

# Understanding the regulation of DIMS

## Frequently asked questions

Here's the latest on how FMA will approach the regulation of DIMS from 1 December 2014. Watch out for further updates when all the regulations have been finalised...

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In this document we outline some of the key terms and frequently asked questions about the future regulation of Discretionary Investment Management Services (**DIMS**). We also include some practical examples and scenarios to help explain our approach to regulating DIMS.

You should read this if you plan to apply for a DIMS licence under the Financial Markets Conduct Act 2013 (**FMC Act**) or you are an Authorised Financial Adviser (**AFA**) who plans to provide personalised DIMS under the Financial Advisers Act 2008 (**FA Act**). This content is based on the law as at March 2014. If there are further exemptions and/or transitional provisions we will update this accordingly (see [Exemptions and transitional provisions](#)).

For a quick guide to the changes AFAs may prefer to read the factsheet '[Changes ahead for AFAs who provide DIMS – Update #2](#)'.

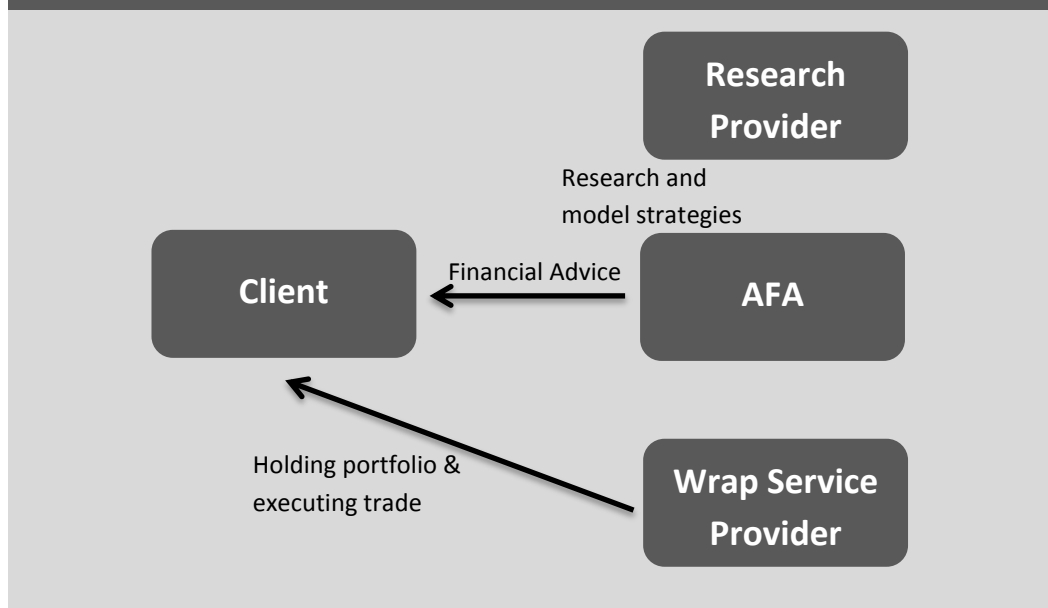
### Unbundling DIMS – what is a DIMS?

A DIMS is an investment arrangement where you make buy-sell decisions about your client's portfolio, rather than your client making those decisions. It 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 that you understand who, if anyone, is providing DIMS.

The key is to consider which parties are making buy/sell decisions concerning the client's portfolio of financial products and who has the authority to execute transactions. If the client is making the buy/sell decisions, then it is not a DIMS, even if the client has granted someone else an authority to execute the transactions. Any party making buy/sell decisions, with authority from the client, is performing DIMS and should read this document carefully to understand what sort of licence they need. If you provide financial advice in relation to DIMS you should also read these FAQs.

### An example bundle of services – is there a 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'](#)); or
- It's possible the research provider could be providing DIMS, instead or as well as other parties (see [Scenario 4: Automation of model portfolio](#)); or
- It's possible no one is providing DIMS.

For more information on what a DIMS is and the obligations of DIMS providers under the current law please refer to [Guidance Note: Discretionary Investment Management Services](#) published by FMA in December 2013.

### Where can I find more information?

If you have any questions, please check FMA's website first to see if there is information to assist with your query. FMA's information line is open Monday to Friday 8.30am to 5pm, phone 0800 434 567 (+64 3 962 2698 for overseas callers).

