

Understanding the regulation of DIMS

Here's the latest on how the FMA will approach the regulation of DIMS.

This document is for providers of Discretionary Investment Management Services (DIMS) to retail clients. It may also be helpful for people providing custody services to DIMS providers, and to those providing financial advice about DIMS.

It contains some key terms and common questions, as well as practical examples and scenarios to help explain our approach to regulating DIMS.

When we refer to an 'AFA', we mean an Authorised Financial Adviser, who is an individual authorised to provide financial advice and/or investment planning, under the Financial Advisers Act 2008 (FA Act). 'Provider' refers to AFAs authorised for personalised DIMS, as well as AFAs and any other person or entity licensed to provide DIMS under the Financial Markets Conduct Act 2013 (FMC Act). 'You' or 'I' is a reference to the provider or AFA reading this document.

Unbundling DIMS – what are DIMS?

DIMS are investment arrangements where you make buy/sell decisions about your client's portfolio, on behalf of your client. This includes arrangements where the client has the right to be consulted, or can change a decision you have previously made. DIMS cover a wide range of services and can vary considerably.

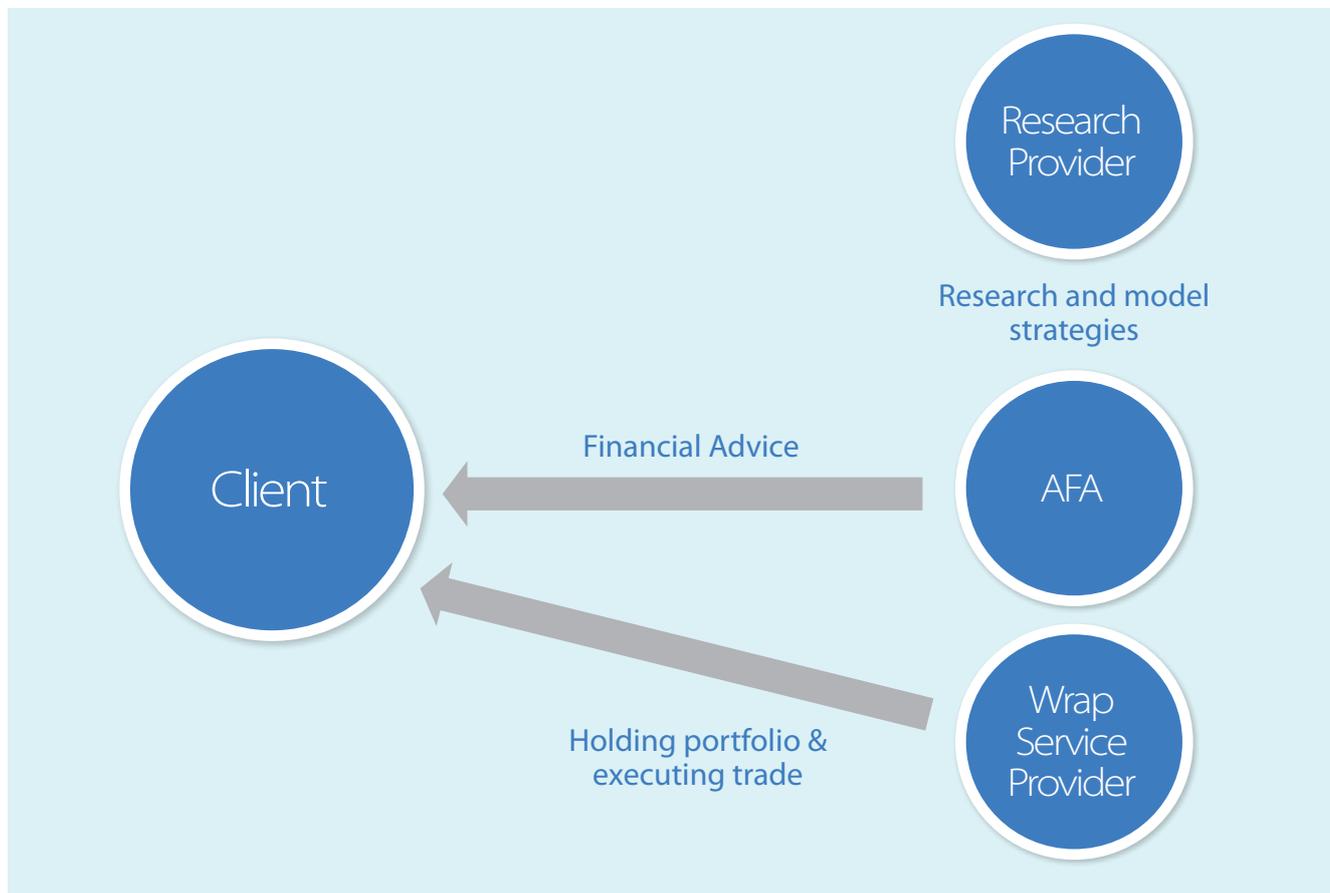
DIMS are often provided alongside other services, such as financial advice or portfolio administration services. You'll need to unbundle the different services provided by different parties so you understand who, if anyone, is providing DIMS.

The key is to consider who is making buy/sell decisions about the client's portfolio of financial products and who has the authority to execute transactions.

If the client is making the buy/sell decisions, the arrangement is not DIMS, even if the client has granted someone else an authority to execute the transactions.

Anyone making buy/sell decisions with authority from the client is performing DIMS and should read this document carefully to understand what sort of licence or authorisation they need.

An example bundle of services – are there DIMS?



This document will help you determine who is providing DIMS. In the example above:

- > it's possible the AFA and/or the wrap service provider could be providing DIMS to the client (see [Scenario 2: Client 'pets and hates'](#))
- > it's possible the research provider could be providing DIMS instead of, or as well as, other parties (see [Scenario 4: Automation of model portfolio](#)), or
- > it's possible no-one is providing DIMS.

Where can I find more information?

If you have any questions, please check our website first. If you still need help, the FMA's information line is open Monday to Friday 8.30am to 5pm, on 0800 434 567 (+64 3 962 2698 for overseas callers).

For the latest news, you can also subscribe to receive FMA Updates via our website.

Common questions

Am I providing DIMS if...?

- > I provide an 'execution-only' service?
- > I always check recommendations with my client before I go ahead with a transaction using his or her investment authority?
- > I make real estate investment decisions for a client under an investment authority?
- > I provide financial advice about whether a client should enter into a DIMS facility?
- > I provide an automatic service to rebalance retail clients' portfolios?

What if I only provide DIMS to wholesale clients?

Who is a wholesale client?

Personalised DIMS or class DIMS?

- > What types of DIMS can AFAs provide?
- > What is personalised DIMS?
- > What is the investment strategy of DIMS?
- > What is the investment authority expected to contain?
- > Can an AFA still use a model portfolio or model asset allocation?

