrangements were only used to rebalance managed fund portfolios via a regulated platform, the regulator may not have an issue. But over the years, many licensees and advisers set up more complex Limited MDA arrangements using a range of instruments far beyond managed funds, as platforms supported a broader range of assets.

This has become so prevalent that there's often no difference between the portfolios available through a licensed MDA operator and a Limited MDA arrangement; except one is regulated under the MDA regime with higher PI (professional indemnity) insurance levels and other requirements.

It's unclear exactly how many advisers have implemented a Limited MDA arrangement but it's understood to be a substantial number and possibly similar to the 190 or so MDA operators that are licensed by ASIC.

If the no action letter is removed, Limited MDA arrangements, particularly those with portfolios across a range of instruments, will probably need to gain specific MDA authorisation on their licence to continue their current approach. An interesting question will be whether their 'experience' running a Limited MDA arrangement will be deemed as experience by the regulator, which has strict experience requirements for advisory firms running a properly licensed MDA arrangement. If not, a number of advisers will need to find an alternative solution.

OPTIONS FOR SMALLER FIRMS

Adding further complexity, ASIC has also flagged plans to increase the capital requirements for MDA operators so that net tangible assets (NTA) of 0.5 per cent of funds under administration (FUA) up to $5 million will need to be maintained (assuming

custody is outsourced). This is in line with the requirement that applies to responsible entities (REs) of managed investment schemes and IDPS (investor directed portfolio services) operators.

Smaller advisory firms endeavouring to obtain a MDA operator authorisation or those who already have a MDA operator authorisation will need to seriously consider their ability and willingness to meet new capital requirements.

Even if the proposed NTA requirements are potentially deferred, advisers can't rest easy. It's likely they'll have to find the money eventually. Having said that, they can satisfy this requirement by partnering with a well-resourced MDA operator in the same way many managed investment schemes have an outsourced RE arrangement.

Alternatively, they can revert to providing advice and services without discretion and go back to providing advice for every change in a client portfolio.

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TIME TO IMPLEMENT A LONG-TERM PLAN

Whatever changes are announced and regardless of whether the industry agrees or not, every participant will need to respond accordingly.

Ultimately, it appears that ASIC's goal is to ensure everyone providing a MDA service is licensed or authorised to do so, in the same way advisers and accountants need to be licensed or authorised to provide personal financial advice. Quite rightly, it appears that the regulator wants to ensure that everyone investing in a managed account, no matter what the legal structure, receives the same level of investor protection.

Many advisers currently operating a limited MDA arrangement will have already considered their options under a scenario where the no action letter is removed. If not, they should carefully consider their choices and start implementing a long-term plan now to avoid the rush.

As other recent industry changes demonstrate, those who make inquiries early, and act decisively, can continue running their business with minimal disruption.

And those who believe their platform provider will be willing to take on the risk of appointing them as an investment manager on their platform, and by doing so, accept liability for their investment management decisions, may wish to think again. ■