We also recommend that you visit the FMA website regularly to keep up to date with the implementation of the new regulatory regime and to understand when the changes that affect you will apply. You can also subscribe to receive FMA Updates for the latest news.

## Frequently asked Questions

### Why is the law changing?

### 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 their investment authority?
- I take real estate investment decisions for a client under an investment authority?
- I provide financial advice relating to 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?

### Personalised DIMS or Class DIMS?

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

### Eligibility requirements

- Will the new eligibility requirements for AFAs providing DIMS be the same as under FMC Act?

### Exemptions and transitional provisions

- Will there be any exemptions that allow AFAs to provide some limited class DIMS?
- Will there be any transitional provisions?

### 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?
- What restrictions are there on an FMC Act DIMS licensee's constitution?

## Examples and scenarios – what type of DIMS is it?

- 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

## Answers

### Why is the law changing?

The FMC Act recognises that because some DIMS can have similar characteristics to a product like a managed investment scheme they should be regulated in the same way. Other DIMS can be entirely personalised to a client’s circumstances. In these cases an AFA’s business model may continue to involve a personalised DIMS that is based on an individual investment strategy.

### 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. Your client determines their own investment strategy and takes investment decisions without reference to you. If your client makes all the investment decisions your service is not a DIMS, even if you execute your client’s instructions using a pre-existing investment authority granted by your client.

*You do not need a DIMS Licence **or** need to be an AFA who is authorised to provide DIMS.*

#### **... I always check recommendations with my retail client before I go ahead with a transaction using their investment authority?**

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

No - If you make recommendations, but are always required to wait for your client’s yes/no decision before executing a transaction, then your service is financial advice not a DIMS.

*You do not need a DIMS licence or to be an AFA that is authorised to provide DIMS.*

Yes - If you suggest transactions and check these with your client, but you are entitled to proceed with transactions on the basis of the investment authority if your client fails to respond, then this is a DIMS because you are making the investment decisions. You will need an FMC Act DIMS licence, or alternatively you may be an AFA that is authorised to provide DIMS if it is personalised DIMS. You need to read these FAQs to determine what type of licence or authorisation you need.

**... I take 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 a DIMS. Direct investment in real estate is not a financial product. If, under an investment authority, you take decisions relating to indirect investment in real estate this could be a 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.

From 1 December 2014 the definition of DIMS in the FA Act, and in the FMC Act, will both refer to financial products as defined in the FMC Act. These financial products are debt securities, equity securities, managed investment products and derivatives (each as defined in the FMC Act). These FAQs will only be relevant to you if you are taking investment decisions in relation to these financial products.

**... I provide financial advice relating to whether a client should enter into a DIMS facility?**

No. If you give a recommendation or opinion about entering into a DIMS facility<sup>1</sup>, this is not a DIMS and you do not need an FMC Act DIMS licence, or to be an AFA that is authorised to provide DIMS. But from 1 December 2014 this service will be financial advice, because a DIMS facility will be a financial product under the FA Act, and the financial advice will be regulated under the FA Act.

**Remember to unbundle the service**

Even after 1 December 2014, AFAs may continue to give either class or personalised financial advice concerning whether or not a client should enter into a DIMS facility. This is regulated as financial advice, not DIMS. It will not matter whether the advice relates to a personalised or class DIMS facility.

Note – Pay particular attention to the questions on [\*financial advice relating to DIMS\*](#).

**... 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 - 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 concerning which financial products to buy or sell and the proportion of each financial product to be held, then the service is not a DIMS. You do not need a DIMS licence or to be an AFA that is authorised to provide DIMS. 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, such as authority to decide to replace one financial product with a similar financial product that the client has not expressly chosen, or the ability to vary the original portfolio (for

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<sup>1</sup> From 1 December 2014, the FA Act will contain a new definition of a 'DIMS facility' which is 'any agreement, arrangement, or understanding for the provision of a DIMS under an investment authority'.

example so that it follows a changing model portfolio), then you are making decisions in relation to the portfolio and the service is a DIMS.