Eligibility requirements for AFAs providing personalised DIMS

- > Are the eligibility requirements for AFAs providing personalised DIMS under the FA Act the same as under the FMC Act?
- > How will the eligibility requirements for AFAs seeking authorisation for personalised DIMS be assessed?

Contingency exemption

- > What is the contingency exemption?
- > When can I provide contingency DIMS?
- > How do I know whether the DIMS are incidental to other financial services provided?
- > What is a known temporary period?
- > When will there be urgent situations?
- > What else do I need to know about the contingency exemption?
- > What do I need to do if I want to provide contingency DIMS to my clients?

Financial advice relating to DIMS

- > Who can provide financial advice about entering into a DIMS facility?
- > What financial advice is covered by an FMC Act DIMS licence?

FMC Act DIMS licensees

- > What types of DIMS can FMC Act DIMS licensees provide?
- > How will FMC Act DIMS licence applications be assessed?
- > Who can provide DIMS within an FMC Act DIMS licensee?
- > Will AFAs employed by an FMC Act DIMS licensee need a separate licence?
- > Are FMC Act DIMS licensees required to provide financial advice to clients?
- > Do FMC Act DIMS licensees have to identify each client's investment objectives?
- > Do FMC Act DIMS licensees need an outsourcing arrangement in place to invest client money in managed funds?

Examples and scenarios – different types of DIMS

- > Scenario 1: AFA provides financial advice and DIMS
- > Scenario 2: Client 'pets and hates'
- > Scenario 3: Automation of pre-agreed client instructions
- > Scenario 4: Automation of model portfolio
- > Scenario 5: Investment reviews

Conduct expectations

- > Classifying investors: retail or wholesale
- > Explaining DIMS
- > DIMS review
- > Investment authority
- > Custody
- > Reporting
- > Record-keeping

Common questions

Am I providing DIMS if...?

... I provide an 'execution-only' service?

No – An 'execution-only' service means you do not provide any advice or recommendations, or make any decisions for your client. If your client makes all the investment decisions your service is not DIMS, even if you execute your client's instructions using a pre-existing investment authority granted by your client.

... I always check recommendations with my retail client before I go ahead with a transaction using his or her investment authority?

This will depend on whether it is you or your client making the investment decisions under the investment authority they have granted.

No – If you make recommendations, but are always required to wait for your client's approval, then your service is financial advice and not DIMS.

Yes – If you suggest transactions and check these with your client, but you can proceed on the basis of the investment authority if your client fails to respond, then this is DIMS because you are able to make the investment decisions. Lack of a response cannot be used as agreement to proceed even if you have advised that lack of a response will be considered agreement to proceed. If you proceed in this situation without a response you're providing DIMS.

... I make investment decisions to purchase real estate for a client under an investment authority?

No – If you do not make investment decisions relating to financial products, then your service is not DIMS. Direct investment in real estate is not a financial product.

However, if you make decisions relating to indirect investment in real estate under an investment authority, this could be DIMS. For example, if the decision relates to an investment in a company which owns real estate, or an investment in a managed investment product.

Financial products, as defined in the FMC Act, are debt securities, equity securities, managed investment products and derivatives.

... I provide financial advice about whether a client should enter into a DIMS facility?

No – If you only give a recommendation or opinion about entering into a DIMS facility, this is not DIMS. This service is financial advice, because a DIMS facility is a financial product under the FA Act, and the financial advice will be regulated under the FA Act (see [Financial advice relating to DIMS](#)).

Remember to unbundle the service

AFA's may give either class or personalised financial advice about whether a client should enter into a DIMS facility. This is regulated as financial advice, not DIMS. It does not matter whether the advice relates to a personalised or class DIMS facility.

... I provide an automatic service to rebalance retail clients' portfolios?

This will depend on whether you have any discretion to make decisions about which financial products to acquire, or dispose of, as part of the rebalancing.

No – The service is not DIMS if you only have a mechanical authority to rebalance your client's portfolio back to the original allocation, and the client has pre-agreed all decisions about which financial products to buy or sell and the proportion of each of them. For example, this type of mechanical rebalancing service could be provided by a wrap service provider without the need to obtain a licence.

Yes – If you have any discretion to make decisions, the service is DIMS. Discretion could include authority to replace one financial product with a similar product the client has not expressly chosen, or the ability to vary the original portfolio. You will need an FMC Act DIMS licence. Alternatively, you may be an AFA authorised to provide personalised DIMS, if the relevant decisions are based on a strategy designed for the client's financial situation and goals (see [Personalised DIMS or class DIMS](#)).

More than one party can exercise discretion. For example, a wrap provider could be rebalancing the client's portfolio in line with a model portfolio, but an AFA could make further changes based on client preferences. In this case, both the wrap provider and the AFA will be providing DIMS, and both will need to be authorised or licensed accordingly.

Check the format of your investment authority

We recommend AFA's check the format of their investment authorities to see whether they are wider than they need to be. If you don't intend to exercise discretion, we recommend you don't have an investment authority that allows you to exercise discretion.

What if I only provide DIMS to wholesale clients?

You do not need an FMC Act DIMS licence to provide DIMS to wholesale clients. However, if you hold an FMC Act DIMS licence you may also provide DIMS to wholesale clients.

People who may provide personalised DIMS, under section 20 of the FA Act, to wholesale clients are:

- > an AFA
- > a QFE adviser
- > a registered person (whether an individual or an entity)
- > an exempt provider (whether an individual or an entity).

Who is a wholesale client?

Wholesale clients relating to DIMS include:

- > a person who is an investment business as defined in clause 37 of schedule 1 of the FMC Act
- > a person who meets the investment activity criteria specified in clause 38 of schedule 1 of the FMC Act
- > a person who is 'large' as set out in clause 39 of schedule 1 of the FMC Act
- > a person who is a government agency as set out in clause 40 of schedule 1 of the FMC Act
- > an eligible investor as set out in clause 41 of schedule 1 of the FMC Act.

Personalised DIMS or class DIMS?

What types of DIMS can AFAs provide?

- > AFAs authorised to provide personalised DIMS under the FA Act are able to provide personalised DIMS to retail clients
- > anyone who provides class DIMS to retail clients must have a DIMS licence under the FMC Act
- > anyone (including an AFA) who works for a person or entity that holds an FMC Act DIMS licence may provide class or personalised DIMS to retail clients, but the service is considered to be – and must legally be – provided by the DIMS licensee, not the AFA (see [Who can provide DIMS within an FMC Act DIMS licensee?](#))
- > AFAs can provide both personalised DIMS and class DIMS to wholesale clients without an FMC Act licence and without authorisation to provide personalised DIMS under the FA Act.

What is personalised DIMS?

