ASIC

Australian Securities & Investments Commission

REPORT 06

Review of the financial advising activities of real estate agents—technical paper

July 1999

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CHAPTER 1: INTRODUCTION

The Australian Securities and Investments Commission ("ASIC") has prepared an interim report on its review of the financial advising activities of real estate agents. The aim of the interim report is to provide ASIC's preliminary conclusions arising from its review, and to seek public comment on them.

The interim report comprises:

- Chapter 1: Introduction
- Chapter 2: Background to and scope of the review
- Chapter 3: Conceptual framework for comparing the regulatory regimes for investment advisers and real estate agents
- Chapter 4: Summary of key findings

This technical paper sets out some details about the nature of the real estate industry and the use of real property as a retail investment vehicle. It then details the regulatory requirements which apply to real estate agents and investment advisers under the relevant New South Wales law and the *Corporations Law*, respectively, in respect of their investment advisory activities. This analysis forms the basis of the comparison which is summarised in chapter 4 of the interim report.

This technical paper is available through the ASIC website, at http:\www.asic.gov.au. Copies of the interim report may be obtained either through the website or by contacting the ASIC Infoline on 1300 300 630.

CHAPTER 2: THE REAL ESTATE INDUSTRY

The purpose of this chapter is to provide some information about the significance of real property as a form of investment, some characteristics of the real estate industry and existing regulation of the industry.

2.1 The significance of real property as a form of investment

2.1.1 Preferred forms of investment

A recent article by Elizabeth Webster of the Melbourne Institute of Applied Economic and Social Research[1] draws on data collected from 3,600 households during 1998.

The article states that based on this data, investment in real estate is the most highly regarded form of investment by Australians.

In answer to a request to nominate their preferred form of investment, 21.6% of persons nominated investment in real estate. This was followed by shares, bonds and debentures which were nominated by 14.7%. "Managed trusts" were nominated by 6.9% and superannuation was nominated by 5.4%.

Security was nominated by 41.6% of householders who owned a holiday home or investment property as a reason for choosing this type of asset. 21.8% nominated capital gain and 13.3% nominated "rate of interest" (ie return). A range of other reasons were also given - multiple responses could be given to this question.

In comparison, the most commonly cited reasons for choosing shares, bonds and debentures was their "rate of interest" (ie return), which was nominated by 29.2%, security, which was nominated by 21.3% and capital gain, which was nominated by 20.8%.

The May 1999 Melbourne Institute of Applied Economic and Social Research Household Savings Report states that it was drawn from a sample size of 1200 and covered persons who were 18 years and older in all States and the ACT.

The Report reveals that during the last two years the interest in investing in holiday homes or investment properties has hovered around 15%. Direct ownership of shares, bonds, debentures etc has been showing an upward trend from a level of 22% in May 1997 to a level of 31% in May 1999. Investments in "managed trusts" were at the 15% level in May 1999, while investments in bank, credit union and building society deposits were at the 61% level[2].

[1] Elizabeth Webster, Melbourne Institute of Applied Economic and Social Research, The University of Melbourne, *Superannuation: Why choose it?* Australian Social Monitor, Vol 2, No 1, March 1999, page 9

[2] Due to multiple responses the total responses exceeded 100%.

2.1.2 Household investors in rental dwellings

In June 1997 the Australian Bureau of Statistics conducted a household survey which identified owners of residential rental property and collected information regarding their reasons for investment, information about the properties they owned and the demographic and financial characteristics of the investors. Information contained in the Bureau's publication *Household Investors in Rental Dwellings, June 1997* is referred to below.

As at June 1997 approximately 584,200 income units had an ownership interest in rental property. (An income unit is a concept used by the Bureau to reflect pooling or sharing of income within families, comprising couple relationships and relationships between parents and dependent children.) These investors represented 6.5% of income units living in private dwellings in Australia.

As 76% of these investors had an ownership interest in only one property, most were small investors.

The median value of the rental properties was $125,000. 17% of properties were valued at over $200,000 and 29% were valued at under $100,000.

66% of investors stated that one of the reasons for purchasing a property was that it provided a secure long term investment. Other reasons included negative gearing (16%), rental income (15%), capital gain (9%) and the provision of a future home (15%).

59% of owners of residential rental properties purchased their properties with a loan or mortgage. 10% bought the properties outright. 26% were leasing out their former homes and 4% inherited the properties.

A mortgage or loan was held against almost 70% of investment properties and the median mortgage value was $81,000.

In June 1997 approximately 200,000 income units stated they had sold a property in the last five years and 95,300 current investors stated they intended to sell an investment property in the next two years. Approximately 203,900 income units stated that they intended to invest in residential rental properties in the following two years. 153,600 of these were new investors and 50,300 were current investors who were planning on purchasing an additional property.

During the previous 5 years over 200,000 income units had sold their ownership interest in a property.

The Bureau also conducted a survey of household investors in rental dwellings in July 1993. During the period July 1993 to June 1997, there was an increase of 18% in the number of persons who owned residential rental properties. Between this period the proportion of all persons in private dwellings who owned residential rental properties increased from 6% to 7%.

2.1.3 Australian stock exchange statistics

The proportion of persons owning residential rental properties may be contrasted with the proportion of persons owning shares in Australia.

The Australian Stock Exchange has published an Australian Shareownership Update as at October 1998. Data was drawn from a randomly selected sample of 1200 Australian adults aged over 18 years.

The Update states that total shareownership is at 40.3% of the Australian adult population. There was no significant change in this number since the February results. This means that over 5.5 million Australians own shares, including 4.4 million who are involved in direct shareownership.

There has been a large increase in the number of new sharemarket entrants in recent years. 2.3 million shareholders, or 17% of the adult population, have invested directly in the sharemarket for the first time since 1995. 57% of direct shareholders have entered the market during the period 1995 - 1998. Drivers of this increase include the AMP listing, under which 11% of the adult population received AMP shares and other floats such as the Commonwealth Bank, Qantas, Colonial Mutual and National Mutual.

31.9% of adult Australians own shares directly, which represents a slight increase since February when the corresponding figure was 28.5%.

The Update also provides information relating to the methods used by investors when buying or selling their shares. During the previous two years, the most common method for direct share owners to buy shares was through a prospectus (39%). 25% used a full service broker when buying or selling shares, only 6% used a discount broker and only 3% used an internet broker. 25% had neither bought nor sold shares during the previous two years.

On average, direct shareholders trade once every 15 months. More than a third of direct share owners have only one company in their portfolio and seven in ten share owners have no more than three securities in their portfolio.

The Update details the average value of share parcels bought or sold in the previous 12 months. 37% of share owners who had traded n the previous twelve months bought or sold parcels, on average, worth $5,000 or more. 15% bought or sold parcels worth, on average, $10,000 or more. Only 1% bought or sold parcels, on average, worth $50,000 or more. The average amount was $6,600.

34% of share owners believed that they were not likely to trade over the following twelve months. 27% believed that they were likely to make further purchases through a prospectus, 33% indicated they would use a full service broker when buying or selling shares, 12% indicated they were likely to use discount brokers and 9% indicated they were likely to use online brokers.

The 1997 Australian Shareownership Survey published by the Australian Stock Exchange states that the average value of share portfolios in 1997 was $33,300.

2.1.4 Comparison

While it is difficult to make direct comparisons between investment in residential rental property and the share market, it seems that a number of conclusions may be drawn.

First, it seems clear that a significantly larger proportion of Australians own shares than residential rental properties.

Secondly, while the number of investors in both sectors have increased in recent years, the rate of increase in the number of Australians holding shares has been significantly greater than those investing in residential rental property.

Thirdly, in relation to frequency of trading, while it is difficult to compare, share owners appear to trade more frequently, although, as noted in the household survey conducted by the Australian Bureau of Statistics, residential rental properties appeared to change ownership quite frequently.

Share owners trade on average around once every 15 months. 34% anticipated that they were not likely to trade at all during the following twelve months.

Of the 584,200 income units which had an ownership interest in rental property, 95,300 current investors stated they intended to sell an investment property in the next two years and 50,300 current investors were planning on purchasing an additional property. During the previous 5 years over 200,000 income units had sold their ownership interest in a property.

Fourthly, in relation to the average value of transactions, it seems clear that the value of real estate transactions is significantly greater than the average value of share transactions. While the median value of residential rental properties was $125,000, the average value of share parcels traded over a twelve month period was $6,600. Only 1% of share owners bought or sold parcels, on average, worth $50,000 or more within the previous 12 months.

2.2 Information about real estate agents

The Australian Bureau of Statistics has conducted a number of surveys of the real estate industry. In its publication *Real Estate Agents Industry, Australia, 1995-96*, the Bureau outlines the results of its third survey of the industry. Information contained in this publication is referred to below.

2.2.1 Size of the industry

As at 30 June 1996 there were 8,082 businesses in the industry. Since June 1993 there had been an 11% increase in this number. While during the period there was an increase of 24% in the number of businesses affiliated with a franchising organisation and a 5% increase in the number of businesses affiliated with a marketing group, 62% of businesses were not affiliated to any marketing group or franchise.

2.2.2 Business size

97% of the businesses in the industry employ fewer than 20 persons. These businesses were associated with 82% of employment in the industry and 76% of the industry's income.

Businesses which employed 100 or more persons comprised less than 1% of businesses in the industry and they were associated with 5% of industry employment and 7% of industry income.

2.2.3 Employment

At 30 June 1996 45,956 persons were employed in the industry and 87% of these worked full time. There had been a 12% increase in employment since June 1993.

In addition, 9,830 persons worked in the industry on a commission only basis. There was a decline by 10% since June 1993 in this number.

Taken together, as at June 1996 there were 55,785 people working in the industry. There was a 7% increase in this number since June 1993.

2.2.4 Income

Income in the industry totaled $3,369.6 million. The major sources of income were sales and leasing commissions (60%) and property management fees (26%).

93% of income from sales and leasing was derived from properties while 7% was derived from vacant land.

Sales and leasing commissions from residential properties comprised 43% of total income. The average income from sales and leasing commissions was $305,500 per business.

In businesses which employed 100 or more persons the total income per person employed ($85,900) was 29% higher than for businesses which employed less than 5 persons ($66,700).

2.2.5 Expenses

Labour costs were the major expense items for businesses in the industry. During 1995-96 labour costs represented 44% of expenses. Payments to staff working on a commission only basis comprised a further 9% of expenses.

Businesses which employed more than 100 persons had the highest labour costs per employee ($45,700). Businesses which employed less than 5 persons had the lowest labour costs per employee ($25,500).

Other expenses included advertising (7%) and rent, leasing and hiring expenses (7%).

2.2.6 Profitability

An operating profit before tax of $275.4 million was recorded by the industry in 1995-96. This represented an operating profit margin of 8.3%, compared with 7.7% in 1992-93.

The operating profit margin was highest for businesses which employed less than 5 persons (11.2%) and it was lowest for those businesses which employed 100 or more persons (4.9%).

69% of businesses made an operating profit before tax. 43% of these were in the $20,000 to $99,999 range. Seventy two businesses had a profit over $500,000.

31% of businesses incurred a loss.

2.2.7 State comparisons

35% of total income in the industry was derived in New South Wales. The other three largest contributors to income were Victoria (20%), Queensland (19%) and Western Australia (14%).

New South Wales had just over one third of all businesses in the industry.

Businesses in Western Australia accounted for 14% of total income although the State's share of Australia's population was 10%. In contrast, Victoria, with 25% of the Australian population, had businesses which accounted for 20% of total income. South Australia, with 8% of the population, accounted for 6% of industry income.

The Australian average was seven persons working per business, but this figure ranged from twenty two in the Northern Territory to five in South Australia.

The State with the lowest income per business operating was South Australia ($283,500) whereas the highest was the Northern Territory ($2 million).

2.2.8 The New South Wales real estate industry

The 1997 issues paper dealing with a review of the *Property, Stock and Business Agents Act 1941 (NSW)* refers to the number of licensed agents and certificate holders as follows[3]:

Agent /Manager	**Number**
Real estate agent	11,149
Business agent	3,316
Stock and station agent	3,845
Strata managing agent	1,084
On-site residential property agent	70

[3] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 55

Certificates

Certificates	8,396
Provisional certificates	271

Restricted licences

Restricted real estate agent	36
Restricted stock and station agent	179
Restricted strata managing agent	5

Corporations

Corporations	3,356

However, it should be noted that licensing statistics do not distinguish between active and non-active licence holders and that multiple licences may also be held by the one person or entity.

The paper also describes the structure of the real estate agents industry[4]. This comprises franchises, marketing groups and independent businesses. While marketing groups operate similarly to franchises, they have a flat fee for participation, rather than being related to turnover, and they do not utilise strict geographical boundaries. Consultations during the review indicated that franchises have around 40 – 50% of the market, however there is no reliable data to indicate whether there are more or less consumer problems associated with franchises.

2.3 State and Territory legislation

The States and Territories have traditionally taken a lead role in the enactment of industry specific regulation dealing with real estate agents. This legislation establishes licensing regimes for real estate agents and deals with matters such as educational requirements, integrity requirements, disciplinary procedures, trust accounts, rules of conduct and compensation funds for consumers.

In New South Wales the primary persons, bodies and institutions involved in the regulation of real estate agents are:

- the Minister for Fair Trading;
- an Advisory Council established under the *Fair Trading Act 1987;*
- the Department of Fair Trading;
- the Commissioner of Police and the Police Department;
- the courts and relevant tribunals.

[4] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, pages 55 - 57

While playing no formal role in regulation, other groups such as industry bodies and consumer groups are represented on the Advisory Council[5]. There is also a range of other State legislation which is not specifically directed at the real estate industry but establishes a general consumer protection framework which may also be relevant to real estate agents and consumers of their services. This includes fair trading legislation, Crimes Acts, consumer credit legislation and legislation establishing consumer claims tribunals.

Legislation affecting the real estate industry is not uniform across the States and Territories. This has the potential for the creation of difficulties for large firms which operate on a national basis or even for smaller firms which operate across State boundaries. For example, the 1997 issues paper dealing with a review of the *Property, Stock and Business Agents Act 1941 (NSW)* refers to the difficulties experienced by shopping centre managers which employ a mobile work force[6]. Licensing requirements in the different States and Territories mean that multiple licences must be held, separate trust accounts must be operated and a range of stationery must be used to comply with the differing requirements in the various jurisdictions.

In addition, ASIC is aware of some views that the industry specific legislation dealing with real estate agents is not always providing an effective and flexible regulatory framework, capable of adapting to the changes in the industry and providing an appropriate degree of consumer protection. Some examples are referred to below.