You will need an FMC Act DIMS licence. Or alternatively, you may be an AFA that is authorised to provide DIMS if the relevant decisions are based on a strategy that is designed to take account of the individual client's financial situation and goals (see [Personalised DIMS or Class DIMS](#)). You will need to read these FAQs to determine what type of licence or authorisation you need.

It is possible that discretion could be exercised by more than one party. For example a wrap provider could be rebalancing the client's portfolio in line with a model portfolio produced by that wrap provider, but an AFA could make further changes to the portfolio to take account of client preferences. In this case, both the wrap provider and the AFA will be providing DIMS and will both need to read these FAQs to determine what type of licence or authorisation they need.

**Check the format of your investment authority**

We recommend AFAs check the format of their investment authorities to see if 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 permits 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. Section 20 of the FA Act defines who may provide DIMS to wholesale clients, which is not changing, although the definition of 'wholesale clients' is changing<sup>2</sup>. The people who may provide DIMS to wholesale clients are:

- (a) an AFA;
- (b) a QFE adviser;
- (c) a registered person (whether an individual or an entity); and
- (d) an exempt provider (whether an individual or an entity).

A person who holds an FMC Act DIMS licence may also provide DIMS to wholesale clients. This is because a service provided under an FMC Act DIMS licence is exempt from being a financial adviser service under the FA Act.

<sup>2</sup> From 1 December 2014, the definition of **wholesale clients** in section 5C of the FA Act will be amended to ensure consistency with the FMC Act. In particular, DIMS clients will need net assets or turnover exceeding \$5 million, rather than the current \$1 million, before they will qualify as wholesale clients.

## Personalised DIMS or Class DIMS?

### What types of DIMS can AFAs provide?

From 1 December 2014<sup>3</sup>:

- AFAs authorised to provide DIMS under the FA Act will be able to provide *personalised DIMS* to retail clients and will still be able to provide any type of DIMS to wholesale clients.
- Anyone who provides a *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 be involved in the provision of class DIMS to retail clients, but the service is considered to be provided by the DIMS licensee, not that individual (see [Who can provide DIMS within a DIMS licensee?](#)).

### What is personalised DIMS?

From 1 December 2014 the definition of personalised DIMS will be added to section 15 of the FA Act. It will say:

- 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 would expect paragraph (a) of this definition to be met by most DIMS, because the investment authority 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. In order to be personalised DIMS the investment strategy must be designed for the client's particular financial situation and goals rather than being customised from a strategy that applies to a class of clients (see [Scenario 2: Client 'pets and hates'](#) for an example of a customised class strategy).

### What is the investment strategy of a DIMS?

An investment strategy is the way you decide what investment decisions to implement for a particular client.

Based on industry feedback once AFAs have determined their client's appropriate risk-return appetite, it seems the most common investment strategies follow either a model portfolio or model asset allocation. Although different advisers may have different understandings of these terms, we define them as follows:

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<sup>3</sup> This date is subject to any applicable exemptions or transitional provisions (see [Exemptions and transitional provisions](#)).

- A **model portfolio** identifies the specific assets and their proportions that should be held by a client meeting a particular set of characteristics, e.g. 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 (**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 set by the model. Specific assets may often be selected from an approved product list.

When determining if a DIMS implements an investment strategy designed for a particular client's financial situation and goals, or a class of clients, it is important to look at the process by which investment decisions are made, not the portfolios that result from those decisions. It is possible that similar investment strategies could lead to different portfolios.

**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*.

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

Yes, model portfolios and model asset allocations can still be used as core tools when AFAs provide financial advice, but where these models are used to make investment decisions under a DIMS this is *class DIMS*, which will need an FMC Act DIMS licence.

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 originally designed to take account of an individual client's financial situation and goals, even though an individual client's financial situation and goals may match a model. A DIMS following a model portfolio will always be a *class DIMS* even though each client's individual portfolio may vary, for example due to differences in timing of implementing investment decisions.

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

For example an AFA could use a high-level model asset allocation to determine that a particular class of clients should invest 40% in debt and 60% 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 model asset allocation to see how the investment decisions are actually being made.

If in all other respects the investment strategy has been designed specifically for the particular client, rather than being an investment strategy that applies to a class of clients, then the overall investment strategy will still be considered to be personalised. After 1 December 2014 an AFA who is authorised to provide DIMS may continue to use this type of personalised investment strategy for their DIMS, although they will be subject to



the new eligibility requirements for DIMS (see [Will the new eligibility requirements for AFAs providing DIMS be the same as under FMC Act?](#)).