The definition of personalised DIMS appears in section 15 of the FA Act. It says:

- 15 (2A) ... a discretionary investment management service... is a **personalised service** or a **personalised DIMS** if —
- (a) the service is provided to a named client or a client who is otherwise readily identifiable by the financial adviser exercising the investment authority under that service; and
 - (b) the investment strategy implemented in, or to be applied under, the investment authority has been designed to take account of the client’s particular financial situation and goals or any 1 or more of them (rather than merely being customised from an investment strategy that applies to a class of clients, for example, by selecting options or by making minor changes to the class strategy or authority).
- 15 (3) A [DIMS] is a **class service** if it is not a personalised service.

We expect paragraph (a) of this definition is met by most DIMS, because the adviser should normally identify the particular client.

Paragraph (b) of the definition focuses on the design of the investment strategy, not the design of the investment portfolio. To be personalised DIMS the investment strategy must be designed for the client’s particular financial situation and goals, rather than customised from a strategy applying to a class of clients (see [Scenario 2: Client ‘pets and hates’](#)).

What is the investment strategy?

An investment strategy is how you make investment decisions for a particular client.

We understand that once AFAs have determined their client’s appropriate risk-return appetite, the most common investment strategies will follow either a model portfolio or model asset allocation.

We define these terms as:

- > A ‘model portfolio’ identifies the specific assets and their proportions that should be held by a client meeting a particular set of characteristics, such as a particular risk-return appetite. An adviser using a model portfolio would not normally have any influence over the assets held.
- > A ‘model asset allocation’ specifies the proportion of different asset types (or ‘asset buckets’) that should be held by a client meeting a particular set of characteristics. Advisers may then pick specific assets to fill the asset buckets by selecting investments that meet the requirements of the model. Specific assets may often be selected from an approved product list.

To determine whether you are providing DIMS designed for a particular client or DIMS for a class of clients, you need to look at how the investment decisions are made, not the portfolios that result from those decisions.

We expect most DIMS to be class DIMS

We understand most AFAs currently use model portfolios and/or model asset allocations as a core part of their investment strategy. This means most DIMS are class DIMS.

What is the investment authority for DIMS expected to contain?

The investment authority for DIMS must include:

- > an authority granted by the client to the provider to manage his or her portfolio of investments
- > a discretion given to the provider to decide which financial products to buy or sell for the client.

(See also [Investment authority](#)).

Can an AFA still use a model portfolio or model asset allocation?

Yes – AFAs can still use model portfolios and model asset allocations as core tools to provide financial advice. However, where these models are used to make investment decisions under DIMS, this is class DIMS, and an FMC Act DIMS licence is needed.

It is class DIMS because model portfolios and model asset allocations (as defined above) are designed for a class of clients. These models are not designed for an individual client's financial situation and goals, even though an individual client's financial situation and goals may match a model. DIMS following a model portfolio will always be class DIMS even though each client's individual portfolio may vary (due to differences in timing of implementing investment decisions, for example).

DIMS following a model asset allocation will generally be class DIMS because at the core of the investment strategy is a model that applies to a class of clients. However, a model asset allocation can be used to help design a personalised investment strategy where the model doesn't form a core part of that strategy.

An AFA could, for example, use a high-level model asset allocation to determine that a particular class of clients should invest 40 per cent in debt and 60 per cent in equity. The model in this case doesn't limit the scope of which financial products may be selected and only has a minor impact on the individual investment decisions. Because the model asset allocation is not material to individual investment decisions, it is necessary to look beyond the allocation to see how investment decisions are actually being made.

If, in all other respects, the investment strategy has been designed for a particular client, rather than applying to a class of clients, the overall investment strategy will be considered personalised.

Eligibility requirements for AFAs providing personalised DIMS

Are the eligibility requirements for AFAs providing personalised DIMS under the FA Act the same as under the FMC Act?

The eligibility requirements for AFAs providing personalised DIMS under the FA Act apply from 1 December 2014 subject to the transitional provisions (see the [transitional information sheet](#) here). They have been drafted to mirror the FMC Act licensee requirements.

How will the eligibility requirements for AFAs seeking authorisation for personalised DIMS be assessed?

We expect AFAs to demonstrate they can perform personalised DIMS effectively and can meet certain minimum standards, such as selecting investments, monitoring investments and reporting to clients.

Bespoke investment strategies need significant time and expertise to design. For this reason we do not expect many AFAs to provide personalised DIMS under the FA Act.

We published an updated [AFA Adviser Business Statement Guide](#) and [AFA Authorisation Guide](#) in January 2015 that provides details on the assessment process and the minimum standards for AFAs providing personalised DIMS.

Contingency exemption

What is the contingency exemption?

The contingency exemption enables an AFA to provide DIMS to a retail client, without holding an FMC Act licence, in limited circumstances (contingency DIMS).

When can I provide contingency DIMS?

Each of the following must apply before you can provide contingency DIMS:

- > the DIMS must be incidental or secondary to other financial services you provide to your client
- > you must not have an investment authority from your client to regularly decide what financial products to buy or sell for his or her portfolio
- > you must have an investment authority from your client that is limited to temporary management of his or her portfolio in situations of absence, incapacity or unexpected contingencies during a 'known temporary period', or in urgent situations.

How do I know whether the DIMS are incidental to other financial services provided?

The DIMS will be incidental to the financial services you are already providing if the client's portfolio is usually managed through you providing financial advice or an investment planning service, and not DIMS.

You may have a standing authority to make decisions on behalf of your client in unexpected situations, but as long as this doesn't become the normal method of decision-making for the management of the client's assets, the DIMS will be incidental to the other financial services you provide to your client and therefore considered contingency DIMS.

What is a 'known temporary period'?

A known temporary period is a specified length of time that has been pre-agreed between you and your client. For example, your client could be going on holiday overseas for three weeks. The investment authority would state you have the authority to provide DIMS during those dates.

When will there be urgent situations?

An urgent situation will arise when it is in the client's best interest for you to act, under the authority, and you are unable to get instructions from the client in time for you to act. It would be urgent to act if failure to do so would cause material loss to the client.

The investment authority needs to state you have authority to provide DIMS for a temporary period to cover any absence, incapacity or contingency when you cannot reasonably obtain instructions from the client.

The DIMS authority will only be for the period covering the client's absence, incapacity or contingency.

What else do I need to know about the contingency exemption?

If you choose to offer contingency DIMS to a client, there are a few requirements which must be met.

Only provide DIMS for less than six months in total.

You can still have a standing authority allowing you to make decisions in urgent situations when you cannot obtain instructions from the client. This authority can last longer than six months.

The periods when you are providing contingency DIMS must not extend beyond six months in any 12-month period and cannot become the main way decisions are managed for your client's portfolio. This limit applies even if the client requests it be extended.

You can't provide contingency DIMS if you, or someone associated with you, is already providing DIMS to that client.