2.3.1 Property, Stock and Business Agents Act 1941 (NSW)

The New South Wales Department of Fair Trading has commented that while the *Property, Stock and Business Agents Act 1941* is the central piece of legislation which regulates the property agency industry in New South Wales the definition of a real estate agent does not include the giving of financial advice, and, accordingly, the regulatory framework of the Act does not specifically cover this function.

The 1997 issues paper dealing with a review of the *Property, Stock and Business Agents Act 1941 (NSW)* states that no clear statement of the Act's objectives can be found. It raises the issue of whether the implied objectives of the Act are to promote efficient contracting and to protect consumers[7]. The paper points out that the major amendments to the Act since its enactment send confusing signals as to the purposes of the Act[8].

The paper considers the range of legislation which establishes a broad legal framework in New South Wales for consumer protection generally. It questions to what extent specialist regulation is required in the property industry and whether there are gaps, conflicts or overlaps between the *Property, Stock and Business Agents Act 1941 (NSW)* and other Acts which apply generally to protect consumers[9].

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[5] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, pages 23, 24
[6] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 52
[7] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 5
[8] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 5
[9] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 23

The scope of regulation under the Act is also raised as an issue in the paper. The paper points out that agents perform both fiduciary roles within the concept of a principal/agent relationship (such as negotiation on behalf of a client and receipt of money on trust) and intermediary roles which, rather than being work on behalf of a principal, facilitates exchange (such as locating properties and assessing the merits of alternative sources of finance). The paper questions which of these roles the Act should seek to regulate[10].

The paper states that if a client suffers a loss the agent is not responsible for this unless the loss occurs as a result of, for example, fraud or negligence and that agency agreements may not always clarify an agent's roles and responsibilities adequately[11]. Even if an agent is employed by a purchaser, and the agent gives the purchaser financial advice, there may, therefore, be some confusion as to the purchaser's understanding of the agent's role.

The paper states that frequent calls have been made for a review of the Act in recent times[12] . In particular, it draws attention to some of the difficulties in enforcing the provisions of the Act[13]:

- the Department of Fair Trading is hamstrung to some extent due to the difficulties of working with an old piece of legislation which has been amended many times
- some matters in the Act are vigorously enforced, whilst others are not
- industry representatives of strata managers have suggested that it was impossible to comply with the Act in every respect
- effort is mainly directed to administration of trust funds, inspections and compensation for consumers rather than strict licensing matters
- it is difficult to take action where there are general deficiencies in trust accounts as the wording of the legislation relates to deficiencies related to specific clients or transactions –prosecutions are difficult and costly
- it may be necessary to look to other legislation for a complete solution to consumer problems relating to agents in the property industry
- there are difficulties in administering the law along State boundaries where, for example, an agent who is licensed in another State or offshore carries on work in New South Wales
- the Act does not cover situations where an agent and a customer in New South Wales arranges a transaction in another State or offshore
- the effectiveness of the auditing function was also raised, with a suggestion that standard audit procedures may be superficial in complex situations.

The issues paper states that many of the compliance problems in the area appear to stem from inadequacies of the *Property, Stock and Business Agents Act 1941* and invited participants in the review to provide examples of inappropriate or unnecessary compliance requirements of the Act.

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[10] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 13
[11] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 13
[12] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 1
[13] Review of *the Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, pages 34, 35

The paper also questions whether the current scheme of regulation is relevant to contemporary agency business. It points to changes in the agency business such as increasing specialisation, increased use of agents by buyers, competition from other areas of the market such as merchant banks, use of the internet, and consumers demanding higher levels of service[14].

2.4 Self regulation

The self regulatory mechanisms in place through the activities of the Real Estate Institutes in the States and Territories provide an additional mechanism to regulate the activities of real estate agents.

The Real Estate Institute of Australia (the "REIA") has pointed out that real estate agents who are members of Real Estate Institutes are subject to internal rules of practice, mandated rules of conduct in some jurisdictions and a national code of ethics which has been undergoing extensive revision in consultation with the Australian Competition and Consumer Commission.

The REIA considers that these rules of conduct are entirely appropriate to deal with the advising functions of real estate agents.

The REIA Code of Ethics deals with relations between members and includes articles dealing with the following:

- a member must always be loyal to the Institute;
- a member must minimise controversies with fellow agents;
- a member must never publicly criticise a fellow agent; and
- a member who is charged with unethical practice must place all pertinent facts before the Institute for investigation;

The Code of Ethics also deals with relations with clients and the public generally. It includes articles which require that a member:

- keep their relationship with a client or customer confidential;
- be fair to the purchaser as well as the owner whom the member represents;
- endeavour to be informed regarding the law, proposed legislation, other essential facts and public policies which affect the interests of those who place their interests in the member's hands;
- acting ostensibly as an agent must not sell any property in which the member or an employee have an interest without first disclosing this in writing to the purchaser;
- must not have any interest in any transaction in which the member acts as agent otherwise than in the capacity of agent, unless the principal gives prior written consent;

[14] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 44

- employed to purchase property should not act for and accept commission from another principal without the knowledge and consent of both parties;
- should never offer an unconsidered opinion when asked for advice on real estate - the member should conduct a full and proper investigation of all the relevant facts and circumstances;
- must be responsible for the actions of employees in their business relationships with other agents, clients and the public;
- must protect the public against fraud, misrepresentation or other unethical practices in connection with real estate transactions;
- must act in a professional manner and ascertain all available pertinent facts concerning the property for which the member accepts the agency, so that in offering the property the member may avoid error, exaggeration or misrepresentation; and
- offer a property solely on its merit, without exaggeration, concealment or any form of deception or misleading statement.

The REIA has also supplied ASIC with a copy of a redrafted Code of Conduct for Members. Included in the requirements imposed by the redrafted code are that a member:

- must have a working knowledge of agency law, estate agents legislation and other legislation such as fair trading and trade practices legislation to the extent they are relevant to the real estate profession;
- must comply with relevant legislation;
- must exercise skill, care and diligence;
- must act in the best interests of the client except where this would be unreasonable or improper;
- must act fairly and honestly in relation to all parties to a transaction;
- must not mislead or deceive any parties in negotiations or a transaction;
- must not engage in harsh or unconscionable conduct;
- must properly supervise the agency business and take reasonable steps to ensure that employees comply with estate agents legislation, the code of conduct and other relevant legislation;
- must, prior to the execution of a contract by a client, make reasonable efforts to ascertain material facts so as to avoid error, exaggeration or misrepresentation;
- must act in a professional manner and ascertain all available pertinent facts concerning the property for which the member accepts the agency, so that in providing the service the member may avoid error, exaggeration or misrepresentation;
- should never offer an unconsidered opinion when asked for advice on real estate - the member should conduct a full and proper investigation of all the relevant facts and circumstances;
- must not accept an engagement to act, or continue to act, where to do so would place the member's interest in conflict with that of the client;
- must not, unless required by law, use or disclose confidential information obtained while acting for a client or dealing with a customer;

- must not accept commission from anyone other than the client for services in respect of which the member is entitled to commission from the client;
- must not receive a discount or rebate in relation to a service by a stocktaker or tradesperson or to advertising in connection with a service provided by the member, without the consent of the client;
- must protect the public against fraud, misrepresentation or other unethical practices in connection with real estate transactions; and
- must minimise disputes with other members, agents and members of the public and resolve complaints or disputes expeditiously and fairly.

The code also provides that an employee of a member must not represent himself or herself as the holder of a real estate agents licence. The code also refers to the fact that the REIA has established the Real Estate Agents' Code Committee to administer the code of conduct. The Committee is comprised of a chairperson, being the President of the REIA or his or her nominee, the President of each of the State and Territory Real Estate Institutes or their nominees, one public representative and one Commonwealth Government representative as observer.

The code also sets out the principles of complaint handling and appeals. Each affiliate member of the REIA is required to establish a committee to deal with arbitration and professional standards. The members are to be drawn from the members of each affiliate body.

The board of directors of each affiliate body shall appoint a number of the members of the arbitration and professional standards committees to act as chairpersons hearing panels of such committees. A member of the board shall be responsible for the oversight of the arbitration and professional standards committees.

All complaints or disputes are required to be submitted to an assessment committee for initial determination as to whether the complaint shall be pursued, referred to mediation or referred to a hearing panel for determination. In New South Wales, complaints and appeals are determined in accordance with clauses 11 and 12 of the By-Laws of the Real Estate Institute of New South Wales. The code also refers to the applicable provisions in each of the States and Territories.

The code states that disciplinary processes provide for sanctions which include reprimand, fines to a maximum of $10,000 and suspension or revocation of Institute membership.

Where a member is alleged to have breached the code of conduct, the code provides that he or she must place all pertinent facts before the relevant arbitration and professional standards committee

However, it is important to note that not all real estate agents are members of the industry bodies and are therefore not subject to their codes of conduct or disciplinary procedures. The REIA has stated that across Australia, around 80% of real estate agents are members of their respective Real Estate Institute

This paper does not discuss in detail the measures included in the Real Estate Institute of Australia Code of Ethics, because it is currently undergoing significant development and ASIC has not been able to assess how it is currently enforced.

2.5 Other sources of regulation

In addition to State and Territory legislation and self regulatory mechanisms, real estate agents are also subject to other sources of regulation. These include the *Trade Practices Act 1974*, the law of contract and negligence and the law relating to the principal/agency relationship.

CHAPTER 3: COMPETENCY, INTEGRITY AND FINANCIAL REQUIREMENTS APPLYING TO INVESTMENT ADVISERS AND REPRESENTATIVES

3.1 Licensing requirements

The licensing provisions contained in the *Corporations Law* protect investors by screening people who set up an investment advice business or a securities business. ASIC considers the expertise, ability and the good fame and character of applicants, and, in the case of corporations, their responsible officers.

A person may not carry on an investment advice business or hold out that he or she is an investment adviser unless the person is licensed or is exempt from the licensing requirements[15]. A person may not carry on a securities business or hold out that he or she is carrying on a securities business unless the person holds a dealers licence or is exempt from the licensing requirements[16].

A person must satisfy a number of requirements in order to be granted a licence. They relate to:

- solvency;
- educational qualifications and experience;
- good fame and character; and
- efficiency, honesty and fairness.

In considering the last two factors, ASIC considers any conviction of the person of serious fraud in the previous ten years[17].

The requirements applicable to a body corporate applying for a licence relate to:

- whether the body is externally-administered;
- educational qualifications and experience of each responsible officer of the applicant; and
- efficiency, honesty and fairness.

In relation to each responsible officer, ASIC considers issues relating to solvency, any convictions during the previous ten years of serious fraud, the fame and character of the officer, and the efficiency, honesty and fairness of the officer[18].

[15] *Corporations Law*, section 781
[16] *Corporations Law*, section 780
[17] *Corporations Law*, section 783
[18] *Corporations Law*, section 784

Within one day after a condition of a licence is breached, the licensee must lodge a written notice setting out particulars[19].

ASIC Policy Statements 116[20], 118[21], 119[22] and 120[23] outline the extent of the application of the licensing provisions. More detail on these requirements is contained in Attachment 1.

There are various exemptions from the licensing requirements. Perhaps the most relevant in a comparison with real estate agents are those dealing with:

- investment advice given that is incidental to some other primary service that is being provided;
- mere referrals to a licensee; and
- asset allocation advice.

3.1.1 Incidental advice

The following section describes the rationale for the exemptions for incidental advice given by solicitors and accountants. More detailed information is contained in Attachment 1.

Investment advice given by a solicitor or an accountant in public practice is disregarded under the definition of an "investment advice business" when it is "merely incidental to the practice of his or her profession" [24]. This is a statutory exemption which excludes the application of all the licensing provisions in the Law to such advice. It is referred to as the "merely incidental exemption".

ASIC's research has indicated that accountants are an important category of persons to whom investors turn for investment advisory services. There is less use of solicitors as investment advisers.

ASIC considers that a solicitor or an accountant in public practice does not need to operate under a licence when all of the following requirements are satisfied:

- the investment advice they give forms an integral and merely incidental part of their overall services;
- they charge no discrete fee for the advice; and
- they do not receive any commissions or other benefits from product issuers.

The investment advice must neither be provided nor held out as a discrete service provided by the solicitor or the accountant. For example, if they use business cards,

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[19] *Corporations Law*, section 787
[20] ASIC Policy Statement 116 *Investment advisory services: licensing and "independent" advisory services*
[21] ASIC Policy Statement 118 *Investment advisory services: media, computer software and Internet advice*
[22] ASIC Policy Statement 119 *Investment advisory services: merely incidental advice by solicitors and accountants*
[23] ASIC Policy Statement 120 *Investment advisory services: mere referrals and other excluded activities*
[24] *Corporations Law*, section 77(5)

letterheads or promotional brochures in which investment advice is stated as a distinct service, such a service is unlikely to be merely incidental to that solicitor's or accountant's practice. Further, there should be no fees charged to the client for the advice either separately or included within any overall fees charged for the main service (of which the advice forms an integral and merely incidental part). For example, if investment advice is given in the course of providing tax advice as a merely incidental part of that tax advice, the remuneration should be only for the provision of tax advice and there should be no fee for the merely incidental investment advice given.

This requirement ensures that the component of investment advice remains merely incidental to the overall service provided to an individual client and does not constitute or is not held out in any way as a discrete service provided to that client.

Accountants and solicitors may have arrangements with product issuers to receive fees, commissions or other benefits for recommending the products of those issuers to clients. In this situation, they are inducing clients, which is a dealing activity. Therefore, they must operate under a dealers licence because they cannot come within the “merely incidental exemption”.

3.1.2 Mere referrals

Referral arrangements are an integral part of current market practices. Persons who provide various financial and related services (such as credit unions, accountants, solicitors, superannuation trustees and life insurance companies or agents) often refer their clients to licensees for advisory and dealing services.

According to ASIC's interpretation of the Law, a person who makes a referral within the guidelines set out in Policy Statement 120 (that is, a mere referral) will not be carrying out a dealing or investment advice activity. Therefore, ASIC considers that such a person does not have to hold a proper authority from the licensee to whom referrals are made. This is because that person is not acting as a representative when making mere referrals to the licensee.

Persons who make referrals to licensees often have arrangements with those licensees and they receive a fee or benefit for making the referrals. These benefits may include a referral or spotter's fee, a share of a commission, an entitlement to rent or cross referrals of clients (for example, clients of a licensee are referred for accounting or legal services).