## Eligibility requirements for personalised DIMS

### Will the new eligibility requirements for AFAs providing DIMS be the same as under FMC Act?

The new eligibility requirements for AFAs providing DIMS under the FA Act have not been finalised yet. The Ministry of Business, Innovation and Employment (MBIE) will consult on draft regulations. Further details can be found on the Ministry's [website](#).

These new eligibility requirements will apply from 1 December 2014 subject to any transitional provisions (see [Will there be any transitional provisions?](#)). We expect AFAs wanting to continue to provide personalised DIMS will need to show FMA they are able to perform this service effectively. The systems, procedures, expertise and controls we will expect AFAs to have will depend on the scope and nature of the personalised DIMS that the AFA provides.

In order for an AFA to demonstrate that they are able to perform their personalised DIMS effectively we will expect them to demonstrate they meet certain minimum standards in relation to the components of their service, for example selecting investments, monitoring investments and reporting to clients. Where an AFA offers a personalised DIMS that only allows investments in a small number of financial products, the systems, procedures and expertise needed will be less than those needed by an AFA offering a DIMS that can invest in the whole universe of financial products.

The bespoke design of investment strategies may need significant time and expertise. For this reason we do not expect many AFAs will be capable of providing significant personalised DIMS under the FA Act. Where an AFA proposes to provide these services after 1 December 2014 FMA may review whether the AFA has adequate systems, procedures, expertise and controls in place to provide the service.

## Exemptions and transitional provisions

### Will there be any exemptions that allow AFAs to provide some limited class DIMS?

At the moment there are no exemptions, but we understand from MBIE that Ministers will consider the merits of exemptions allowing AFAs to continue to provide class DIMS in some limited circumstances (for example, where discretion is only exercised under an investment authority to cover contingencies such as clients being on holiday or temporarily out of contact). The Ministry is currently seeking submissions on whether any exemptions are required. Consultation closes on 8 April 2014. Further details can be found on the Ministry's [website](#).

FMA also has the power to grant exemptions from the FMC Act license requirement if we are satisfied that it is necessary or desirable in order to promote the purposes<sup>4</sup> of the FMC Act. FMA will consider exemptions on a case by case basis.

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<sup>4</sup> The purposes of the FMC Act are set out in sections 3 and 4 of the Act.

## Will there be any transitional provisions?

The changes described in these FAQs will begin to take effect on 1 December 2014. MBIE has issued a consultation document seeking input on what transitional provisions are necessary to give existing providers time to meet any licensing requirements and change business processes. Consultation closes on 8 April 2014. Further details can be found on the Ministry's [website](#).

## Financial advice relating to DIMS

### Who can provide financial advice about entering into a DIMS facility<sup>5</sup>?

#### **AFA's are key to financial advice on DIMS**

Only AFAs will be allowed to provide personalised financial advice concerning entry into a DIMS facility that invests in category 1 products from multiple issuers.

From 1 December 2014 a DIMS facility will be a category 1 product under the FA Act (unless the investment authority only covers category 2 products, in which case the DIMS facility will be a category 2 product).

Financial advice concerning the entry into, retention of, or exit from a DIMS facility will be regulated in the same way as financial advice in relation to other financial product (as defined in the FA Act). If the DIMS involves investment in any category 1 products, then only the following individuals will be permitted to provide personalised financial advice to retail clients about whether an investor should enter into that DIMS facility:

- (i) an AFA; or
- (ii) a QFE adviser (but only if the QFE or a member of the QFE group is the promoter of all the category 1 products that may be invested in under the DIMS)<sup>6</sup>.

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

- (i) an AFA,
- (ii) a registered individual or
- (iii) a QFE adviser.

Financial advice about whether or not 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?](#)). If you want to provide recommendations to individuals about investing in your DIMS facilities, these recommendations will be subject to the requirements of the FA Act described in the previous paragraph. Any service where you review the suitability

<sup>5</sup> A DIMS facility is any agreement, arrangement, or understanding for the provision of a DIMS under an investment authority.

<sup>6</sup> 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.