If you, or someone you are associated with, are generally managing the client's portfolio through DIMS, the contingency exemption will not apply. The client is receiving the service in more than just contingency situations, so the person providing the service needs to be authorised or licensed.

'Associates' can be relatives, people you have a director or senior manager professional relationship with, or people you have a substantial degree of influence over.

If, for example, you are a director of a financial adviser company and your senior manager has authority to provide DIMS to a client, you won't be able to provide contingency DIMS to the same client.

The client's portfolio must be directly held by the client or an independent custodian.

It can't be held by you.

The client agreement must meet specific requirements.

You must have an agreement that allows you to provide contingency DIMS to the client.

The agreement must be in writing and must:

- > state that, in acting under the contingency aspect of the investment authority, you agree to comply with your duties under the FA Act if you were authorised to provide personalised DIMS. These include the duty to act honestly, and the duty to comply with a professional standard of care.
- > cover how you will report on any transactions under the provision of contingency DIMS, including when you will report and what information will be in your report. Where you have provided contingency DIMS in an urgent situation, your report must include an explanation of why you considered it necessary to act urgently without the client's authority.
- > allow the client to immediately revoke your contingency investment authority by giving you written or oral notice.

The investment authority must meet specific requirements.

Before you provide contingency DIMS to a client, your client must authorise you to provide contingency DIMS to manage some, or all, of his or her portfolio for a known temporary period and/or in urgent situations.

The contingency investment authority must:

- > be in writing
- > clearly describe the scope of your investment authority. It must also describe any limits on the investments you can make and the proportion of

each type of financial product. If there are no limits, the investment authority must say so

- > not be changed without the client's prior written agreement.

What do I need to do if I want to provide contingency DIMS to my clients?

If you want to provide contingency DIMS to your clients, you will need to do the following:

1. Make sure you have an independent custodian. A client's assets will need to be held by an independent custodian or directly by the client. They can't be held by you.
2. Review and amend your client agreements and investment authorities to make sure:
 - > your documents don't give you an authority to make decisions about all or some of your client's assets permanently
 - > your client agreements meet the content requirements listed above
 - > you have authority to provide DIMS for a known temporary period and/or in urgent situations and your investment authority meets the requirements outlined above.
3. Update your Adviser Business Statement and any other disclosure documents as necessary to reflect what type of DIMS you are offering.
4. Monitor the use of each investment authority to ensure you do not use contingency DIMS as a regular way of managing a portfolio and that you do not exceed the six-month limit within 12 months.
5. Ensure you can provide adequate reporting to clients as detailed in your client agreement.

Financial advice relating to DIMS

Who can provide financial advice about entering into a DIMS facility?

AFA's are the key source for financial advice on DIMS

Only AFA's can provide personalised financial advice to retail clients about entry into a DIMS facility that invests in category 1 products from multiple issuers.

A DIMS facility is a category 1 product under the FA Act (unless the investment authority only covers category 2 products). Financial advice about entering, retaining, or exiting from a DIMS facility is regulated in the same way as financial advice on other financial products (as defined in the FA Act).

If the DIMS involve investment in any category 1 products, only the following individuals are allowed to provide personalised financial advice to retail clients:

- > an AFA, or
- > a QFE adviser (but only if the QFE, or a member of the QFE group, is the promoter of all the category 1 products available under the DIMS).¹

If the DIMS facility only involves investment in category 2 products, financial advice may be given by:

- > an AFA
- > a registered individual, or
- > a QFE adviser.

Financial advice about whether an investor should enter into a DIMS facility is not provided 'in the ordinary course of, and incidentally to' your DIMS, so will not be covered by your FMC Act licence (see [What financial advice is covered by an FMC Act DIMS licence?](#)).

Recommending people invest in your DIMS facilities is subject to the requirements of the FA Act described in the previous paragraph.

Any service where you review the suitability of your existing DIMS for a particular client will also be subject to the requirements of the FA Act described above.

What financial advice is covered by an FMC Act DIMS licence?

The definition of DIMS in section 392 of the FMC Act includes the provision of 'financial advice in the ordinary course of, and incidentally to, providing a discretionary investment management service'. This incidental financial advice is included so DIMS licensees do not need to consider the separate requirements of the FA Act when providing DIMS.

An example of incidental financial advice is where you advise your client to widen the scope of his or her investment authority to allow the purchase of shares in a particular company, provided the existing investment strategy being implemented involves investing in companies similar to that particular company.

FMC Act DIMS licensees

What types of DIMS can FMC Act DIMS licensees provide?

The FMC Act does not distinguish between personalised DIMS and class DIMS. This means an FMC Act DIMS licensee can provide both personalised DIMS and class DIMS (see [What is personalised DIMS?](#)).

An FMC Act DIMS licensee needs to describe the types of service the licensee provider intends to provide, but does not need to categorise any DIMS as either personalised or class (see [What financial advice is covered by an FMC Act DIMS licence?](#)).

How will FMC Act DIMS licence applications be assessed?

Information about this process is available in our [two-part licensing guide](#).

¹ In practice this will mean that only an AFA will be able to provide financial advice on a DIMS facility that involves direct equity investments.

Who can provide DIMS within an FMC Act DIMS licensee?

It is the FMC Act DIMS licensee that provides DIMS, not its employees, contractors or other agents. If the licensee is a company, it is the company that provides DIMS, even though it acts through its employees.

This is similar to companies offering a managed investment scheme, or any other financial product. It is the company that provides the product, not the individual employees.

The DIMS licensee can provide DIMS using the processes and procedures described in its original licence application, or any approved update. The approved processes and procedures will describe the various agents of the licensee involved in delivery of the service.

Will AFAs employed by an FMC Act DIMS licensee need a separate licence?

No – When you apply for a DIMS licence under the FMC Act, we assess whether your business is able to perform the type of DIMS you propose, not whether individual advisers are capable of performing the service. If we are satisfied your business meets the minimum standards for DIMS licensees, we will grant you a licence to conduct that type of DIMS.

You can choose how you structure and deliver your DIMS, provided you have accurately described this in your licence application or update. You may structure the service so AFAs, or other non-AFA employees, liaise with your clients.

Even if an AFA delivers the service, the DIMS licensee remains responsible for the service. It is also responsible for supervising staff delivering the service. AFAs do not need to have their own FMC Act DIMS licence, nor do they have to be authorised to provide DIMS under the FA Act, because the service is being provided through the DIMS licensee.

An FMC Act DIMS licensee that employs AFAs may choose to perform some DIMS under its DIMS licence and allow its AFAs to deliver other personalised DIMS

under their AFA authorisation. If so, this business model needs to be described in the DIMS licence application. Where an AFA undertakes personalised DIMS under their FA Act authorisation, the AFA will be subject to the eligibility criteria and be personally responsible for that service. This must be made clear to the client (see [How will the eligibility requirements for AFAs seeking authorisation for personalised DIMS be assessed?](#)). Where an AFA is authorised to provide personalised DIMS under the FA Act but provides DIMS under another person's licence, that must also be made clear to the client. It must be clear in the client agreement investment authority, and both the FMC Act and FA Act disclosing documents.