When a person makes a referral to a licensee, the referral may be the act of a representative which is very broadly defined[25]. A person does an act as a representative of another person only if they do it in connection with the securities or investment advice business of the other person and as an employee or agent of, or otherwise on behalf of, on account of, or for the benefit of, that other person. (Note: there is an exclusion for work of a kind ordinarily done by accountants, clerks and cashiers.)

According to ASIC's interpretation of the Law, unless a person carries out any of the functions of dealing in or advising on securities in connection with a securities or investment advice business of a licensee, that person would not generally be acting as a

[25] *Corporations Law*, section 99(3)

representative and invoking section 806 or section 807. These prohibit a person from doing an act of a representative without a proper authority from the licensee.

When a person makes referrals to a licensee (or its representatives), ASIC considers that the person making the referral is not carrying out a dealing or an investment advice activity if certain guidelines are met. These guidelines are designed to ensure that the referral remains an activity which is not an act of a representative.

This interpretation of the Law is based upon the reasoning that when a person does an act which does not involve a function of dealing in or advising on securities, the regulatory protection under the licensing requirements is not needed.

Further information about referrals is contained in Attachment 1.

3.1.3 Asset allocation advice

Asset allocation advice may be provided by a range of professionals including accountants and actuaries. Although the current Law does not expressly deal with asset allocation advice, the licensing provisions in the Law apply if it includes advice on securities.

Any advice on securities falls within the definition of securities advice because the term is very broadly defined and includes advising other persons about securities. (This may also amount to a dealing activity if such advice is given to induce persons to enter into securities transactions.) In this sense, technically, any asset allocation advice containing some advice on investments in securities attracts the licensing provisions in the Law. This means that a person giving such advice must operate under an appropriate licence.

However, ASIC, on policy grounds, does not enforce the licensing provisions on persons who give general recommendations to allocate assets in a particular way (for example, in securities, life insurance and tangibles). This is because, although technically investment advice, the advice on securities in the general asset allocation context is too general and insignificant to warrant the application of the licensing provisions to persons giving that advice.

If asset allocation advice goes beyond being a very general recommendation on securities and identifies any specific securities (for example, interests in X trust) or classes of securities (for example, income or growth funds, franked or unfranked securities, mining shares or property trusts), the advice is more than general asset allocation advice. A person who conducts a business of providing such advice must operate under an appropriate licence.

3.2 Competency and integrity standards

ASIC Policy Statement 138[26] outlines the competency standards ASIC expects of applicants and how ASIC assesses whether an applicant has integrity. This policy statement outlines who must meet the competency standards, education and experience

[26] ASIC Policy Statement 138 *Investment advisory services: Personal competencies for licensees*

requirements and how ASIC assesses whether an applicant has integrity. ASIC must have no reason to believe that the applicant will not perform the duties of an investment adviser efficiently, honestly and fairly.

The following sets out ASIC requirements in this area as outlined in ASIC Policy Statement 138. More detail is contained in Attachment 1.

3.2.1 Who must hold a licence?

The underlying principle is that it is important that persons providing investment advisory services relating to all securities (including superannuation interests) are subject to the same standards of personal competencies. Applying the same standards of personal competencies promotes investor confidence and also promotes a level playing field among persons providing investment advisory services.

ASIC considers that the directors and key senior staff of the licensee who are responsible for making decisions about the investment advisory business should be the persons nominated as responsible officers. They are the persons ASIC holds responsible for the performance of the licensee's duties.

3.2.2 Education and experience requirements

ASIC's objective is to license only those applicants who demonstrate competency to perform the duties of a licensee at a professional level. Persons will meet ASIC education and experience requirements if they, or an adequate number of their responsible officers, satisfy either Option 1 or Option 2.

Under Option 1, a person must have:

- one of the full industry qualifications listed in Attachment 1 (for example, a Graduate Diploma in Applied Finance and Investment (Securities Institute of Australia)); and
- the equivalent of three years relevant industry experience over the immediate past five years.

Under Option 2, a person must have:

- one of the more general qualifications listed in Attachment 1, such as a university degree in a financial discipline; and
- a 'short industry qualifications', such as a short course offered by the Securities Institute of Australia; and
- the equivalent of three years relevant industry experience over the immediate past five years.

ASIC considers that appropriate standards of education and experience are necessary to satisfy the requirements of the Law and to protect investors.

To satisfy these standards, a licensee or its responsible officers must have educational qualifications and experience which give them a knowledge and understanding of the

Australian financial system and the operations of financial markets and investment products. This will demonstrate that they are competent to:

- advise their clients about investments, and
- perform the duties and discharge the obligations of a licensee providing an investment advisory service.

ASIC considers that it has set, after consultation with the securities industry, minimum educational standards for licensees at a reasonably high level. The purpose of setting standards is to:

- raise the quality of technical advice given to investors;
- raise the level of confidence that investors have in licensees who give investment advice and, therefore, in the industry;
- enhance the professional reputation of the securities industry; and
- give ASIC some certainty that the licensee is capable of carrying out its additional responsibilities, including the obligation to train and supervise their representatives.

If a person or a responsible officer holds an industry qualification not listed, that course may be nominated for approval. The application must set out details of the course, including a description of and the number of subjects, method of examination or assessment, contact hours and entry level. The list of approved courses will be updated from time to time in the ASIC Dealers and Investment Advisers Licensing Kit.

3.2.3 Integrity

ASIC assesses whether a person or a responsible officer have integrity by:

- examining the information about past conduct given in the licence application and from the ASIC internal databases, and
- making sure there are no convictions for serious fraud or dishonesty by requiring the provision of police checks.

ASIC considers that setting high standards of personal integrity enhances investor protection and provides a foundation for investor confidence in the securities industry. Screening out unsuitable participants will minimise the risk of fraud and unethical behaviour.

To assist ASIC to form a view on integrity, there is a requirement to declare any matters in the last ten years which reflect on a person's or a representative's character and honesty. Matters such as the following must be declared:

- insolvency;
- suspension or refusal of membership of any professional or industry association; and
- history of convictions (if any).

Australian Federal Police checks must be attached to applications.

A licence application must be accompanied by at least two character references about a person's or a responsible officers' past conduct and good character. The detailed requirements of the references are set out in the ASIC Dealers and Advisers Licensing Kit.

3.3 Financial requirements

To be granted a licence an applicant must not be insolvent[27].

A licence is subject to prescribed conditions and conditions which may be imposed by ASIC[28]. For example, conditions and restrictions relating to the financial position of the holder of a dealers licence may be imposed. ASIC may also require the holder of a dealers licence or an investment advisers licence to lodge a security with ASIC.

The security amount, which is a maximum $20,000[29], is used by ASIC to compensate a person who has suffered loss due to the failure of the licensee, or an agent or employee of the licensee, to carry on business under the licence adequately and properly, whether or not this has resulted in a conviction[30]. The security deposit can be used to compensate investor losses resulting from inappropriate advice.

ASIC's financial conditions include the imposition of capital adequacy requirements. Generally, it is dealers who are subject to what is known as a surplus liquid asset requirement, which is a requirement to hold $50,000 or 5% of adjusted liabilities of the dealer, whichever is the higher. However, investment advisers who are required to operate under a dealers licence because they operate under commission arrangements with product providers (that is, if they induce clients), are generally subject to a less stringent capital requirement of having to hold net tangible assets of $25,000.

ASIC must be notified about events which may adversely affect the financial position of the licensee. If any event occurs that may adversely affect the financial position of a licensee, the licensee must, within a day of becoming aware of it, give notice to ASIC setting out details[31].

3.4 Representatives

The structure of industry is such that licensees usually contract or employ others to act on their behalf. Under the *Corporations Law*, people who act for or on behalf of licensees are called 'representatives'. This section briefly describes the regulatory framework for representatives. Further detail is in Attachment 1.

The critical features are that:

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[27] *Corporations Law*, sections 783 and 784
[28] *Corporations Law*, section 786
[29] *Corporations Regulations*, regulation 7.3.03
[30] *Corporations Regulations*, regulation 7.3.04
[31] *Corporations Regulations*, regulation 7.3.01

- representatives of investment advisers and dealers must hold a proper authority from licensees[32]; and
- licensees are liable for the conduct of their representatives[33].

ASIC may impose conditions about what a licensee is to do:

- to prevent the holder's representatives from contravening a securities law or another condition of the licence; and
- to ensure that each representative has adequate qualifications and experience[34].

A licence is subject to the condition that the licensee must ensure that each representative is adequately supervised in the performance of his or her duties, is sufficiently trained, and keeps up to date through continuing training programs. ASIC may require a licensee to satisfy it that these conditions have been met[35].

ASIC Policy Statement 117[36] outlines when a person who provides investment advisory services must hold a proper authority from a licensee. Attachment 1 gives more details about Policy Statement 117 and representatives.

3.4.1 When must a person have a proper authority?

A person must have a proper authority when that person carries out certain activities in connection with a securities (dealing) or an investment advice business conducted by another person (principal).

The guidelines in Policy Statement 117 focus on the investment advisory activities of representatives rather than their dealing activities. However, some of the general guidelines may apply equally to dealing activities of a representative.

Who is a representative and what is an act of a representative are defined in section 94 of the Law. Person X is a securities representative of person Y if X:

- acts as employee of, or for, or by arrangement with, Y in connection with Y's securities or investment advice business, or
- holds a proper authority from Y.

Person X does an act in a representative capacity only where X acts as an employee or agent of, or otherwise on behalf of, on account of, or for the benefit of Y in connection with Y's securities or investment advice business. Work which is ordinarily done by accountants, clerks and cashiers is not considered to be acts of a representative.

[32] *Corporations Law*, sections 806, 807
[33] *Corporations Law*, sections 817, 818, 819, 820 and 821
[34] *Corporations Law*, section 786
[35] *Corporations Regulations*, regulation 7.3.02
[36] ASIC Policy Statement 117 *Investment advisory services: acting as a representative*

3.4.2 Licensee's obligations in relation to representatives

The Law imposes heavy responsibilities on licensees in relation to the conduct of their representatives. Licensees who conduct their securities or investment advice business through representatives must ensure that the representatives have appropriate levels of competence, efficiency and integrity. This protects investors who use the services offered by licensees.

Anything done by a representative is considered to be done by their licensee. Therefore, if a representative does not act efficiently, fairly and honestly it is considered that their licensee has failed to act efficiently, fairly and honestly. Such conduct by a representative can expose the licensee and the representative to ASIC's disciplinary procedures, such as suspending or revoking of a licence, or issuing a banning order.

3.4.3 When does a person not need to hold a proper authority?

ASIC considers that in some situations, the policy of the Law will not be achieved by requiring a person who may carry out what may be purely a technical act of a representative to hold a proper authority. In these situations, holding a proper authority would just add to the licensee's operating costs without benefiting clients who obtain investment advisory services from that licensee. More details are in Attachment 1.

Some licensees use para-planners who assist in preparing financial plans although such plans are often authorised by representatives of the licensee who act as client advisers. Para-planners are no different to other employees and agents of a licensee. They must hold proper authorities unless their activities fall within routine administrative activities.

3.4.4 When should a representative get their own licence?

If a person deals in or advises on securities in such a manner as to raise a reasonable inference that the person is acting on their own behalf, the person needs to be licensed in their own right. A proper authority from a licensee will not be sufficient in such a situation to overcome the prohibition against conducting or holding out as conducting a securities or investment advice business.

A licensee may enter into a franchise agreement allowing its representatives to use the business name of the licensee. However, such franchise agreements do not remove the principal's obligations relating to its representatives which include being accountable for the conduct of, and adequately training and supervising, the representatives.

ASIC considers that a licensee who enters into a franchise agreement which allows the franchisee to operate with minimum supervision will breach its obligation to adequately supervise representatives. Such agreements may also lead to a failure by the licensee to conduct its business efficiently and fairly. If this happens, ASIC can take administrative action against the licensee (for example, revoke or suspend the licence).

Where a licensee does not adequately supervise a franchisee, the franchisee may carry out dealing or investment advisory activities in such a manner as if they are conducting the business in their own right. Such conduct may amount to a breach of the prohibition

against conducting, or holding out as conducting, a securities or investment advice business without a licence.

3.5 CLERP

As part of the Corporate Law Economic Reform Program ("CLERP") the Government has released proposals for reform to the regulation of financial markets and investment products. In March 1999, the Government released a consultation paper "Financial Products, Service Providers, and Markets - An Integrated Framework".

The paper proposes harmonised regulation of all financial products with a single licensing regime for financial service providers, minimum standards of conduct relating to the provision of financial services including specific requirements when dealing with retail clients and uniform product disclosure obligations to retail clients.

The consultation paper [37] states that a single licensing regime will be introduced for all who carry on a financial services business. Financial services will include advising on financial products. To obtain a financial service provider's licence several criteria will need to be satisfied including:

- adequate financial resources for the performance of the proposed activities;
- competence, skills and experience to provide the relevant services; and
- adequate systems for training and supervision of representatives.

To ensure that licence criteria are satisfied on a continuing basis, conditions will apply to a licence.

Licensees will be able to authorise natural persons or corporate representatives to act on their behalf.

Licensees who offer services to retail clients will be subject to additional obligations such as having adequate arrangements for compensating clients. This would replace the existing requirement for lodgement of a security bond.[38]

[37] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, pages 3, 4

[38] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, pages 26, 27

CHAPTER 4: COMPETENCY, INTEGRITY AND FINANCIAL REQUIREMENTS APPLYING TO REAL ESTATE AGENTS AND SALESPERSONS

4.1 Licensing requirements for real estate agents

A person may not act as or carry on the business of a real estate agent unless that person is licensed to do so[39].

A real estate agent is defined[40] to mean:

> "...a person (whether or not the person carries on any other business) who, for reward (whether monetary or otherwise), carries on business as an agent for:
>
> (a) inducing or attempting to induce or negotiating with a view to inducing any person:
>
> * to buy, sell, exchange, lease, assign or otherwise dispose of any land, or
> * to make an offer to buy, sell, exchange, lease, assign or otherwise dispose of any land, or
> * to accept an offer to buy, sell, exchange, lease, assign or otherwise dispose of any land, or
> * to enter into a contract for the buying, selling, exchanging, leasing, assigning or other disposal of land, or
>
> (b) buying, selling, exchanging, leasing, assigning or otherwise disposing of any land, whether or not an auction is involved, or
>
> (c) collecting rents payable in respect of any lease of land, or
>
> (d) compiling for publication or compiling and publishing any document that contains a list relating solely or substantially to the acquisition or disposal by any person of land,
>
> but does not include a person who carries on business as such an agent in respect of any parcel of land used for agricultural or pastoral purposes with an area of more than 2.5 hectares."