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*” (**incidental financial advice**). This incidental financial advice is included within the definition of DIMS so that DIMS licensees do not need to consider the separate requirements of the FA Act when providing the DIMS.

An example of incidental financial advice is where you advise your client to widen the scope of their investment authority so that it allows the purchase of shares in XYZ Limited, provided the existing investment strategy being implemented involves investing in companies similar to XYZ Limited.

## **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?](#)).

In their licence application an FMC Act DIMS licensee will need to describe the types of service they intend to provide, but they will 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?**

FMA published a [consultation document](#) in November 2013 summarising the proposed minimum standards that will be expected of DIMS licensees. Consultation responses have been considered and we will shortly publish a guide describing the application process.

### **Who can provide DIMS within an FMC Act DIMS licensee?**

It is the FMC Act DIMS licensee itself that provides the DIMS. Where the licensee is a corporate entity, the individual employees within the licensee are not themselves providing the service, even though a corporate entity will always act through its employees.

This is similar to the situation where a corporate entity offers a managed investment scheme or any other financial product. It is the corporate entity that provides the product, not the individual employees.

The DIMS licensee can provide the DIMS in accordance with its processes and procedures described in its original licence application or any approved update. The approved processes and procedures will describe the various roles within 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 we assess whether your business as a whole is effectively able to perform the type of DIMS you propose to provide, not whether individual advisers are capable of performing the service. If we are satisfied that your business meets the minimum standards for DIMS licensees we will grant you a licence to conduct DIMS in the way you have described in your licence application.

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 that AFAs, or other non-AFA employees, act as the interaction point between you and your clients, but even where an AFA is involved in delivery of the service the DIMS licensee remains responsible for the service and responsible for supervising staff involved in delivery of the service. The AFA is not required to have their own FMC Act DIMS licence, nor are they required 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 will need to be described in the DIMS licence application and will need to be made clear to clients. Where an AFA undertakes personalised DIMS under their FA Act authorisation the AFA will be subject to the new eligibility criteria (see [Will the new eligibility requirements for AFAs providing DIMS be the same as under FMC Act?](#)) and the AFA will be personally responsible for that service.

### **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, but 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 that you need to record your clients' investment objectives, but if you are providing a class DIMS it does not mean you need to identify different investment objectives for each individual client. For a class DIMS, you may specify the investment objectives of your particular DIMS and if your client confirms that they would like to proceed on the basis of those investment objectives there is no need for you to consider whether the investment objectives are appropriate for that particular client.

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

Remember that any advice to your 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 in place to invest client money in managed funds?**

No. If the relevant investment authority allows you to invest in managed investment products this is an investment decision you can make under the DIMS. You would not be considered to be outsourcing management of your client's portfolio.

## What restrictions are there on a FMC Act DIMS licensee's constitution?

Where an FMC Act DIMS licensee is a corporate body or other entity, section 396(f) of the FMC Act requires that the DIMS licensee's constitution must not have *"any provision under which directors of the applicant or authorised body (as the case may be) may, when exercising powers or performing duties as a director, act otherwise than in the best interests of the applicant or authorised body"*.

Section 131 of the Companies Act 1993 would normally allow directors of companies that are subsidiaries, or are engaged in joint ventures, to take into account the interests of a holding company or shareholder if they are expressly permitted to do so by the company's constitution. The effect of section 396(f) of the FMC Act is that any such provisions in your constitution must be removed before you may apply for an FMC Act DIMS licence. This restriction is not applicable where the applicant is an individual rather than an entity.

## Example scenarios – what type of DIMS is it?

There are many different ways you can provide DIMS. In this section we include examples to help illustrate the guidance in this document. However, they are not exhaustive of all the different types of DIMS. You will need to review your own arrangements to decide who is making investment decisions and so who is providing DIMS and what kind of DIMS they are providing. These scenarios do not take account of possible exemptions or transitional provisions as these are not yet decided (see [Exemptions and transitional provisions](#)).

### 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 taken into account the client's risk profile and financial needs. She has determined the best investments by reviewing research material, including review of 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 initial recommendation of a particular portfolio will be *personalised financial advice* (not DIMS) under the FA Act because the client decides whether or not to establish the initial portfolio. Any recommendation<sup>7</sup> that the client grants the investment authority to the AFA will also be a recommendation to enter into a DIMS facility and so is *personalised financial advice* from 1 December 2014.