Are FMC Act DIMS licensees required to provide financial advice to clients?

No – There is no requirement for you to provide financial advice to your clients. However, it may sometimes be difficult to avoid providing financial advice alongside DIMS, especially where you hold personal meetings with clients to identify their investment objectives.

Any financial advice provided to clients that is not in the ordinary course of, and incidental to, the provision of the DIMS, must comply with the provisions of the FA Act (see [Who can provide financial advice about entering into a DIMS facility?](#)).

Do FMC Act DIMS licensees have to identify each client's investment objectives?

Yes – Section 437(2) of the FMC Act requires you to 'ensure that the investment authority provides adequately for the investment objectives'. This means you need to record your clients' investment objectives. However if you are providing class DIMS, you do not need to identify different investment objectives for each client. For class DIMS, if you specify the investment objectives of your particular DIMS and the client confirms they would like to proceed, there is no need to consider whether they are appropriate for that particular client.

The investment objectives should be the same for all clients within a class DIMS, because the investment strategy from the investment authority will be the same.

Remember any advice to clients about the suitability of your DIMS is not covered by your FMC Act DIMS licence. This is regulated separately as financial advice (see [Who can provide financial advice about entering into a DIMS facility?](#)).

Do FMC Act DIMS licensees need an outsourcing arrangement to invest client money in managed funds?

No – If the relevant investment authority allows you to invest in managed funds, you can do this under DIMS. You would not be considered to be outsourcing management of your client’s portfolio.

Example scenarios – different types of DIMS

There are many different ways you can provide DIMS. In this section we include examples to help explain our guidance. However, these are not exhaustive. You need to review your own arrangements to decide who is making investment decisions and, if so, who is providing DIMS, and what kind of DIMS they are providing.

Scenario 1: AFA provides financial advice and DIMS

An AFA recommends her client establish a particular portfolio of direct equity investments and managed funds. The AFA has considered the client’s risk profile and financial needs. She has determined the best investments by reviewing research material, including one or more asset allocation models.

The client tells the AFA to go ahead with the investments and also gives her an authority to make changes to the portfolio in future.

The AFA makes changes to the portfolio and reports to the client after each change has been made.

The client is a retail client.

The initial recommendation of a particular portfolio will be **personalised financial advice**, not DIMS, under the FA Act because the client decides whether to establish the initial portfolio.

If the client grants an investment authority, recommended by the AFA, this is a recommendation to enter into a DIMS facility and is **personalised financial advice** from 1 December 2014.

Subsequent changes made to the portfolio are DIMS because the AFA is making decisions about which investments to buy or sell. If the changes to the portfolio are generally in line with one of the asset allocation models considered by the AFA then, subject to any transitional provisions², the service will be **class DIMS** and an FMC Act DIMS licence is needed.

The service will be **personalised DIMS** if the model asset allocations are not a core part of investment decisions, and these decisions have been made in line with an investment strategy designed for the individual client.

The AFA may continue to provide this **personalised DIMS** only if authorised under the FA Act (see [‘How will the eligibility requirements for AFAs seeking authorisation for personalised DIMS being assessed?’](#)).

² Find out about the transitional provisions in our [Transitional Information Sheet](#)

Scenario 2: Client ‘pets and hates’

A wrap business offers three different model portfolios which can be held through their wrap service.

An AFA that is not employed by, or aligned to, the wrap service recommends a mix of these portfolios based on their client’s financial situation and goals. The client may choose to exclude particular investments (‘hates’) and include others (‘pets’) that would not otherwise be within the portfolio.

The wrap service makes changes to the portfolio to reflect changes in the model portfolios, but the AFA also has authority to make changes to the portfolio to take account of ‘pets’.

The client is a retail client.

The initial recommendation of a particular mix of model portfolios will be **personalised financial advice** under the FA Act. Any recommendation that the client should grant the DIMS investment authority to the DIMS provider will be a recommendation to enter into a DIMS facility and so is also **personalised financial advice**.

The wrap service provider and AFA are providing DIMS because they are both making investment decisions on behalf of the client.

The DIMS provided by the wrap service provider is **class DIMS**, because it uses model portfolios, so the wrap service providers will need an FMC Act DIMS licence. The DIMS licence could also authorise the AFA to trade the ‘pet’ investments if this service was part of the wrap provider’s business as described in the DIMS licence approval.³

The DIMS provided by the AFA is limited in scope because the AFA can only trade in a limited list of ‘pets’, and so could be either class DIMS or personalised DIMS.

It will be **personalised DIMS** where the investment strategy for buying and selling those ‘pets’ is designed specifically for that client. This will be more likely where there are only a few ‘pets’ the AFA can trade, and the investments are different from other clients’ investments so that a class investment strategy can’t be used.

It will be **class DIMS** where the investment strategy is not designed specifically for the client, such as where a model or part of a model is used.

Taking this scenario one step further, what if the DIMS described in this example were to be provided by one person? Where, for example, the AFA does not use a wrap service and instead the AFA makes buy or sell decisions to reflect changes in a model portfolio, while also taking into account ‘pets’ and ‘hates’.

In this case, the customisation of the model portfolio with ‘pets’ and ‘hates’ would not make the class DIMS into a personalised DIMS. The AFA would be providing **class DIMS** and would need an FMC Act DIMS licence or would need to be acting through a DIMS licensee.

If the ‘pets’ and ‘hates’ are so extensive that the model portfolio no longer forms a core part of the strategy, and the decisions are instead generally determined by an investment strategy designed specifically for that client, then the service would be **personalised DIMS**, and the AFA would either need an FMC Act DIMS licence or would need to be acting through a DIMS licensee, or would need to be authorised to provide personalised DIMS under the FA Act.

Scenario 3: Automation of pre-agreed client instructions

A wrap service offers investments in two different managed investment schemes– one growth, and one income-focused.

An AFA advises his customer to invest 50 per cent of his or her funds in each fund and the client agrees to make those investments. The wrap service offers an automatic rebalancing service that rebalances the

³ The service would then be provided by the DIMS licensee, not the AFA. The AFA would be part of the service delivery process, but the DIMS licensee would be responsible for the service. See [Who can provide DIMS within an FMC Act DIMS licensee?](#)

funds whenever the value of one fund becomes 55 per cent or more of the total value invested.

The client is a retail client.

The initial recommendation of the funds mix is **financial advice**.

If the client provided specific instructions when they agreed to the automatic rebalancing service, so it is just a mechanical function (without any discretion concerning which financial products to buy or sell), the rebalancing service will be an execution-only service, not DIMS.