Corporations which act or carry on the business a real estate agent must be licensed and must also employ an appropriately licensed person to be in charge of its sole or principal

[39] *Property, Stock and Business Agents Act 1941 (NSW)*, section 20
[40] *Property, Stock and Business Agents Act 1941 (NSW)*, section 3

place of business[41]. At least half the directors of the corporation must be licensed real estate agents although the Minister may exempt a corporation from this requirement[42].

Where a real estate agent conducts business at more than one place, a licensed real estate agent must be in charge at each place of business[43].

Licence applications must be lodged with the Director-General of the Department of Fair Trading[44].

A licence may not be granted[45]:

- to an applicant who is disqualified from holding a licence or is not of good fame and character nor otherwise a fit and proper person to hold a licence;
- to a corporation where the court is satisfied that any director or the secretary of the corporation is not of good fame and character or otherwise a fit and proper person or that the corporation is not a fit and proper person; or
- where the application contains false or misleading material.

In addition, a licence may not be granted to a natural person unless the applicant[46]:

- has produced evidence that the applicant has had such experience to enable the applicant to perform the duties generally performed by the holder of such a licence;
- has passed the examination conducted by the Technical and Further Education Commission or other examination approved by the Minister; and
- has been the holder of a certificate of registration as a real estate, stock and station or business salesperson or trainee managing agent for at least 2 years.

The Director-General may exempt an applicant from the last two requirements set out above[47]. In assessing the first of the above three requirements, the Director-General may rely on information obtained from the register of supervising licensees[48].

The Department of Fair Trading has indicated that in respect of the grant of a real estate agent licence, for the twelve month period between 1 May 1998 and 30 April 1999 the Director-General approved 205 applications for exemption from the education and certificate of registration requirements of the Act.

The Department advised that exemptions are usually granted in cases where applicants from related industries and occupations are able to demonstrate that they have the relevant experience and qualifications necessary to perform the duties of a real estate agent.

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[41] *Property, Stock and Business Agents Act 1941 (NSW),* section 20
[42] *Property, Stock and Business Agents Act 1941 (NSW),* section 23
[43] *Property, Stock and Business Agents Act 1941 (NSW),* section 21
[44] *Property, Stock and Business Agents Act 1941 (NSW),* section 23
[45] *Property, Stock and Business Agents Act 1941 (NSW),* section 23
[46] *Property, Stock and Business Agents Act 1941 (NSW),* section 23
[47] *Property, Stock and Business Agents Act 1941 (NSW),* section 23
[48] *Property, Stock and Business Agents Act 1941 (NSW),* section 58A

The Minister has approved a range of courses for the purpose of meeting the licensing requirements.

The approved courses vary quite markedly in their duration. A Real Estate Agent Bridging NCC course from the Centre for Agency Licensing Education, University of Western Sydney, which is recognised until 31 July 2000, has a duration of four weeks full time. A Diploma in Business (Real Estate Management) No 8806 from TAFE New South Wales is generally one year full time or two years part time. A Master of Real Estate from the University of New South Wales, which is recognised until 1 March 2003, has a duration of two years part time.

The Department of Fair Trading has also referred ASIC to the fact that a nationally applicable set of competencies for real estate agents has been developed and licensing and education curses are currently being redesigned to reflect competency standards. Some 29 units have been developed for real estate agency and a working party of the Standing Committee of Officials of Consumer Affairs is currently considering which of these units of the national competency standards should constitute entry level competence for the grant of a real estate agent's licence.

The Department has stated that the key consideration in the selection of competencies was to ensure that the entry level will require agents to show competency in those aspects of real estate practice which constitute a significant and demonstrated risk to the public involved in real estate transactions.

However, the Department has also noted that the standards which have been developed for the industry, including the subset proposed to be recognised for licensing purposes, specifically relate to those functions concerned with the delivery of real estate services, and do not include competence in financial advising.

In relation to the assessment of integrity, the Department of Fair Trading has indicated that good fame refers to the applicant's good reputation amongst those who know her or him and this requirement is usually satisfied by character references.

Being a fit and proper person involves honesty, knowledge and ability and the Department advises that a police check is a necessary part of the fit and proper test. The Department has also advised that as part of their application for a licence prospective licensees are required to declare whether they have been convicted of any offence or declared bankrupt. While there is no specific requirement in the legislation which precludes a person from holding a licence if they are an undischarged bankrupt, the Department advises that the circumstances surrounding a bankruptcy might be relevant to whether they are a fit and proper person to hold a licence.

An applicant must be 21 years old[49].

The application fee for a licence is $576. This is for a three year licence period.

[49] *Property, Stock and Business Agents Act 1941 (NSW),* section 23

A contribution of $144 is required which is paid to the Property Services Compensation Fund which may be called upon to meet claims from consumers in the event of a trust account fraud.

Lower fees apply to applications for an on-site residential property manager's licence[50].

4.2 Employment restrictions

A licensee may not, except with the approval of the Director-General, employ in connection with the licensee's business a person[51]:

- who is disqualified from holding a licence or whose licence has been cancelled, unless a licence has subsequently been granted;
- whose application for a licence has been refused (otherwise than for reasons relating to age, experience or technical qualifications) unless the application has been subsequently granted;
- who is disqualified from holding a certificate of registration as a real estate salesperson, a stock and station salesperson, a business salesperson or a trainee managing agent, or whose registration as such has been cancelled or refused, unless registration has been subsequently granted.

4.3 Registration requirements for real estate salespersons

A person may not act as a real estate salesperson unless they are registered as such, and they are employed by and under the supervision of a licensee[52].

A real estate salesperson is defined[53] as:

> "...a person (other than the holder of a real estate agent's licence) who, as an employee of a real estate agent or a corporation that employs a real estate agent (``the employer''):
> (a) induces or attempts to induce or negotiates with a view to inducing any person:
>
> * to buy, sell, exchange, lease, assign or otherwise dispose of any land, or
> * to make an offer to buy, sell, exchange, lease, assign or otherwise dispose of any land, or
> * to accept an offer to buy, sell, exchange, lease, assign or otherwise dispose of any land, or
> * to enter into a contract for the buying, selling, exchanging, leasing, assigning or other disposal of land, or
>
> (b) elsewhere than at a place of business of the employer:

[50] *Property, Stock and Business Agents (General) Regulation 1993,* regulation 42
[51] *Property, Stock and Business Agents Act 1941 (NSW),* section 39
[52] *Property, Stock and Business Agents Act 1941 (NSW),* section 56
[53] *Property, Stock and Business Agents Act 1941 (NSW),* section 51

*collects rent payable in respect of any lease of land, or
*collects instalments of principal or interest payable under a mortgage of land or under a contract for the sale on terms of land, or
*collects amounts payable to a company by a person whose shares in the company entitle their holder to the possession of premises, or

(c) for or on behalf of the employer, introduces or arranges for the introduction of prospective buyers, sellers, lessees or licensees of premises to a real estate agent or stock and station agent or to the owner, or to an agent of the owner, of the premises, or

(d) for or on behalf of the employer, arranges for the erection of buildings for any other person,

except where the land concerned is used for agricultural or pastoral purposes and has an area of more than 2.5 hectares."

Registration applications are lodged with the Director-General of Fair Trading. A certificate of registration may not be granted[54]:

- unless the applicant is over the age of 16;
- unless the applicant has obtained an approved educational qualification;
- to an applicant who is not of good fame and character not otherwise a fit and proper person to be registered; or
- where the application contains false and misleading matters.

The application fee for registration is $50[55].

4.4 1997 issues paper

The 1997 issues paper on the *Property, Stock and Business Agents Act 1941 (NSW)* states that the purpose of licensing is to establish standards of integrity and service in the interests of consumers and to enhance efficient contracting [56].

In relation to the licensing regime, the paper states that it is exceedingly complex due to the fact that there are fifteen main categories of licenses, a large number of processes related to licensing and that it is governed by legislation which is difficult to read and interpret[57].

A large number of licensees and certificated persons hold licences and certificates in more than one category[58].

[54] *Property, Stock and Business Agents Act 1941 (NSW),* section 57
[55] *Property, Stock and Business Agents (General) Regulation 1993,* regulation 42
[56] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 25
[57] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, pages 25,26
[58] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 46

4.4.1 Educational requirements

The paper also discusses the Act's educational requirements[59]. The certificate course for a real estate salesperson is of a minimum thirty six hours duration which can be completed in five days (for example, through the Real Estate Institute). The longest educational course for a salesperson is four weeks. The licence course for real estate agents is of a minimum twelve weeks full time (for example, through the Centre for Agency Licensing Education, University of Western Sydney).

A range of bodies run courses for those wishing to become a real estate agent or salesperson including the Real Estate Institute, which has four to five thousand course participants per year, and for salespersons and licensees the courses range from $60 to $4800.

The paper referred to criticisms of some courses which are available and stated the view that the educational requirements in the Act do not provide a high barrier to entry to the area, compared with the amount of study required for most professions.

The Institute of Strata Title Management expressed concern that some essential elements of strata title management are not covered in present licensing courses, which are based on real estate issues, with strata management "tacked on".

While a real estate agent is licensed to perform a wide variety of tasks, the paper notes that basic training could not possibly cover all of these areas satisfactorily[60].

Large national agents are of the view that the educational requirements imposed by the licensing regime provide no commercial return to them. They consider that their employees do not use what they learn from these courses and the national firms provide their own training to their employees[61].

The paper also notes that re-examination of competencies is not required for licence renewal, which raises issues about the relevance of the educational requirements as a method of protecting consumers from incompetence.

4.4.2 Experience requirements

Concerning the requirements relating to experience in the Act, the paper refers to a view that the experience required to fulfil licensing requirements can be perfunctory and artificial[62].

4.4.3 Integrity requirements

Powers to check applicants independent of the police checking process are not normally used[63].

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[59] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, pages 27 – 30 and 51

[60] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, pages 46 - 47

[61] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 52

[62] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 51

4.4.3 Enforcement issues

The paper states that the primary focus of the Department is directed towards trust funds, rather than strict licensing issues, because trust funds are the area where most consumer difficulties originate[64].

The paper refers to work by property consultants, merchant banks and corporate advisers which would fall within the definition of real estate agency work. They work for another party in commercial transactions, by performing tasks such as locating properties, conducting research and advising on available finance. According to the strict terms of the Act they should hold agent's licences and some of them do. The paper raises the issue of whether this agency work should be regulated[65].

In addition, the paper refers to the increasing use of the internet to facilitate property transactions. Some services on the internet, which operate across State boundaries, locate properties, conduct research and advise on finance availability. Again, parties providing these services should be licensed under the Act, however the paper raises as an issue whether the regulatory framework should be extended in practice to include these parties[66].

4.4.4 Regulatory options

The paper raises the issue of what degree of occupational intervention is justified in relation to property, stock and business agents[67]. Intervention can range from registration (consisting of merely recording those in the occupation), to certification (where consumers can choose between persons who are certified by a government or industry body and those who are not), to compulsory licensing regimes. The paper points out that jurisdictions such as Victoria and South Australia use "negative licensing" systems for salespersons and sub-agents where persons are disqualified for failing to comply with legal requirements relating to the way they conduct business.

The paper considers a range of alternative methods of regulation to the current scheme.

One regulatory option discussed by the paper is that of business licensing[68]. Under this approach it is the business which is licensed and which is subject to requirements for licensing (such as requirements for insurance) rather than a system of occupational licensing which imposes a set of detailed standards which must be complied with to obtain entry to the occupation.

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[63] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, pages 63, 64
[64] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 34
[65] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 48
[66] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 48
[67] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, pages 19 - 21
[68] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, pages 65, 66

Negative licensing is also discussed[69]. Under this system, no licence is required, however an agent may be prevented from practising in certain circumstances (for example, where the agent has engaged in unacceptable behaviour).

Accreditation by a government or an industry body is an alternative to registration which could be combined with business licensing or negative licensing[70]. Accreditation does not restrict entry to an occupation but allows consumers the choice between accredited and non-accredited agents.

The paper notes that the role of tribunals and mediation could be expanded and combined with either business licensing, negative licensing or accreditation[71]. Further, disclosure, while probably not an option in its own right, may also be a useful element in a regulatory system, however there is potential for a cost burden to be imposed where suppliers are required to provide information[72].

The paper notes that compulsory insurance is also a method of reducing risks to consumers[73].

[69] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, pages 66, 67
[70] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 67
[71] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page68, 69
[72] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 69
[73] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, pages 69, 70

CHAPTER 5: COMPARISON - COMPETENCY, INTEGRITY AND FINANCIAL REQUIREMENTS

5.1 Comparative table

The following table outlines and compares some of the main features of the regulatory regimes relevant to competency, integrity and financial requirements.

Investment advisers	**Real estate agents**
Licensing requirements	**Licensing requirements**
Entry level An applicant for a licence must satisfy specific requirements relating to: • solvency • educational qualifications and experience • good fame and character • efficiency, honesty and fairness A licence may not be granted to a person who is the subject of a banning order.	**Entry level** Applicants for a real estate agency licence must be able to satisfy requirements relating to: • whether disqualified from holding a licence • must be at least 21 years old • good fame and character • fit and proper person • whether application contains false and misleading material • experience • qualifications • whether registered as a salesperson etc for 2 years
a. Competency	**a. Competency**
An applicant must satisfy the educational and experience standards specified in ASIC Policy Statement 138. For example, a degree or an industry diploma relevant to the financial advice business and a minimum of three years relevant experience will be required to obtain a licence under which investment advice can be given to retail investors.	Examinations are approved by the Minister. The Director-General may exempt a person from the requirement to hold qualifications or to have been registered as a salesperson etc for 2 years. In assessing experience, information from the register of supervising licensees can be relied on.
b. Integrity	**b. Integrity**
An applicant must demonstrate its integrity. This is generally established by the absence of any: • current banning orders; • current convictions; and • evidence of refusal or revocation of membership with relevant industry/professional associations; and, • other information that indicate that an applicant (or its responsible officers) is not of good fame and character. Integrity is assessed by consideration of: • ASIC databases • police checks • requirement for declarations of matters such as insolvency, refusal of membership of professional or industry associations and	Good fame requirement usually satisfied by character references. A police check is part of the fit and proper test. Applicants are required to declare any offence and whether they have been declared bankrupt.

convictions • character references	
c. Solvency	**c. Solvency**
An applicant for a licence must not be insolvent. An applicant must demonstrate its solvency by: • not being an insolvent or under administration; • being able to lodge a security bond (up to $20,000) with ASIC; and • where required by ASIC, by being able to meet financial conditions (eg net tangible asset tests).	Applicants are required to declare whether they have been declared bankrupt. Circumstances surrounding the bankruptcy may be relevant to the fit and proper test.
Representatives	**Salespersons**
Are not directly licensed/registered but are subject to authorisation and on-going supervision by a licensee. ASIC requires a licensee to ensure that representatives who are involved in giving investment advice to retail clients have appropriate competencies and ethical standards to be able to give investment advice. Licensees are liable for the conduct of their employees and cannot contract out of that liability.	Must be directly registered and be under the supervision of a licensee. Registration requirements relate to: • minimum age of 16 • must have approved educational qualification • good fame and character • fit and proper person • whether application contains false and misleading matters. Common law principles govern the accountability of the licensee for the acts of salespersons.
Employment restrictions	**Employment restrictions**
Where a person is subject to a banning order they may not be a representative of a dealer and/or an investment adviser (as specified in the order) and they are ineligible to be licensed as an investment adviser or a dealer.	Restrictions apply to the employment of persons who: • are disqualified from holding a licence or whose licence has been cancelled • have had an application for a licence refused • are disqualified from holding a certificate of registration or whose registration has been cancelled.
Breaches of licence conditions	
Breaches of licence conditions must be notified to ASIC within one day.	