The subsequent changes made to the portfolio are DIMS because the AFA is making the decisions about which investments to buy or sell. If the changes to the portfolio are generally in line with changes recommended by one of the asset allocation models considered by the AFA, then the service will be *class DIMS* and an FMC Act DIMS licence will be needed from 1 December 2014.

If the model asset allocations do not form a core part of the investment decision-making process and the investment decisions have been made in line with an investment strategy designed for the individual client, then the service will be *personalised DIMS*. The AFA may continue to provide this *personalised DIMS* if

<sup>7</sup> A recommendation does not need to be explicit and could be implied from the surrounding circumstances. For more information on activities that may amount to financial advice see our [Guidance Note: Sale and Distribution of KiwiSaver](#).

authorised under the FA Act. The new eligibility requirements in the FA Act will apply to the AFA (see '[Will the new eligibility requirements for AFAs providing DIMS be the same as under FMC Act?](#)').

## 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 as appropriate for 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 initial recommendation of a particular mix of model portfolios will be *personalised financial advice* under the FA Act, and any recommendation that the client should grant the DIMS investment authorities will be a recommendation to enter into a DIMS facility and so is also *personalised financial advice*.

The wrap service provider and AFA are both providing a DIMS service, 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 is implementing model portfolios and the wrap service provider will need an FMC Act DIMS licence from 1 December 2014. The DIMS licence could also authorise the AFA to trade the pet investments if this service were part of the licensee's business as described in the DIMS licence approval<sup>8</sup>.

The DIMS provided by the AFA is limited in scope because the AFA can only trade in a limited list of pets. This could be either *class DIMS* or *personalised DIMS* depending on how the investment decisions are made.

Where the investment strategy for buying and selling those pets is designed specifically for that client, this will be *personalised DIMS*. This will be more likely where there are a very limited number of pets the AFA can trade and the investments are different from other clients' investments so that a class investment strategy can't be used.

Where the investment strategy is not designed specifically for the client, e.g. where a model or part of a model is used, this will be *class DIMS*.

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

In this case, then generally 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 to determine investment decisions, and the investment decisions are instead generally determined by an investment strategy designed specifically for that client, then the service would be *personalised DIMS*.

<sup>8</sup> 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 a DIMS licensee?](#)

### 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% of their funds in each fund and the client agrees to make those investments. The wrap service offers an automatic rebalancing service that rebalances the funds whenever the value of one fund becomes 55% or more of the total value invested.**

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

When the client agreed to the automatic rebalancing service, if they provided specific instructions such that the rebalancing service is just a mechanical function without any discretion concerning which financial products to buy or sell, then the rebalancing service will simply be performing an execution-only service, not DIMS.

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

### Scenario 4: Automation of model portfolio

**A research provider 'Research Ltd' produces model portfolios that it provides to an AFA. The AFA considers her client's personal situation and advises that they invest in a particular model portfolio. She also advises her client to use the services of a wrap provider 'Wrap Ltd' which provides an automated service so that 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 that the client should use an automated (DIMS facility) service, will be 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 different services and look carefully at who is taking the on-going investment decisions on behalf of the client. Any person taking investment decisions on behalf of the client, with the client's authority, will be providing DIMS. This will depend on the contractual and practical arrangements between the parties.

If the AFA has oversight over the portfolio provided by Research Ltd (i.e. the AFA always checks the proposed changes and has authority from the client to prevent a change going ahead) then this will tend to indicate that 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 work through an entity with an FMC Act DIMS licence) from 1 December 2014.

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 authorise the party making the investment decisions to make those decisions. The person making the investment decisions will be providing DIMS and will need an FMC Act DIMS licence.



If Wrap Ltd has 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 by the client, then Wrap Ltd is effectively making the investment decisions and is providing the class DIMS.

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.

#### **Review your arrangements**

We encourage parties to review their arrangements to ensure it is clear which party is taking 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 a 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 with his client at which he advises whether the client should amend their mix of portfolios in line with their 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 from 1 December 2014.

From 1 December 2014 the AFA's initial recommendation will be a recommendation to enter into a DIMS facility and so 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\*](#)).



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