However, if the rebalancing service has discretion over which financial products to buy or sell, the person exercising that discretion will be performing DIMS. For example, if the wrap service provider has discretion to decide which replacement investments to buy when an investment matures, then the wrap service provider (not the AFA) is providing DIMS. If these investment decisions are made by the AFA, then the AFA is providing DIMS.

Scenario 4: Automation of model portfolio

A research provider, 'Research Ltd', provides model portfolios to an AFA.

The AFA considers her client's personal situation and advises them to invest in a particular model portfolio.

The AFA also advises her client to use the automated services of a wrap provider, 'Wrap Ltd', so the client's portfolio is changed every time there is a change to Research Ltd's published portfolio.

The AFA's initial recommendation of a particular model portfolio, and their recommendation the client use an automated (DIMS facility) service, is a recommendation to enter into a DIMS facility and so is **personalised financial advice** under the FA Act.

To assess who is providing DIMS, in this example, it is important to unbundle the services and look carefully at who is making the on-going investment decisions on behalf of the client. This will depend on the contractual and practical arrangements between the parties.

If the AFA always checks the proposed changes to the portfolio and has authority from the client to prevent a change going ahead, the AFA is making the investment decisions. The decisions are being made on the basis of a model portfolio, so the DIMS will be **class DIMS** and the AFA will need an FMC Act DIMS licence (or need to be acting through an entity with an FMC Act DIMS licence).

If Wrap Ltd implements the model portfolio without reference to the AFA, then either Research Ltd or Wrap Ltd must effectively be making the on-going investment decisions for the client. The client agreement needs to be between the client and the person making the investment decisions and must authorise that person to make those decisions. The person making the investment decisions will be providing DIMS and will need an FMC Act DIMS licence.

If the client has granted Wrap Ltd the authority to ignore a change in the model produced by Research Ltd, for example because Wrap Ltd believes it deviates from the investment strategy agreed with the client, then Wrap Ltd is effectively making the investment decision and will be providing the class DIMS and will need an FMC Act DIMS licence.

Research Ltd could be providing class DIMS, for example, if the arrangements agreed by the client require Research Ltd's model portfolio to be automatically implemented without the AFA or Wrap Ltd being able to intervene in individual investment decisions. In these circumstances the client is effectively giving Research Ltd authority to make the investment decisions. Research Ltd will need an FMC Act DIMS licence and also a compliant client agreement.

Review your arrangements

We encourage parties to review their arrangements regularly to ensure it is clear which party is making any on-going investment decisions for the client and to ensure that party has authority to do so.

Scenario 5: Investment reviews

A DIMS provider offers five different model portfolios, ranging from conservative to high growth.

An AFA initially advises his client to invest in a particular mix of the portfolios based on the client's individual financial situation.

He holds regular investment reviews where he advises whether the client should amend his or her mix of portfolios in line with his or her updated financial situation and goals.

The AFA has an authority to execute transactions on behalf of his client but can only change the client's mix of portfolios if the client agrees.

The DIMS provider offering the five model portfolios is providing a **class DIMS** service and will need an FMC Act DIMS license.

An AFA's initial recommendation to enter into a DIMS facility is **personalised financial advice**. The recommendation to change the mix of model portfolios will also be **personalised financial advice**. The AFA is not providing DIMS because the client is making the investment decisions rather than the AFA.

A licensed FMC Act DIMS provider will not be permitted to provide the type of financial advice provided by this AFA under its DIMS licence, because the advice is not provided 'in the ordinary course of, and incidentally to' the DIMS service. This is because the financial advice involves a change to the investment strategy (see [Financial advice relating to DIMS](#)).

Conduct expectations

Classifying investors: retail or wholesale

What this might look like

An AFA recommends a client to enter into a DIMS facility (either with the AFA or with a third party) and the client agrees. The DIMS provider asks the client to complete a fact-find document, a needs analysis and a risk assessment questionnaire. The DIMS provider uses this information to classify the client.

Legal requirements

Clients of DIMS providers will be regarded as retail clients unless they qualify as wholesale clients. Retail clients have more protection than wholesale clients under the legislation. This includes disclosure requirements for DIMS providers providing DIMS to retail clients and custodial requirements.

A client can qualify as a wholesale client for DIMS in one or more categories under clause 36 of schedule 1 of the FMC Act. These categories include a person who is an 'eligible investor' (under clause 41 of schedule 1 of the FMC Act) who certifies to the provider they understand the consequences of the certification.

If a provider is not satisfied with a client's reasons for providing an 'eligible investor' certificate or believes it is incorrect, the FMC Act requires that the certificate must not be accepted.

Expected practice

When classifying clients as wholesale under the FMC Act, we expect DIMS providers to:

- > have robust systems in place to ensure they correctly identify and distinguish between retail and wholesale clients

- > explain to wholesale clients how and why they are categorised. Providers are expected to take all reasonable steps to ensure the client is aware they are regarded as a wholesale client, and are also aware of the consequences
- > be able to demonstrate how each decision was made to categorise clients as wholesale, and to retain records of those decisions
- > review each wholesale client's categorisation at least on an annual basis.

We do not object to a DIMS provider including wholesale clients in the retail investor category, or classifying all clients as retail investors. However, we would be concerned if retail clients were included in the wholesale client category.

Explaining DIMS

What this might look like

After an AFA has recommended her client use a DIMS facility, she gives them an overview of key information about the service, and explains the benefits and risks.

A potential benefit might be that her client wants to keep track of his investments by receiving a consolidated report for his investment portfolio managed through DIMS, instead of one for each of his investments. Another benefit may be that investment decisions can be made quickly as there is no waiting for client approval.

The AFA also explains that her client could manage his investment portfolio himself, instead of using DIMS, and explains the issues to consider for both types of services. (The AFA may or may not provide both types of service).

Legal requirements

Providers must give clients a disclosure statement (for FMC Act DIMS licensees refer to section 423 of the FMC Act, and for AFAs authorised to provide personalised DIMS under the FA Act refer to section 21 of the FA Act). This includes information about the provider's authorisation or licence to provide DIMS, the fees and/or commissions they will receive, and how the service works.

Providers must have legally enforceable client agreements and written investment authorities. The investment authority must clearly disclose the scope of the service granted by the retail client. This will need to include any limits on the nature or type of investments, and on the proportion of each type of asset invested in. If there are no limits on any of these matters, or the authority can be changed without the client's prior written consent, this needs to be clearly disclosed.

Expected practice

In recommending DIMS to a client, AFAs are expected to clearly explain the following to their clients:

- > the principal benefits and risks involved in having the client's portfolio managed through DIMS
- > how this service may, or may not, meet their needs.