CHAPTER 6: DISCLOSURE OBLIGATIONS APPLICABLE TO INVESTMENT ADVISERS AND REPRESENTATIVES

6.1 Information about licence holders and representatives

The *Corporations Law* includes requirements for certain information to be kept about licence holders and their representatives. These requirements ensure that there is a mechanism by which members of the public can check that the person with whom they are dealing is properly licensed and/or authorised under the Law, and that that person does not hold interests in securities that may affect their recommendation to the investor. Further details about these requirements appear at Attachment 2.

ASIC keeps a register of licence holders[74]. The register includes a copy of each licence and each instrument that imposes conditions on the licence, or revokes or varies conditions of the licence.

The register is open for inspection and copies or extracts may be taken from it.

Licensees must keep a register of representatives which is open for inspection[75]. (ASIC also maintains a public register of representatives and of persons who have been banned from acting as representatives.)

The register must be open for inspection without charge[76]. Where a person requests a licensee in writing to give to the person a copy of the whole, or of a part, of a register, the licensee must comply within two business days after:

- if the licensee requires the person to pay for the copy an amount of not more than the prescribed amount - receiving the amount from the person; or
- in any other case - receiving the request.

The regulations have prescribed an amount of fifty cents per page for this purpose[77].

Licensees, representatives and financial journalists must keep a register of their relevant interests in securities in a public company or body included on the official list of a securities exchange[78]. The particulars to be entered in the register include:

- the date on which the person began or ceased to have the relevant interest or on which the change in relevant interests occurred;
- the number of securities to which the relevant interest relates;

[74] *Corporations Law*, section 789
[75] *Corporations Law*, section 810
[76] *Corporations Law*, section 812
[77] *Corporations Regulations*, Schedule 4, item 3A
[78] *Corporations Law*, section 881

- if the relevant interest was acquired or disposed of or the change occurred for valuable consideration - details of the consideration;
- if the securities are not registered in the name of the person - the name of the person who is registered as the holder of the securities or, if any other person is entitled to become registered as the holder of the securities, the name of that other person.

ASIC may require a person to produce the register for inspection by a person authorised by ASIC and the authorised person may make a copy of, or take extracts from, the register[79]. ASIC may give a copy of the register to any person where it considers this is in the public interest[80].

6.2 Information about the service being provided: the advisory services guide

Products and services available in the financial markets are increasingly complex. As a result, it is often not easy for retail investors to understand the nature of the services offered to them, particularly on a comparative basis. Therefore, ASIC considers that retail investors must be given clear key information on the nature of the advisory services offered.

If a licensee gives investment advice to a retail investor[81], the investor must be given an advisory services guide[82] unless only general securities advice is given in a non personal context (for example, at an investment seminar, by means of brochures or newsletters or through advertisements), or a guide has already been given.

The purpose of the advisory services guide is to ensure that the investor understands the nature of the investment advice service being offered, the fees being charged, and can compare the services with similar services offered by others.

ASIC Policy Statement 121[83] provides guidance in relation to the advisory services guide. Further details appear in Attachment 2.

ASIC considers that including advertising and promotional material in an advisory services guide would generally detract from its intended purpose of giving retail investors key information about the investment advisory services being offered. The information in an advisory services guide must also be easy to understand and in a readily comparable form. To achieve this purpose, a retail client must be able to clearly distinguish the advisory services guide.

However, ASIC considers that it may be possible for a licensee to give an advisory services guide in a package of information which contains advertising and promotional

[79] *Corporations Law*, section 885
[80] *Corporations Law*, section 887
[81] The term "retail investor" is defined in regulation 7.3.02B(10) of the *Corporations Regulations*
[82] *Corporations Regulations*, regulation 7.3.02B
[83] ASIC Policy Statement 121 *Investment advisory services: retail investor protection requirements*

material, if the main purpose of the advisory services guide is not defeated. Therefore, a licensee will be able to comply with the advisory services guide licence condition if:

- the other information does not overwhelm the investor and detract from the key information that the must contain; or
- an investor's attention is not distracted from the key information in the advisory services guide because it is part of another document or in a package of documents.

6.3 Information about benefits and conflicts of interest

Section 849 of the Law requires securities advisers to disclose to their clients any commissions or fees they may receive as a result of recommendations made to their clients[84]. This requirement, and the "know your client" rule in section 851 of the *Corporations Law*, are referred to as the "Conduct of Business" rules.

Where a securities adviser makes a securities recommendation to a client who may reasonably be expected to rely on it, the adviser must disclose to the client[85]:

- any commission or fee, or any other benefit or advantage, that the securities adviser or an associate has received, or will or may receive, in connection with the making of the recommendation or a dealing by the client in securities as a result of the recommendation; and
- any other pecuniary or other interest of the securities adviser or an associate, that may reasonably be expected to be capable of influencing the securities adviser in making the recommendation.

This does not apply in relation to a commission or fee that the securities adviser receives from the client.

ASIC Policy Statement 122[86] sets out the scope of this obligation and the appropriate method of disclosure. It sets out who must comply with the rules relating to disclosure of conflicts of interests. Further details appear in Attachment 2.

A breach of the disclosure of conflict of interests obligation in section 849 is an offence punishable by a fine of $2,500 and/or imprisonment for six months. Persons deemed to have made a securities recommendation (such as a partner) also incur primary liability for breaching section 849.

Any securities adviser who breaches the disclosure of conflict of interest obligation in section 849 and/or the know-your-client rule in section 851 when making a securities recommendation to a client is liable to compensate that client for any loss or damage resulting from reasonably relying on the recommendation[87].

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[84] *Corporations Law*, section 849
[85] *Corporations Law*, section 849
[86] ASIC Policy Statement 122 *Investment advisory services: the conduct of business rules (s 849 and s 851)*
[87] *Corporations Law*, section 852

A breach of section 849 or 851 can give ASIC grounds for exercising its administrative powers to revoke or suspend a licence, or ban a person from the securities industry, after a hearing.

A securities adviser may recommend shares in a company in which they hold shares. (Note: There is a separate legal obligation requiring a dealer to disclose when acting on their own account.) A holding of shares in the same company would not generally need to be disclosed under section 849 unless a significant volume of trading is likely to be generated through the recommendation. If this is the case, it is reasonably capable of influencing the share price in such a way so as to give the adviser a benefit or advantage. One example is thinly-traded stock in a company being recommended in large volume.

A securities adviser must give particulars of any material benefits, advantages and interests of the adviser and any associates of the adviser. Therefore, ASIC considers that any "blanket" or "generic" disclosure in the following terms would not comply with the section 849 obligation:

- commissions might be paid by fund managers from time to time;
- commissions range from, for example, 0–6%, depending on the amounts invested; or
- the adviser may or will receive a benefit in connection with a dealing by a client.

The adviser should disclose material benefits, advantages and interests in a manner that is clear and easy to understand for the client. The securities adviser must take into account the level of sophistication of the client when deciding on an appropriate level of detail and a suitable format.

6.3.1 Execution related telephone advice by dealers

Telephone advice which stockbrokers and other dealers give as an integral part of their execution services on quoted securities generally contain personal securities recommendations. Therefore, stockbrokers and other dealers who provide execution related telephone advice must comply with the Conduct of Business Rules.

However, the making of these recommendations differs from the other types of personal securities recommendations. Therefore a modified approach to applying the Conduct of Business Rules is needed because the recommendation, investment decisions and trade execution generally occur within a very short period, making them an integrated transaction, and the type of investors who seek this kind of service generally have expectations that match the type of service being offered.

ASIC considers that as a matter of policy it is appropriate that the Conduct of Business Rules apply in a modified manner to execution related telephone advice by a stockbroker or other dealer only if:

- the advice is provided as an integral part of the execution services offered by that dealer;

- the advice relates to securities quoted on an ASIC regulated stock market or an ASIC authorised foreign exchange within the terms of ASIC foreign securities relief; and
- no discrete fee for the related telephone advice is charged (that is, no fee is charged in excess of the commission for the execution service).

The above restrictions ensure that such services are confined to securities on which information is available in the market and where the advice relates to time critical execution services provided to clients who have expectations that match the type of service provided.

The obligation to disclose material benefits, advantages and interests under section 849 also applies to execution related telephone advice by dealers. However, this disclosure does not have to be made every time execution related telephone advice is given to a client if the relevant disclosure has already been made and that disclosure remains accurate and up to date.

The dealer must also satisfy the product knowledge aspect of the section 851 requirement when making recommendations on quoted securities. The dealer must have an adequate product specific knowledge about those securities, as well as a reasonable level of knowledge about other comparable securities. For example, in the case of a stockbroker providing execution related advisory services on quoted securities, this may mean knowledge of securities in the same or a similar industry sector. In all cases, the guiding principle is that an adviser should have the knowledge of relevant securities necessary to conduct business of the kind they offer in a fair and efficient manner.

6.4 Specific disclosure by representatives

A representative may not do as a representative an act by which the principal deals in securities with a non-dealer on the principal's own account unless the representative has informed the non-dealer that the principal is acting in the transaction as principal and not as agent[88].

ASIC Policy Statement 117[89] gives guidance on how a representative should disclose their capacity and the identity of the principal in business documents and other promotional materials. Attachment 2 gives further details.

ASIC considers it important for investor protection that a representative clearly discloses to investors that they act in a representative capacity and the identity of their principal or principals. This disclosure must be easy to understand and should not mislead or confuse investors.

Disclosing this information is important. This is because under the Law the principal is accountable for its representative's activities and has ultimate responsibility for redressing any investor claims arising because of the representative's activities. Representatives

[88] *Corporations Law*, section 813
[89] ASIC Policy Statement 117 *Investment advisory services: acting as a representative*

should therefore disclose their capacity and the identity of their principal to investors in business documents they use.

6.5 CLERP

The consultation paper [90] states that financial service providers will be required to give a Financial Services Guide to their retail clients. This will be based on the current Advisory Services Guide and the requirements contained in the Life Insurance Code of Practice relating to disclosure of capacity.

Retail clients would, however, be able to opt to be treated as wholesale clients. By opting to be treated as a wholesale client, the client would lose the benefits of service provider and product disclosure and the benefit of the various conduct of business obligations. This would be subject to a number of safeguards such as the requirement for retail clients to be warned about the consequences of opting to be treated as a retail client.[91]

A register of financial service provider licensees and authorised representatives will be kept by ASIC[92].

The paper states[93] that the existing *Corporations Law* approach to remuneration will be adopted. This will ensure that consumers are informed of potential influences on the services provided through requirements to disclose fees, commissions and conflict of interests.

ASIC will be able to give licensees information about authorised representatives in a similar way to which it is currently able to do so[94].

ASIC will be required to publish details regarding the persons it has banned from providing financial services[95].

[90] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, page 40
[91] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, pages 15 - 17
[92] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, pages 30,31
[93] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, page 28
[94] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, page 33
[95] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, page 34

CHAPTER 7: DISCLOSURE OBLIGATIONS APPLICABLE TO REAL ESTATE AGENTS AND SALESPERSONS

7.1 Register of real estate agents

The Director-General of Fair Trading is required to keep a register[96] showing:

- licences;
- renewals, restorations and cancellations of licences;
- refusals of applications;
- disqualifications.

The register is available to the public on the payment of a prescribed fee. The regulations prescribe a fee of $20[97].

7.2 Information given to the Director-General

Every licensee is required to have a registered office in New South Wales. Licensees are required to notify the Director-General where there is a change in the situation of the registered office or the registered address and this information is required to be entered in the register[98]. Changes must be notified within fourteen days of the change[99].

The Director-General must also be notified where a person commences employment as, or ceases to be employed as, the person in charge of a place of business of a corporation.[100]. This must be notified within fourteen days[101].

7.3 Publication of names of licensees

There are requirements for licensees to display their name and description as a licensee outside their registered office and other places where their business is carried on. Additional requirements apply where the licensee is a corporation[102].

It is an offence for a person to display a sign implying that an office, house or place of business is that of a licensed real estate agent, where this is not the case[103].

[96] *Property, Stock and Business Agents Act 1941 (NSW),* section 30
[97] *Property, Stock and Business Agents (General) Regulation 1993,* regulation 42
[98] *Property, Stock and Business Agents Act 1941 (NSW),* section 34
[99] *Property, Stock and Business Agents (General) Regulation 1993,* regulation 43
[100] *Property, Stock and Business Agents Act 1941 (NSW),* section 34
[101] *Property, Stock and Business Agents (General) Regulation 1993,* regulation 43
[102] *Property, Stock and Business Agents Act 1941 (NSW),* section 35
[103] *Property, Stock and Business Agents Act 1941 (NSW),* section 35

7.4 Requirements for licensees to keep records

Every licensee is required to keep at his or her registered office legible written records containing full particulars of all transactions by or with him or her as licensee and other written records as prescribed[104].

A licensee may be required to give details to the Director-General as to a transaction within the previous 3 years. A person directly concerned in a transaction within the previous 6 months may require a licensee to provide an itemised account of the transaction[105].

The records are required to be open to inspection by the Director-General, a member of the police force or an authorised officer of the Department. In addition, there is a power to require the production for inspection of contracts, agreements and other documents[106].

7.5 Production of licences

Licensees are required to produce their licence when this is demanded at their place of business by a police officer, an authorised officer of the Department of Fair Trading or by any person with whom the licensee is transacting business[107].

