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ROYAL COMMISSION RECOMMENDATIONS AND MANAGED DISCRETIONARY ACCOUNTS

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The managed account services industry was given much to ponder by Commissioner Hayne in the final report. The major talking point for the industry is undoubtedly the fact that the vertical integration model was left untouched. It will certainly be a relief for advisers and providers of managed account services that structural separation was considered to be “a very large step to take” even in spite of the concerns of the inherent conflicts raised by many, including ASIC. The focus was instead shifted to the management of conflicts and ensuring the adherence to the best interests duty for the client.

While the sector was not specifically called out as an industry in focus for recommendations, there are a number of recommendations that will impact the industry which are summarised below.

Fees for no service

Recommendation 2.1 – Annual renewal and payment

The law should be amended to provide that ongoing fee arrangements (whenever made):

- must be renewed annually by the client;
- must record in writing each year the services that the client will be entitled to receive and the total of the fees that are to be charged; and
- may neither permit nor require payment of fees from any account held for or on behalf of the client except on the client's express written authority to the entity that conducts that account given at, or immediately after, the latest renewal of the ongoing fee arrangement

Impact

This will increase the obligations of advisers to be more transparent with all of the clients, and to ensure that there is consent to the services and the payments made in respect of them.



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MDA providers will need to be more vigilant with regard to ongoing fees that are automatically deducted from accounts.

MDA providers will need to be more vigilant with regard to ongoing fees that are automatically deducted from accounts. However, this will likely have little impact for full advice clients, as they will now simply need to opt-in on an annual, rather than biennial basis. There is an expectation that MDA providers monitor accounts to identify overcharging of fees, although it is unclear what the obligation will be upon identification of such issues.

Inappropriate advice

Recommendation 2.2 – Disclosure of lack of independence

The law should be amended to require that a financial adviser who would contravene section 923A of the Corporations Act by assuming or using any of the restricted words or expressions identified in section 923A(5) (including independent, impartial and unbiased) must, before providing personal advice to a retail client, give to the client a written statement (in or to the effect of a form to be prescribed) explaining simply and concisely why the adviser is not independent, impartial and unbiased.

Impact

Where they are likely to recommend managed account services with which they have an interest, advisers will have to provide a written statement to the client detailing why they are not independent.

While there are requirements to disclose some matters regarding conflicts of interest in the FSG, Commissioner Hayne was of the view that these are insufficient for personal advice to a retail client. The inclusion of external MDA adviser details in an MDA provider's FSG may present some issues if the FSG is not individually tailored.

Conflicted remuneration

Recommendation 2.4 – Grandfathered commissions

Grandfathering provisions for conflicted remuneration should be repealed as soon as is reasonably practicable.

Impact

This recommendation will end grandfathered commissions effective from 1 January 2021.

This will impact the revenue and value of advice services relying on traditional models. However, this is unlikely to have any effect on advisers using managed account services.

Professional discipline of financial advisers

Recommendation 2.7 – Reference checking and information sharing

All AFSL holders should be required, as a condition of their licence, to give effect to reference checking and information-sharing protocols for financial advisers, to the same effect as now provided by the ABA in its 'Financial Advice – Recruitment and Termination Reference Checking and Information Sharing Protocol'.

Recommendation 2.8 – Reporting compliance concerns

All AFSL holders should be required, as a condition of their licence, to report 'serious compliance concerns' about individual financial advisers to ASIC on a quarterly basis.

Recommendation 2.9 – Misconduct by financial advisers

All AFSL holders should be required, as a condition of their licence, to take the following steps when they detect that a financial adviser has engaged in misconduct in respect of financial advice given to a retail client (whether by giving inappropriate advice or otherwise):

- make whatever inquiries are reasonably necessary to determine the nature and full extent of the adviser's misconduct; and
- where there is sufficient information to suggest that an adviser has engaged in misconduct, tell affected clients and remediate those clients promptly.

Recommendation 2.10 – A new disciplinary system

The law should be amended to establish a new disciplinary system for financial advisers that:

- requires all financial advisers who provide personal financial advice to retail clients to be registered;
- provides for a single, central, disciplinary body;
- requires AFSL holders to report 'serious compliance concerns' to the disciplinary body; and
- allows clients and other stakeholders to report information about the conduct of financial advisers to the disciplinary body.

Impact

These recommendations will ensure that there is increased communication between licence holders, as well as with ASIC, regarding misconduct. It should have little impact specifically on the managed accounts sector, although it remains to be seen whether the sector will be obliged to report issues concerning advisers themselves, if identified.

As managed accounts minimise the risk of any individual piece of advice inappropriate or non-compliant, licensees may be more likely to prefer managed accounts in recommendation due to these changes. ASFL holders will be required to be individually registered, with new responsibilities being tied to the licence as conditions.

Disciplinary action will be tied these conditions, with deregistration as the harshest disciplinary action. This may result in funding costs for providers of managed funds. However, this will not be clear until the details of the new system are released.

What can you do now to prepare?

Providers should ensure that their fee models meet the relevant requirements for all of their clients. Advisers should also review their policies with regard to conflicts of interest and further develop them to ensure that the disclosure obligations are met where there is a lack of in-

dependence. As the regulators and government sharpen their focus on the larger concerns of conflicts and interests of the client, it would be appropriate for participants to do all they can to address these areas to ensure that further scrutiny is avoided.

Conclusion

While there are many considerations for the industry, advisers and providers of managed accounts services will not be adversely affected by the final report. The Commissioner did not recommend the structural separation of the vertical integration model, so the major concern that many carried from the hearings and interim report did not come to fruition.

Despite this, the conflicts that are inherent in such structural models will need to be appropriately managed to ensure that the increased regulatory scrutiny and upcoming reviews of arrangements will throw the industry into a bad light. This is particularly important in the areas of remuneration and the best interests duty that were major issues highlighted in the final report. In situations where advisers are recommending in-house managed portfolios, there will need to be increased awareness of

whether alternative options may provide a more appropriate solution.

Also, there are many themes throughout the final report and recommendations that are relevant to all financial services entities and this is called out as such throughout the report. Managed account service providers should closely review the observations and recommendations arising in the areas of governance (particularly effective oversight by boards and management of non-financial risk) and culture (including the impacts of remuneration on behaviour and the need for clear lines of accountability). While the extension of the Banking Executive Accountability Regime is currently recommended for the superannuation and insurance industries, it will likely be extended to all financial services entities in the future if the UK experience is to be followed.

Finally, it is important to note that the regulatory environment will be significantly more robust post-Royal Commission with the introduction of more severe penalties under the Corporations Act (particularly for breach of obligations under the financial services regime – Chapter 7), removal of exemptions and expanded responsibilities and oversight of the regulators themselves. **FS**



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