Providers are expected to clearly explain the following to their clients:

- > the scope of the authority to manage the investment portfolio (including what is outside the authority, if this is relevant)
- > the effect of the authority if the client becomes sick, absent or unable to conduct his or her affairs
- > the scope of the provider's discretion to decide on which financial products the provider can buy or sell for the client (including what is outside the provider's discretion, if relevant). The provider may refer the client to the investment authority for a more detailed explanation of the scope of the provider's discretion

- > the principal benefits and risks involved in having the client's portfolio managed through the DIMS
- > the fees payable by the client (including all fees paid to the provider, platform providers and other third parties)
- > information about any platform provider, custodian, agent or other third party appointed to provide any services in connection with the DIMS, including an explanation of the scope of service
- > how additional cash will be treated (for example, from client contributions, dividends from client property, and proceeds of the sale of financial products)
- > the likely timeframe for making withdrawals from the DIMS portfolio, including any likely liquidity risk that may affect processing withdrawals within usual timeframes
- > the process for terminating the DIMS and winding up the investment portfolio.

Providers can give clients a brief explanation of the above matters and refer to the investment authority, client agreement and/or terms of business for more details.

AFAs should exercise their professional judgment when recommending a client enter into a DIMS facility and must decide whether to include additional relevant information that would enable the client to make an informed decision about using the service.

DIMS review

What this might look like

A provider arranges a time to speak with the client over the phone to conduct an annual review of the DIMS being provided. The client has received a copy of his statement of portfolio holdings from the platform provider who the provider has contracted to provide custody, administrative and reporting services for his investment portfolio.

The provider compares the client's holdings of financial products in the investment portfolio against the asset allocation and benchmarks contained in the investment authority. The provider draws the client's attention to the returns earned on the portfolio that are reported in the statement, and explains what factors are likely to have influenced these returns. The provider also asks the client a series of questions to understand whether any changes to his client's circumstances are relevant to the suitability of the DIMS being provided.

Expected practice

Key facts about the client's circumstances that are relevant to the proposed DIMS should be documented, as well as a brief explanation of why the proposed DIMS are suitable for the client.

The client's circumstances are likely to change during the period covered by DIMS. Without regular updating of the investment authority, the investment portfolio may become unsuitable for the client. Therefore, reviews of the client's circumstances, portfolio allocations and benchmarks should be conducted at least annually.

The thoroughness of the annual review will depend on the nature of the DIMS being provided. An investment authority may specify an indicative timeframe for how long an investment strategy or position should be held. If so, a more comprehensive inquiry may be required when the investment strategy is reviewed. Providers should ensure they do not provide a service outside their licence or authorisation, and ensure only AFAs recommend or advise about the suitability of DIMS to clients.

Investment authority

What this might look like

A provider uses relevant information obtained during the client induction to prepare the investment authority for the client. This should include a detailed investment mandate that specifies the portfolio's investment objectives, asset allocation (including asset classes, sectors and geographic regions), ranges, benchmarks and a broad selection of criteria for choosing financial products. The provider prepares a letter for the client that encloses the investment authority, the terms of service, and summarises the explanation given to the client about DIMS. The client authorises the provider to establish and manage an investment portfolio according to the investment authority by accepting the terms of service.

Legal requirements

AFA personalised DIMS (see sections 41 and 43 of the FA Act) and FMC Act licensed DIMS (see sections 430 and 437 FMC Act) must:

- > have a written investment authority signed by the client (or clearly acknowledging in writing acceptance by the client)
- > have a written investment authority clearly disclosing the scope of the authority, including limits on type and proportions of investments or, if there are no limits, states that there are no limits
- > ensure it is clearly stated whether the investment provider can be changed without the prior written consent of the client
- > ensure the investment authority is entered into at the same time as, or after, the client agreement is entered into.

Section 437 of the FMC Act requires that the FMC Act licensed DIMS must:

- > disclose the methodology for developing and amending the investment strategy, and for measuring performance against investment objectives.

Regulation 183 of the FMC regulations states that contingency DIMS must:

- > be restricted to temporary provision of DIMS for either a known period or unknown period when there is urgency to act
- > have a written investment authority signed by the client, or clearly acknowledged acceptance by the client in writing
- > have an investment authority clearly disclosing the scope of the authority, including limits on type and proportions of investments, or stating that there are no limits, and
- > only be changed with the client's prior written consent.

Expected practice

The written investment authority should comprehensively set out the following information about the proposed DIMS, as described in the expected practice for [explaining DIMS](#) section.

The FMA expects investment authorities to set out clear arrangements to deal with the following:

- > how frequently the investment portfolio is re-balanced or re-aligned to the asset allocation, and whether re-balancing also occurs following specified events
- > frequency of reports on the investment portfolio's value
- > documents relating to investments, or transactions and other communications relating to investments (such as shareholder reports, notices, and proxies relating to investments) and whether these should be sent to the client
- > who will be responsible for exercising voting and other rights attached to client property in the investment portfolio

- > collecting and reinvesting or distributing income (including dividends and distributions of any kind) and principal (including the proceeds of the sale of client property), and
- > the method and addresses for communications.

Where relevant, the FMA expects the investment authority to state or refer to:

- > the nature and type of assets that can make up the portfolio
- > the benchmark asset allocation for those types of assets
- > the methods for valuing those assets
- > the limits or ranges within each benchmark asset allocation.

Custody

What this might look like

A provider has a client who does not directly hold financial products in their portfolio. Instead, they are held by either a custodian who is independent of the provider or an associated person if permitted in the conditions of the DIMS licence.

Legal requirements

A DIMS provider must ensure investor money and investor property are held either directly by the client, by an independent custodian, or by an associated person if permitted by the DIMS licence conditions.

Entities and individuals⁴ who act as the intermediary for a client in the receipt, holding, payment or transfer of client money or property must comply with the conduct obligations under part 3A of the FA Act. This person is a 'broker'. Brokers must be registered to provide 'broking services' on the Financial Services Providers Register. AFAs do not need to be separately registered as a broker if their employer is registered, even though they may still be dealing with client money or property. However, for ease of reference, we'll describe everyone who is responsible for handling client

⁴ Individuals do not need to register for broking services under the Financial Service Providers Register if they are employees and their employer is registered for broking.

money and/or client property as a 'broker'.

The general conduct obligations (set out in sections 77J to 77O of the FA Act) include obligations:

- > to exercise care, diligence and skill
- > not to engage in misleading or deceptive conduct.

There are specific obligations for broking services for retail clients (sections 77P- 77T of the FA Act), which include requirements:

- > to hold client money and property on trust in a separate trust account
- > to properly account to the client for money and property held
- > to maintain adequate records of the client money and property
- > not to use or apply client money or property except as expressly directed by the client. The money or property cannot be used to pay creditors of the broker.

Expected practice for brokers

The expected practice below is relevant in a DIMS context, and is not an exhaustive guide.