7.6 Publication of name and place of business in advertisements

There are requirements as to the publication of a licensee's name and place of business in advertisements. In addition, it is an offence for a licensee to advertise property in which he or she has an interest without disclosing that fact in the advertisement[108].

7.7 Register of real estate salespersons

The Director-General keeps a register of all certificates of registration. The register may be perused by the public on the payment of the prescribed fee[109]. The regulations prescribe a fee of $20 for this purpose[110].

Changes to the name or address of the registered employer are recorded in the register[111]. There is a $1 fee for variation to certificates of registration to reflect these changes[112].

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[104] *Property, Stock and Business Agents Act 1941 (NSW)*, section 38
[105] *Property, Stock and Business Agents Act 1941 (NSW)*, section 38A
[106] *Property, Stock and Business Agents Act 1941 (NSW)*, section 38B
[107] *Property, Stock and Business Agents Act 1941 (NSW)*, section 40
[108] *Property, Stock and Business Agents Act 1941 (NSW)*, section 43
[109] *Property, Stock and Business Agents Act 1941 (NSW)*, section 58
[110] *Property, Stock and Business Agents (General) Regulation 1993*, regulation 42
[111] *Property, Stock and Business Agents Act 1941 (NSW)*, section 59
[112] *Property, Stock and Business Agents (General) Regulation 1993*, regulation 42

7.8 Register of supervising licensees

The Director-General keeps a register of the licensees in charge of the places of business at which holders of certificates of registration are employed. A real estate salesperson is required to give notice to the Director-General within 14 days of a change in the place of business where he or she is employed[113].

7.9 Production of certificate of registration

Real estate salespersons are required to produce their certificate of registration when this is demanded by a police officer, an authorised officer of the Department of Fair Trading or by any person with whom the salesperson is transacting business[114].

7.10 Disclosure of commission

A licensee who acts as agent for the sale, purchase, leasing or management of residential property is required to display at each separate place of the licensee's business a guide to the licensee's fees and commissions and the expenses for which the licensee will require to be reimbursed. The guide must state that the fees, commissions and expenses are subject to negotiation. The guide must be visible to members of the public visiting the place of business[115].

A licensee is also required to give a printed guide to the licensee's fees, commissions and expenses in respect of which reimbursement will be required to the other party to any proposed agreement relating to the sale, purchase, leasing or management of residential property before entering into the agreement. The guide must state that the fees, commissions and expenses are subject to negotiation. The guide must be provided to anyone who requests a copy of it[116].

7.11 Agency agreements

The regulations specify a number of terms which are required to be included in agency agreements[117]. These include terms specifying:

- the duration of the agreement or how the agreement may be terminated;
- the circumstances under which the licensees is entitled to remuneration, the amount of the remuneration or how it is to be calculated and when the remuneration is payable;
- that the fee has been negotiated between the parties to the agreement - this must appear immediately after the term fixing the agent's remuneration[118];

[113] *Property, Stock and Business Agents Act 1941 (NSW)*, section 58A
[114] *Property, Stock and Business Agents Act 1941 (NSW)*, section 62
[115] *Property, Stock and Business Agents (General) Regulation 1993*, regulation 13
[116] *Property, Stock and Business Agents (General) Regulation 1993*, regulation 14
[117] *Property, Stock and Business Agents (General) Regulation 1993*, regulation 9
[118] This requirement does not apply where the agreement is for a service relating to arbitration, a service relating to certain commercial land or a service relating to the sale of residential property under an agreement entered into prior to 1 march 1994.

- the circumstances under which a licensee is entitled to be reimbursed for expenses or charges incurred by the licensee;
- a warranty by the principal that the principal has authority to enter into the agreement with the licensee.

Additional terms are also specified for agreements in respect of the sale of land, the sale of residential property, the leasing of an interest in land, the management of property and the sale of a business. In relation to agreements for the sale of residential property, they must contain the following additional terms:

- a term that the licensee cannot act on behalf of the principal in respect of the sale of residential property unless the licensee has a copy of the proposed contract of sale available for inspection;
- a term specifying the way in which the licensee's remuneration is to be calculated (with the dollar amount of that remuneration in relation to the licensee's estimate of the selling price of the land) and an estimate of the amount of expenses or charges the licensee expects to incur in respect of which there is an entitlement to reimbursement.

A number of agency agreements are exempted from the operation of the above requirements[119]. These include agreements entered into before 1 October 1981.

7.12 Inspection of proposed contracts

If a real estate agent indicates that a residential property is for sale, a copy of the proposed contract, together with other required documents, must be available for inspection by any proposed purchaser, except in prescribed circumstances[120].

7.13 1997 issues paper

The 1997 issue paper on the review of the *Property, Stock and Business Agents Act 1941* states that the Department of Fair Trading seldom receives requests from members of the public to peruse the registers relating to licensees and holders of certificates of registration which are required to kept by the Department. It notes, however, that the provision of 1800 telephone numbers has provided a partial substitute for access to the public registers. It questions whether registers may play a more significant role in public education if the public knew of their existence[121].

The paper states that some consumers may not have a clear understanding of agents' roles and responsibilities and agency agreements may not necessarily clarify such responsibilities in an adequate way[122].

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[119] *Property, Stock and Business Agents (General) Regulation 1993,* regulation 10

[120] *Property, Stock and Business Agents Act 1941 (NSW),* section 84AA. See also regulation 19 of the *Property, Stock and Business Agents (General) Regulation 1993*, which exempts certain fee sharing agreements from the operation of section 84AA.

[121] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 38

[122] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 13

The paper also describes the way in which strata managers may act as insurance agents[123]. Strata managing agents may use a broker to obtain some prices for insurance for the owner's corporation and then split the commission with the owners of the strata scheme. The paper questions whether these arrangements guarantee full disclosure of the commission arrangements to the owners of the strata scheme.

The paper refers to the fact that commission rates in New South Wales have been deregulated. However, there is still a requirement that agents display a scale of fees in their offices. Some take the view that this is unnecessary given that fees are negotiable, whereas others consider this is an aid in the negotiation process[124].

[123] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 58
[124] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 63

CHAPTER 8: COMPARISON - DISCLOSURE OBLIGATIONS

8.1 Comparative table

The following table sets out and compares some of the features of the regulation of investment advisers and real estate agents in relation to disclosure obligations.

Investment advisers	Real estate agents
Register of licensees	**Register of real estate agents**
The register includes: • a copy of licences, • other information relating to licences such as conditions on the licence, name of licensee, name of its officers, day of grant of licence, • name of the business using the licence, • address where the business is carried on, and • details of any suspension of licence	The register includes: • licences • renewals, restorations, cancellations • refusals of applications • disqualifications • changes in the situation of the registered office or the registered address
Changes to the information relating to the licensee must be notified to ASIC within 21 days.	Changes are required to be notified within 14 days.
Register is open for inspection and copies may be made.	Register is open for inspection on payment of $20.
Publication of name of licensee	**Publication of name of licensee**
The identity of a licensee who provides retail advisory services must be disclosed in the advisory services guide.	Real estate agents are required to display their name and their description as a licensee outside their place of business and to put their name and place of business in advertisements. Agents are also required to produce licences to any person with whom they are doing business.
Register of proper authorities	**Register of salespersons**
Every licensee is required to maintain a register of its representatives containing: • a copy of each proper authority issued, • the name, address, date of birth and business address of each representative. ASIC must be notified of any changes to its content within 2 days. The licensee must also lodge an annual statement setting out the number of proper authority holders. This information is posted on ASIC's public database.	The Director-General keeps a register containing: • certificates of registration • changes to name and address of the registered employer A salesperson is required to give notice within 14 days of a change in the place of business where he or she is employed.
Register is open for inspection without charge. Charge may be made for copies.	The Register is open to the public for inspection on payment of $20.

Disclosure by representatives	**Disclosure by salespersons**
No express requirement, but if a representative acts in a manner that gives a reasonable impression it is acting not as a representative, it may amount to a breach of the prohibition against holding out in s780 and s781.	Salespersons are required to produce their certificate to any person with whom they are transacting business.
Register of interests in securities	
Licensees and representatives are required to keep a register of their interests in securities in a public or listed company. This is not a public register. ASIC may require production of the register and may supply copies of the register to any person if ASIC considers this is in the public interest.	No comparable requirement.
Disclosure to investors	**Disclosure to clients**
Contract Notes Securities dealers must issue a contract note immediately after entering into a transaction for the sale or purchase of securities. The contract note must generally be issued to the person with whom the dealer enters into the transaction if the transaction is carried out in the ordinary course of business of a securities exchange. The contract note must contain information relating to the transaction such as, the name of the dealer, exchanges in which the dealer is a member, the name of the person to whom the contract note is issued, whether or not the transaction is on-exchange, the price, description, and amount of securities, consideration paid, the amount of commissions charged and stamp duties. **Advisory Services Guide (ASG)** Investment advisers must comply with the requirement to provide advisory services guides to retail investors. An ASG must contain key information relating to the service offered which enables an easy comparison of services such as: • identity of the licensee and any representative responsible for the provision of advice; • the nature and method of remuneration of adviser including other charges; • basic rights of the investor when obtaining the services; and • complaints procedures available to investors.	Fees and commissions must be displayed at each place of business. A printed guide to fees and commissions must be given to a person before entering an agreement relating to the sale of property. It must be made clear that fees and commissions are subject to negotiation. Agency agreements are required to specify: • the duration of the agreement or how the agreement may be terminated • the circumstances under which the licensee is entitled to remuneration, the amount of the remuneration or how it is to be calculated and when it is payable • that the fee has been negotiated between the parties • the circumstances under which a licensee is entitled to be reimbursed • a warranty by the principal that the principal has authority to enter into the agreement with the licensee. Agreements for the sale of residential property must also contain the following: • that the licensee cannot act on behalf of the principal unless the licensee has a copy of the proposed contract of sale available for inspection • a term specifying the way in which the licensee's remuneration is to be calculated and an estimate of expenses or charges.
Disclosure of conflicts of interest	
Persons giving investment advice must, when making recommendations about investments in securities to their clients, disclose any commissions, fees and other benefits which they or their associate obtain as a result of those clients acting on reliance of recommendations.	No comparable requirements for disclosure of commissions, fees or other benefits to **intending purchasers.** However, there are some prohibitions that deal with conflicts of interest: • a prohibition from receiving any remuneration from any person other than a person on whose behalf the licensee has agreed to act as an

	agent (which is generally the vendor); and • a prohibition that commission may not be shared with unlicensed persons other than employees.

CHAPTER 9: RULES OF CONDUCT APPLICABLE TO INVESTMENT ADVISERS AND REPRESENTATIVES

9.1 "Know your client" rule

A securities adviser must have a reasonable basis for making a securities recommendation[125]. This is referred to as the "know your client" rule.

A securities adviser does not have a reasonable basis for making a securities recommendation unless:

- in order to ascertain that the recommendation is appropriate having regard to the information the securities adviser has about the person's investment objectives, financial situation and particular needs, the adviser has given such consideration to, and conducted such investigation of, the subject matter of the recommendation as is reasonable in all the circumstances; and
- the recommendation is based on that consideration and investigation.

ASIC considers that the "know your client" rule applies only when a personal securities recommendation is provided[126]. Policy Statement 122 sets out what inquiries an adviser should make about a client, and what is adequate product research.

The purpose of the know-your-client rule is to ensure that securities advisers give their clients personal securities recommendations which are appropriate to the investment objectives, financial situation and particular needs of individual clients. The obligation is not a requirement that a securities adviser must provide the "best advice". The obligation sets a suitability standard by requiring an adviser to take into account certain information when preparing a personal securities recommendation.

The obligation under section 851 is to have regard to the information the securities adviser has about a client's investment objectives, financial situation and particular needs. ASIC considers that a securities adviser must carry out a full needs analysis to comply with this requirement. In order to carry out a full needs analysis, the securities adviser must either:

- have in their possession adequate information about the client's individual needs and circumstances, or
- make reasonable inquiries to obtain that information from the client

Some clients may not want to give personal information to a securities adviser or may want to only give limited personal information for a specified or limited purpose. Therefore, it is important that securities advisers take reasonable steps to make retail

[125] *Corporations Law*, section 851
[126] ASIC Policy Statement 122 *Investment advisory services: the conduct of business rules (s 849 and s 851)*

clients fully aware of the limitation of any personal securities recommendation which is not based on full personal information about them. ASIC therefore requires a securities adviser who provides personal securities recommendation to a retail client who refuses to give full personal information to warn that client.

A securities adviser who does not comply with the section 851 obligation is liable to compensate clients who act or omit to do an act by relying on a recommendation. When the securities adviser is a representative, the licensee is also accountable and must make good any loss suffered by a client because of their representative's breach of section 851.

There is a defence available for breaches of section 851under section 852(4). The adviser can use this defence if they can show that the recommendation was, in all the circumstances, appropriate in light of the information the adviser had about the client's investment objectives, financial situation and particular needs when making the recommendation. However, according to ASIC's interpretation of the Law, this does not relieve a securities adviser from liability if the adviser had not made reasonable inquiries about the client's needs and circumstances before making the recommendation.

9.1.1 Execution related telephone advice by dealers

ASIC Policy Statement 122[127] sets out a modified approach to applying the conduct of business rules in relation to stockbrokers and other dealers who provide execution related telephone advice.

While section 851 applies to execution related telephone advice, the nature and scope of an analysis of a client's needs would reflect the type of service offered and the client's expectation. Generally, the dealer should have a sufficient client profile for assessing whether that client's expectations match the execution related advisory service being offered. This excludes the possibility of such advice being made available to a first time client before obtaining relevant information about them. When such services are provided on an on-going basis, the dealers should update the client profile at reasonable intervals.

9.2 Warnings

Warnings must be given where a licensee gives general securities advice which is not tailored to the personal needs of an investor or where investors do not give their advisers relevant information[128].

If a licensee gives a personal securities recommendation (that is, a recommendation given to a person that certain securities transactions are appropriate to the person, having regard to the investment objectives, financial situation and particular needs of that person) to a retail investor and the investor fails to give to the licensee relevant personal information, the licensee must give the investor a warning that:

- the licensee has not been able to undertake a comprehensive financial needs analysis for the investor;

[127] ASIC Policy Statement 122 *Investment advisory services: the conduct of business rules (s 849 and s 851)*
[128] *Corporations Regulations*, regulations 7.3.02C and 7.3.02D

- sets out the limitations on the appropriateness of the recommendation because of the lack of relevant personal information about the investor; and
- states that the investor needs to consider whether the recommendation is appropriate in light of the particular investment needs, objectives and financial circumstances of the investor.