The DIMS provider should complete due diligence when selecting a custodian. Factors to consider may include:

- > the custodian's previous experience
- > the amount of assets under its control
- > public reports and information about the custodian's service
- > reported complaints about the custodian and the custodian's complaint handling procedures
- > the good character of the custodian's directors and controllers.

The providers and the custodian must enter into a custody agreement that clearly sets out client money and property handling arrangements, including:

- > whether money and property will be held in a separate client account for each client, or in an aggregated client account
- > whether handling of money and property is outsourced, and
- > how and when administrative **fees** and other expenses that will be charged for handling money and property, will be collected.

Brokers must have adequate systems and processes to ensure client money and property is:

- > identified and recorded on a regular basis (at least daily) in a client register or ledger, and also separately identifies each client's portfolio holdings
- > segregated from the broker's own assets
- > held in a trust account. The trust status of each client's money or property account should contain the word 'trust' and/or 'client funds account', and the broker should get a letter from each trust account provider acknowledging the trust status
- > reconciled on a regular basis with money and property records of external providers (such as banks, external custodians and sub-custodians). The frequency of reconciliation will depend on how often the investment is traded. Reconciliations relating to equities are likely to be daily, for example, while direct physical property investments might be reconciled when transactions occur.⁵

IT systems should be sufficiently robust and protected from potential threats, including fraud. Records should be backed up regularly and systems should include disaster recovery arrangements, such as having records stored off-site.

We expect systems for wholesale clients to include processes and controls similar to those for retail clients, to meet their care, diligence and skill requirements (section 77K of the FA Act).

⁵ Reconciliations should be carried out by a person independent of the person making decisions regarding the investment portfolio and processing the transactions.

Outsourcing to agents

Where the broker contracts out broking services to a third party (the 'agent'), the broker (either the AFA or their employer) remains responsible to the client for broking services (section 77U of the FA Act).¹ The broker should carry out and record a reasonable level of due diligence when selecting an agent. The proposed arrangements under an agency agreement between the broker and the agent should also be recorded. This should include:

- > whether the agent has adequate processes and controls to ensure compliance with this expected practice for brokers
- > whether the agent has internal audit or external review processes to verify compliance with this expected practice for brokers
- > whether the agent will be allowed to appoint any sub-agents
- > the agent's standing and reputation with other brokers and publicly available information on the agent's compliance history, owners and directors
- > the agent's capability to perform core administrative activities, including IT, accounting and risk management systems; proven capability of managing risk events; and the agent's arrangements for how various types of assets are held
- > whether the agent has adequate professional indemnity insurance, and any capital adequacy requirements
- > whether the agent's fees are reasonable
- > how the agent must hold and deal with client money and property. This is particularly important if overseas custodians are used.

Brokers should consider how they will monitor an agent's performance and compliance on a regular basis, and review their appointment of agents at least annually.

Reporting

What this might look like

The DIMS provider produces regular statements with information about the content, value and performance of the client's DIMS portfolio. The provider and/or AFA analyses the report, with the client's relevant circumstances in mind, to determine whether the investment portfolio remains suitable. The provider also uses the report to determine whether the investment portfolio needs to be re-balanced back to the asset allocations in the investment authority.

Legal requirements

DIMS providers are obliged to provide regular ongoing reporting, as well as annual reports, to the client. The reports can be provided by an electronic facility, if agreed by the client, or to the client's address (including their email).

Ongoing reports must be provided either on a substantially continuous basis via an electronic facility or at the end of every quarter. Ongoing reports must contain (amongst other things, as set out in clause 210 of the FMC regulations and in clause 7 of the Financial Advisers (Personalised DIMS) Regulations 2014):

- > a record of all transactions made by the provider for the client
- > details of the financial products and cash currently held
- > details of incomings and outgoings
- > if the information is provided by a third party, a statement saying that.

⁶ The agent will need to be registered to provide 'broking services' on the Financial Services Providers Register but will not be treated as the broker having the broker obligations to the underlying client under the Financial Advisers Act 2008.

Annual reports must be available to the client within 20 working days of the end of the annual reporting period. Annual reports must contain (amongst other things, as set out in clause 211 of the FMC regulations and clause 9 of the Financial Advisers (Personalised DIMS) Regulations 2014):

- > a description of the investment strategy and any material changes to that strategy during the reporting year
- > the before-tax (but after-fees and trading expenses) return on the client's portfolio for both the past year and the previous five reporting years
- > a bar graph showing the return on the client's portfolio before tax but net of fees for each complete year the client has been using the service, up to the past 10 years
- > the names of the class of each financial product in the portfolio
- > the value of the portfolio and the products and cash in the portfolio
- > details of incomings and outgoings
- > a pie graph showing the composition of the client's portfolio
- > a reminder the investor may request past quarterly reports, or obtain further information from an electronic facility, if applicable.

Expected practice

Portfolio reports should be easy for a non-expert investor to understand.

We expect portfolio reports to:

- > contain accurate information about the content, value and performance of a portfolio for the relevant reporting period
- > contain a brief explanation of what performance figures relate to (such as whether fees include deductions for tax and the period for measuring performance)
- > be concise, but contain all the information required,

and needed for the client to be comfortable about what is happening with his or her portfolio

- > clearly explain outgoings, particularly fees and what the fees are for, and who they are paid to.

Record-keeping

Legal requirements

DIMS providers must comply with the professional standard of care when providing DIMS to retail clients.

Brokers must keep records of client money and property under section 77R of the FA Act. Records must be complete, accurate and made on a timely basis, with property appropriately valued and client ownership clearly specified.

Expected practice

We expect DIMS providers to record sufficient information to show the decisions made were consistent with the applicable investment authority.

We expect DIMS providers to keep client files. These can be held electronically, in hard copy, or both, provided they are retrievable and accessible in a readable format. The kinds of records that DIMS providers should keep include:

- > copies of the investment authority and client agreements
- > the results of the enquiry to determine suitability of the proposed DIMS
- > information relating to investment decisions, including research and analysis conducted by the DIMS provider or another person who the DIMS provider has reasonably relied on, and
- > if a wrap provider has entered into an agreement with the client, copies of any agreements between the wrap provider and the client, showing the extent of the DIMS provider's authority over the portfolio.

We expect brokers to maintain records that demonstrate the following:

- > **Receipt of money or property from clients** – all money received is accurately entered into the client trust account or general ledger, and then entered into the client ledger and allocated to the correct client on a timely basis.
- > **Holdings of money or property** – records clearly show the client’s money or property (including money earned on client property and money) in the trust account. There should be regular reconciliations appropriate to the nature of the property held and independently reviewed and authorised.
- > **Use of money or sale of property, including for buying or selling property** – use and receipt of money or property is accurately recorded in the general ledger and the client ledger on a timely basis, and allocated to the correct client account. Records show the use of money or sale of property is within the client’s instructions and money not reinvested has gone to a bank account authorised by the client.