If a licensee gives general securities advice (that is, advice or a report on securities given to an investor or prospective investor without recommending that a particular transaction in those securities is appropriate to the particular investment needs, objectives and financial circumstances of the investor or prospective investor), the licensee must warn an investor that:

- in preparing the advice, the licensee did not take into account the investment objectives, financial situation and particular needs of any particular person; and
- before making an investment decision on the basis of that advice, the investor should consider how appropriate the advice is to their particular investment needs, objectives and financial circumstances.

Information contained in ASIC Policy Statement 121[129] relating to the requirement to give warnings is outlined in more detail in Attachment 3.

9.2.1 Execution related telephone advice to a retail client

The adviser must obtain adequate information about the client's investment objectives, financial circumstances and particular needs to ensure that execution related telephone advice on quoted securities is appropriate to a particular retail client. If the client refuses to give this information, the adviser should warn the client before giving any telephone advice. It is also appropriate to maintain a record of the warnings provided either in the form of a file note or tapes of the telephone conversation.

9.3 Representations about abilities and qualifications

A licensee may not represent or imply in any way that his or her abilities or qualifications have been approved by ASIC[130].

9.4 Use of the term “independent”

ASIC Policy Statement 116[131] contains guidelines on when a person can call their advisory services “independent”.

Payment and ownership structures that exist between issuers and distributors of securities products have become increasingly complex and diverse. Investors are often not fully aware of the existence, nature, or implications, of these payment or ownership structures.

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[129] ASIC Policy Statement 121 *Investment advisory services: retail investor protection requirements*
[130] *Corporations Law*, section 841
[131] ASIC Policy Statement 116 *Investment advisory services: licensing and “independent” advisory services*

Some persons providing investment advisory services advertise or promote their services as being "independent". The use of the word "independent" by a person providing investment advisory services has strong connotations for retail investors. "Independent" suggests to the investor that the adviser:

- does not have any actual or potential conflict of interest in relation to any investment products recommended, and
- is free to choose products appropriate for the personal investment needs and circumstances of the client - it suggests that the choice is from a wide range of products available in the market and the recommended products are selected objectively and without any product bias that may influence the advice

ASIC considers it important to ensure that the word "independent" is not used in circumstances which do not meet these investor expectations.

ASIC considers that if an adviser wants to call their advisory services "independent" they must:

- avoid any commissions, trailing commissions, soft dollar arrangements and other benefits from product providers which may tend to create a product bias;
- operate free from any direct or indirect restrictions relating to the securities recommended; and
- operate without any conflict of interests created by ownership links to product providers.

Where a licensee is unable to meet the above guidelines, any representative of that licensee will also not be able to use the term "independent" when providing advisory services on behalf of the licensee.

An adviser (that is, a licensee or a representative) who uses the word "independent" when describing their advisory services when they are not truly independent breaches the statutory prohibitions against misleading or deceptive conduct[132]. A person who suffers loss because of misleading or deceptive conduct may therefore take civil action against a licensee.

If ASIC considers that a licensee or representative has engaged in misleading or deceptive conduct by using the word "independent", ASIC may take action under section 826 or section 827 of the Law. ASIC can revoke or suspend the licence of the licensee or it can issue a banning order against a person, such as a representative, under section 829. ASIC can take this action on the basis that the licensee or representative has not performed its duties efficiently, honestly and fairly or has contravened a securities law.

Although ASIC has issued these guidelines, the question of independence depends on the exact circumstances in each case. Therefore, merely following these guidelines may not actually ensure independence. Complying with the guidelines may not protect a licensee from civil liability if they or their representative are engaging in misleading and deceptive

[132] For example, *Corporations Law*, section 995

conduct. Licensees and representatives therefore need to carefully consider their own particular circumstances before describing themselves as “independent”.

More details on the use of the term “independent” is contained in Attachment 3.

9.5 Dealings by employees of licensees

A person who is an investment adviser or a dealer and an employee of that person may not, as principals, jointly buy or subscribe for securities[133].

A person who is a partner in a partnership that carries on an investment advice business or a securities business and an employee of the partnership shall not, as principals, jointly buy or subscribe for securities.

There are also restrictions on giving credit to employees or their associates if the purpose is to assist the person to purchase securities.

9.6 Liability of principal for representatives

Where a person engages in conduct as a representative of another person (the "principal"), then, as between the principal and a third person (other than ASIC), the principal is liable for that conduct[134].

Where a representative engages in conduct while the person is a representative of 2 or more principals and the representative engaged in the conduct as a representative of some unknown principal then:

- if only one of the principals is a party to the proceeding, he, she or it is liable in respect of that conduct as if he, she or it were the unknown principal
- if 2 or more of the indemnifying principals are parties to the proceeding, each of those 2 or more is liable in respect of that conduct as if he, she or it were the unknown principal[135].

The Law provides for the liability of principals where acts are done in reliance on representative's conduct[136].

ASIC Policy Statement 117[137] outlines the circumstances where a licensee is liable to third parties for acts of its representatives. More detail is contained in Attachment 3.

9.7 Other prohibited conduct

The *Corporations Law* prohibits a wide range of conduct in relation to securities. This includes prohibitions against misleading or deceptive conduct[138], stock market

[133] *Corporations Law*, section 845
[134] *Corporations Law*, section 817
[135] *Corporations Law*, section 818
[136] *Corporations Law*, section 819
[137] ASIC Policy Statement 117 *Investment advisory services: acting as a representative*

manipulation[139], false trading and market rigging transactions[140], false or misleading statements in relation to securities[141] and fraudulently inducing persons to deal in securities[142]. The Law also contains provisions relating to short selling of securities[143], insider trading[144] and share hawking[145].

There are also various provisions in the *Corporations Law* concerning the conduct of a securities business. These deal with, for example, the issue of contract notes by a dealer[146], dealings and transactions on a dealer's own account[147], and the requirement for a dealer to give priority to clients' orders[148]

In addition, the *Australian Securities and Investments Commission Act* contains a range of provisions containing prohibitions dealing with unconscionable conduct and consumer protection in relation to financial services[149]. "Financial service" is defined to mean a service of providing a financial product or a service that is otherwise supplied in relation to a financial product. The concept of a financial product includes a security. These provisions include prohibitions relating to unconscionable conduct[150], misleading or deceptive conduct[151], false or misleading representations[152], bait advertising[153], harassment and coercion[154] and assertion of rights to payment for unsolicited financial services[155].

9.8 CLERP

The consultation paper [156] states that when dealing with clients minimum standards of conduct will apply to financial service providers including 'know your client' requirements in relation to retail clients, separation of funds held on a client's behalf, and reporting and accounting requirements.

The paper suggests two options relating to cold calling, pressure selling and cooling off and states that a prohibition on unconscionable conduct in the provision of financial services will apply.

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[138] *Corporations Law*, section 995
[139] *Corporations Law*, section 997
[140] *Corporations Law*, section 998
[141] *Corporations Law*, section 999
[142] *Corporations Law*, section 1000
[143] *Corporations Law*, Part 7.4, Division 2
[144] *Corporations Law*, Part 7.11, Division 2A
[145] *Corporations Law*, section 1078
[146] *Corporations Law*, section 842
[147] *Corporations Law*, section 843
[148] *Corporations Law*, section 844
[149] *Australian Securities and Investments Commission Act*, Part 2, Division 2
[150] *Australian Securities and Investments Commission Act*, sections 12CA and 12CB
[151] *Australian Securities and Investments Commission Act*, section 12DA
[152] *Australian Securities and Investments Commission Act*, section 12DB
[153] *Australian Securities and Investments Commission Act*, section 12DG
[154] *Australian Securities and Investments Commission Act*, section 12DJ
[155] *Australian Securities and Investments Commission Act*, section 12DM
[156] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, page 4

In relation to codes of conduct, the consultation paper [157] states that the role of the codes will be to establish best practice standards for meeting the requirements of the Law. In addition, codes may establish best practice in areas not covered by the Law. ASIC will have power to approve a code as being consistent with the Law, however it will not be mandatory for an industry participant to be party to a code.

The paper[158] notes that the current Financial Planning Code of Ethics and Professional Conduct sets out general standards such as integrity, competence and objectivity. It also has specific rules on matters such as disclosure statements to prospective clients and the preparation and explanation of a financial plan.

The paper[159] proposes that a general prohibition on misleading and deceptive conduct will apply to dealings in financial products and provision of financial services. This will be based on the current provision in section 995 of the *Corporations Law*.

It also states[160] that consideration will be given to including a general fraud offence in the Law in relation to financial services.

There will be restrictions on the use of the term "independent"[161].

Warnings will be required where personal advice is given on the basis of incomplete personal information or in time critical transactions or where general advice is provided[162].

The paper[163] provides that licensees will be responsible for the conduct of their authorised representatives in relation to financial services and will be responsible for ensuring that licence criteria and conditions are not breached by any authorised representatives. Licensees will also be responsible for the actions of persons who engage in conduct relating to financial services as their representative (including employees), whether or not they acted within the scope of their employment or agency. This will be subject to joint and several liability provisions.

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[157] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, page 5
[158] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, page 63
[159] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, pages 111,112
[160] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, page 115
[161] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, page 29
[162] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, pages 44, 46
[163] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, page 28

CHAPTER 10: RULES OF CONDUCT APPLICABLE TO REAL ESTATE AGENTS AND SALESPERSONS

10.1 Sharing commissions

A licensee may not enter into an arrangement to share commissions with anyone, other than an employee, who is not licensed under the *Property, Stock and Business Agents Act 1941* or a corresponding Act in another State or Territory[164]. Corresponding Acts are listed in the regulations[165].

10.2 Lending licences

It is an offence for a licensee to lend their licence to another person[166].

10.3 Lending certificates of registration

It is an offence for the holder of a certificate of registration to lend their certificates to another person[167].

10.4 Statements in connection with the sale of allotments of land

It is an offence[168] for a real estate agent or an employee of a real estate agent to make the following types of statements to induce a purchaser to buy an allotment of land:

- false or misleading statements;
- statements that someone will buy the land from the purchaser and the purchaser will make a profit;
- statements that someone will obtain a profit for the purchaser through the future sale of the land.

10.5 False or misleading advertisements

It is an offence for a licensee to publish false or misleading advertisements which are intended to promote the sale of any property[169].

10.6 Misrepresentations

It is an offence for a real estate agent or salesperson to induce a person to enter any contract by making false, misleading or deceptive statements or by concealing material facts[170].

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[164] *Property, Stock and Business Agents Act 1941 (NSW)*, section 39A.
[165] *Property, Stock and Business Agents (General) Regulation 1993*, regulation 8
[166] *Property, Stock and Business Agents Act 1941 (NSW)*, section 41
[167] *Property, Stock and Business Agents Act 1941 (NSW)*, section 63
[168] *Property, Stock and Business Agents Act 1941 (NSW)*, section 84
[169] *Property, Stock and Business Agents Act 1941 (NSW)*, section 84A

10.7 Incorrect statements

It is an offence for a person to make incorrect statements in applications made under the *Property, Stock and Business Agents Act 1941*[171].

10.8 Selling at higher than the stipulated price

Where a real estate agent is retained as agent for the sale of land at a stipulated price, it is an offence if he or she, on his or her own behalf or on behalf of someone other than the person who retained the agent, negotiates for the sale of the land at a price which is higher than the stipulated price[172].

10.9 Preparation and exchange of contracts

A real estate agent may insert details on a contract about the purchaser's name, address and description, the name and address of the purchaser's solicitor, the purchase price, the date and a description of the furnishings or chattels to be included in the sale.

A real estate agent may also participate in the exchange or making of contracts for a party unless the party has a solicitor acting for him or her. In that case, the real estate agent may only participate if expressly authorised to do so by the party or the solicitor.

In performing these functions, the real estate agent is liable to compensate any party to a contract or proposed contract for any loss or damage caused to that person as a result of any negligent act or omission or any unauthorised action of the real estate agent.

A real estate agent may not charge a fee for performing any of these functions[173].

10.10 Wrongful conversion and false accounts

Licensees are also subject to provisions relating to wrongful conversion and false accounts, which, without affecting the generality of the *Crimes Act 1900,* render them liable to a maximum term of imprisonment of 10 years[174].

10.11 Offences under the *Property, Stock and Business Agents Act 1941*

Where penalties are not specified for particular offences, the maximum penalty is 40 penalty units for corporations and 20 penalty units for individuals. The court may, in addition to any penalty or imprisonment, order that a person's registration or licence be

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[170] *Property, Stock and Business Agents Act 1941 (NSW)*, section 84B
[171] *Property, Stock and Business Agents Act 1941 (NSW)*, section 86
[172] *Property, Stock and Business Agents Act 1941 (NSW)*, section 84
[173] *Property, Stock and Business Agents Act 1941 (NSW)*, section 84AB
[174] *Property, Stock and Business Agents Act 1941 (NSW)*, section 88

cancelled and order that the person be disqualified from holding a licence or certificate of registration[175].

10.12 Rules of conduct in Schedule 1 of the regulations

Licensees and holders of certificates of registration employed by licensees are required to comply with the rules of conduct which are contained in the regulations, unless there is a reasonable excuse for non-compliance[176]. Schedule 1 of the regulations sets out a range of rules of conduct, some of which are described below.

10.12.1 Inspection of property

A licensee must conduct a preliminary physical inspection of a property before acting on behalf of a principal in respect of the sale of the property. This does not apply to the sale of livestock or certain commercial property.

10.12.2 Sales inspection reports

After inspecting the property, the licensee must give the principal a sales inspection report which contains, where applicable:

- the name and address of the principal;
- the date of preparation of the report;
- the licensee's name, business address and telephone number;
- a description of the property sufficiently detailed so as to allow it to be readily identified;
- any fittings and fixtures which are to be included in the sale of the property;
- the price at which the property is to be offered for sale;
- the terms and conditions of sale as are known to the licensee (for example, whether or not vacant possession is to be given);
- the licensee's recommendation as to the most suitable method of sale of the property;
- any covenants, easements, defects, local government notices or orders affecting the property which are known to the licensee;
- the name, business address, telephone number and address for service of documents of the principal's solicitor;
- the signature of the licensee.

10.12.3 Informing principals of offers

A licensee who acts on behalf of a principal in respect of the sale of any property must, as soon as practicable after the licensee receives an offer to acquire any interest in that property, inform the principal of that offer. This does not apply to an offer received in the course of an auction.

[175] *Property, Stock and Business Agents Act 1941 (NSW)*, section 87
[176] *Property, Stock and Business Agents (General) Regulation 1993*, regulation 12

10.12.4 Preliminary deposits

When a holder of a licence or a certificate of registration issues a receipt for a deposit in respect of the proposed purchase of any property, which is not paid under a contract for the sale of that property, the holder must inform the person who paid the deposit that the principal has no obligation to sell that property or the purchaser to buy that property, and the deposit is repayable to that person in the event that a contract is not entered into between that person and the principal for the sale of the property. The information must be provided in writing and may be provided on the receipt.

A holder must promptly inform a person who has paid the holder such a deposit of any subsequent offers to purchase the property that are received from any other person.

10.12.5 Delivery of account of costs to prospective lessees

A licensee acting as an agent of a prospective lessor who intends to enter into a lease which contains a requirement that the lessee pay the lessor's costs relating to the lease must, before submitting the proposed lease to a prospective lessee provide the prospective lessee with an itemised account of those costs. The itemised account must include a legible and conspicuous notice concerning the right under section 42A of the *Property, Stock and Business Agents Act 1941* for review of an itemised account.

10.12.6 Disclosure of information

A holder of a licence or a certificate of registration must not divulge to another person any information of a confidential nature obtained through acting for a principal or obtained from a vendor, prospective vendor or prospect (that is, a person who has indicated to a holder an interest in buying or otherwise acquiring an interest in property). This does not apply if the holder divulges the information with the consent of the person from whom it was obtained. A licensee must not inform a holder of the details of any property in respect of which another licensee acts as agent without the consent of that other licensee.

10.12.7 False representations

A holder of a licence or a certificate of registration must not falsely represent that he or she is authorised or has been instructed to sell, lease, purchase, manage or otherwise deal with property, whether as an agent or not.

A holder must not falsely represent to a prospect, principal or other holder that the holder is a prospect.

A holder must not falsely represent to a person the nature or effect of a provision of the Act or any regulation under the Act.

A holder must not falsely represent to a person that a particular form of agency agreement or any term of such an agreement is required by the Act or any regulation under the Act.

10.12.8 Recommending solicitors

A holder of a licence or a certificate of registration must not recommend that a principal or prospect engage the services of the same solicitor or the same firm of solicitors as the solicitor or firm acting for the other party to any proposed agreement.

10.12.9 Inducements

A holder of a licence or a certificate of registration must not offer to provide any person (other than another holder) with any gift, favour or benefit, in order to induce another person to engage the services of the holder as agent in respect of any matter.

10.12.10 Insertion of material particulars in documents

A holder must not submit to any person for signature a document in which a material particular is to be inserted, unless the material particular has been inserted.

10.12.11 Delivery of signed documents

If a holder submits or tenders a document to any person for signature, he or she must, immediately after the person has signed the document, deliver a copy of the document to the person for retention by the person.

10.12.12 Service of document signed by holder

If a holder signs a document as a holder for and on behalf of another person (other than another holder), the holder must serve a copy of the document on the person within 48 hours of signing it.

10.12.13 Remuneration of licensee by principal

A licensee must not, in the course of the licensee's business, receive any remuneration, whether by way of commission, fee, gain or reward, or any reimbursement for expenses or charges, from any person other than a person on whose behalf the licensee has agreed to act as agent.

This does not apply to remuneration or reimbursement received by a licensee on behalf of a principal where this is paid to the licensee pursuant to an agreement between a principal on whose behalf the licensee acts and another person who has agreed to pay specified costs associated with the agreement.

10.13 1997 issues paper

The 1997 issues paper on the review of the *Property, Stock and Business Agents Act 1941* questions whether some of the provisions in the Act regulating the conduct of agents have significant consumer benefits and whether agents would have more to lose than consumers if there was no agency agreement executed.

The paper also questions whether the code of ethics of the Real Estate Institute are more likely to be complied with than the statutory code, given that it is created by participants in the industry and has been voluntarily adopted. The fact that the industry has seen fit

to voluntarily adopt a code of ethics raises the issue of the adequacy of the statutory code of ethics[177].

The paper referred to the fact that the relevance of the requirement that each place of business is required to have a licensee in charge when agents can do business on a State-wide basis with the aid of electronic communications. The review was told that this provision was widely flouted by the practice of license lending[178].

[177] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 40
[178] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 61

CHAPTER 11: COMPARISON - RULES OF CONDUCT

11.1 Comparative table

The following table compares some of the main features of the regulatory regimes relating to rules of conduct.

Investment advisers	Real estate agents
Reasonable basis for making a recommendation	**Reasonable basis for making a recommendation**
Persons giving investment advice must, when making recommendations about securities to their clients, ensure that such recommendations have a reasonable basis. This requires the adviser to undertake a comprehensive needs analysis of the client, and conduct adequate product research to be able to match the client's needs with suitable products.	There are no suitability requirements applicable to real estate agents and salespersons.
Warnings	**Warnings**
Warnings must be given where a licensee gives general securities advice which is not tailored to the personal needs of an investor or where investors do not give their advisers comprehensive information relating to their particular circumstances and investment objectives. Such warnings must alert persons who are likely to rely on such advice of the limitations relating to such advice.	There are no requirements for real estate agents to give potential investors warnings.
Use of the term "independent"	**Use of the term "independent"**
ASIC has issued guidelines on when an adviser can call their services "independent". Generally the term "independent" or any other terms which have similar connotations can only be used by advisers who act with no direct or indirect associations or affiliations with product issuers, for example investment advisers who are remunerated solely by clients.	A licensee must not receive any remuneration from any person other than a person on whose behalf the licensee has agreed to act as agent.
Prohibitions against misleading and deceptive conduct and other representations	**Prohibitions against misleading and deceptive conduct and other representations**
There are prohibitions against misleading and deceptive conduct relating to securities. This encompasses promotional activities including advertising. A licensee may not represent that his or her abilities or qualifications have been approved by ASIC.	There are prohibitions against false and misleading statements. This encompasses promotional activities including advertising.

Conduct of representatives	Conduct of salespersons
A licensee carries liability for any losses resulting from the conduct of representative (whether within actual or ostensible authority). Representatives or licensees may be banned from participating in the securities industry if their conduct is not efficient, honest or fair.	Salespersons may be disqualified and have their registration cancelled where their conduct renders them unfit to be registered.

CHAPTER 12: COMPLAINTS RESOLUTION AND CONSUMER REMEDIES - INVESTMENT ADVISERS AND REPRESENTATIVES

12.1 External complaints resolution

A licensee giving investment advice on securities to a retail investor must be a member of an external complaints resolution scheme approved by ASIC[179].

One of ASIC's primary objectives is to promote the informed and confident participation of consumers and investors in the financial sector. Complaints resolution schemes that provide consumers and investors with access to effective, low-cost and fair dispute resolution procedures, are critical to achieving this objective.

In July 1999 ASIC released Policy Statement 139[180], which sets out how ASIC will approve external complaints resolution schemes operating across the finance sector. Policy Statement 139 supersedes ASIC's interim policy statement, which focussed on interim approval guidelines for those schemes considering complaints about licensees. It has been the subject of extensive consultation with representatives of industry and consumer organisations, financial sector schemes and the government.

ASIC's role to approve and oversee schemes derives from a number of sources including licensing conditions and ASIC's function to approve industry codes of practice for financial services. ASIC will assess a scheme for approval against the guidelines for alternative dispute resolution contained in section 12FA(2) of the *Australian Securities and Investments Commission Act.*

Some of the key issues that are contained in Policy Statement 139, and which are based on the section 12FA guidelines, are discussed below.

The guidelines require that a scheme cover a "sufficiently broad range" of complaints. In accordance with the Department of Industry, Science and Tourism benchmarks[181], sufficient coverage for the purposes of ASIC's policy may be interpreted broadly as meaning that a scheme has power to consider:

- the vast majority of consumer complaints in the relevant industry (or industries) and the whole of each complaint; and
- consumer complaints involving monetary amounts up to a specified maximum that is consistent with the nature, extent and value of consumer transactions in the relevant industry or industries.

As part of the approval process, ASIC will seek to ensure that there is consistent coverage across schemes that consider complaints about similar financial products and

[179] *Corporations Regulations,* regulation 7.3.02B(4)
[180] Policy statement 139 *Approval of external complaints resolution schemes*
[181] *Benchmarks for Industry-Based Customer Dispute Resolution Schemes*, Department of Industry Science and Tourism, August 1997

services, or that have a common membership. In particular, ASIC will consider what is an appropriate monetary claims limit for each scheme that seeks approval.

In the interim policy statement a limit of $50,000 was specified for schemes considering complaints about investment advice provided to retail investors. The interim policy statement noted that this limit would be reviewed and that it would be likely to increase for schemes seeking approval under the final policy statement. ASIC is currently reviewing this limit in consultation with stakeholders.

ASIC will only approve a scheme if it is satisfied that the scheme is effectively independent of the industries that provides its funding and that constitute its membership. In practice, this means that the decision makers and/or staff of the scheme are:

- entirely responsible for the handling and determination of complaints;
- accountable only to the scheme's overseeing body; and
- adequately resourced to carry out their respective functions.

An approved scheme must have in place appropriate mechanisms for ensuring that members comply with its decisions. These mechanisms should include that the scheme contractually requires members to comply with scheme decisions. ASIC must also be informed of any proposal by a scheme to terminate the membership of a non-compliant licensee. This is because termination of membership may place the licensee in breach of their licence.

12.2 Internal complaints handling

A licensee must have in place at all times, to deal with complaints from retail investors, internal complaints-handling procedures that are in accordance with Australian Standard AS 4269 - 1995, Complaints Handling, as in force on 1 October 1998[182].

ASIC Policy Statement 121[183] points to the benefits of internal complaints handling procedures.

These procedures are particularly beneficial to a licensee because they:

- enhance retail clients' confidence in the licensee's services; and
- give important feed-back to the licensee about client satisfaction or lack of it.

Retail investors greatly benefit from an easy to access and relatively inexpensive process (when compared to judicial processes) of obtaining redress through the service provider, who is in the best position to deal with complaints in the first instance. ASIC considers that the benefits of having internal procedures far outweigh any cost involved because it promotes greater investor confidence in advisory services.

Because AS 4269-1995 has adopted a functional approach in setting out minimum standards, it is suitable for both small as well as large businesses.

[182] *Corporations Regulations*, regulation 7.3.02B
[183] ASIC Policy Statement 121 *Investment advisory services: retail investor protection requirements*

12.3 Unlicensed persons

A range of remedies are provided where unlicensed persons enter into agreements with their clients relating to dealing in securities, advising the client about securities or giving the client securities reports. For example, a client may give a notice of rescission of the agreement and recover commission from the unlicensed person. ASIC may, on public interest grounds, bring an action on behalf of the client for recovery of commission[184].

12.4 Compensation

Where an adviser contravenes the conduct of business rules, the client acts in reliance on the recommendation and the client suffers loss or damage as a result, the adviser may be liable to pay damages to the client[185].

12.5 CLERP

The consultation paper[186] states that licensees who provide services to retail clients must have adequate arrangements for compensating clients for losses suffered, for example, professional indemnity insurance, membership of an approved fidelity fund, or other arrangements approved by ASIC. Licensees will also be required to have adequate internal dispute resolution procedures to resolve complaints from clients which must be in accordance with Australian Standard AS 4269-95 or approved by ASIC. Licensees will also be required to be a party to an external dispute resolution mechanism approved by ASIC.

[184] *Corporations Law*, Part 7.3, Division 2
[185] *Corporations Law*, section 852
[186] *Financial Products, Service Providers and Markets – An Integrated Framework*, Implementing CLERP 6, Consultation Paper, March 1999, pages 26,27

CHAPTER 13: COMPLAINTS RESOLUTION AND CONSUMER REMEDIES - REAL ESTATE AGENTS AND SALESPERSONS

13.1 Unlicensed persons

Commissions or fees may not be claimed in any court proceeding in relation to services as a real estate agent, unless the service was performed by a licensed real estate agent or an employee of a licensed real estate agent[187].

13.2 Agency agreements and recovery of commissions

A licensee is not entitled to remuneration unless the agency agreement is in writing, signed by the licensee and the person for whom the services are to be performed, the agreement contains prescribed terms, and a copy of the agreement is given to the person for whom the services are to be performed within 48 hours of that person signing the agreement. A licensee who recovers remuneration without complying with these requirements is guilty of an offence. Persons who pay licensees remuneration when they are not entitled to it because these requirements have not been complied with may bring court proceedings to recover it[188].

13.3 Review of commissions

The paper states that section 42A of the Act provided that a person may request the Director-General of the Department of Fair Trading to review remuneration claimed by a licensee from the person. The person may claim from the licensee amounts paid to the licensee in excess of the amount certified by the Director-General to be reasonable[189].

It should be noted, however, that section 42A of the Act has recently been amended[190] to delete provisions relating to review of commissions by the Director-General. The provision now refers to available remedies under the *Consumer Claims Act 1998.*

Disputes concerning commission fees charged by real estate agents are now dealt with in the Commercial Division of the Fair Trading Tribunal[191]. The Fair Trading Tribunal was established to provide an informal and inexpensive method of resolving disputes. It replaces a number of tribunals including the Property, Stock and Business Agents Commission Review Panel.

The jurisdiction of the Tribunal is conferred on it by a number of Acts. The *Consumer Claims Act 1998* confers jurisdiction on the Fair Trading Tribunal in relation to consumer claims. The Consumer Claims Division of the Tribunal resolves general

[187] *Property, Stock and Business Agents Act 1941 (NSW)*, section 42
[188] *Property, Stock and Business Agents Act 1941 (NSW)*, section 42AA
[189] *Property, Stock and Business Agents Act 1941 (NSW)*, section 42A
[190] *Fair Trading Tribunal Act 1998*, Schedule 4
[191] *Consumer Claims Regulation 1999*, regulation 8

disputes about goods and services. This includes claims by consumers for relief from payment of a specified sum of money.

In addition to hearings, a range of mechanisms are available to the Tribunal to resolve disputes. These include mediation, neutral evaluation and preliminary conferences.

The Tribunal is able to make various orders to resolve a consumer claim including orders for the payment of money or for goods or services to be supplied or stating that money is not owing to a person. The Tribunal's jurisdiction to make orders in respect of consumer claims is limited to a maximum of $25,000. However, this limit does not apply to claims relating to commission fees charged by agents licensed under the *Property, Stock and Business Agents Act 1941*[192].

Applications to the Tribunal generally require the payment of a filing fee[193].

13.4 Statutory interest account

Money held in the statutory interest account may be applied to meet the costs of operating a scheme for resolving disputes between consumers and the providers of property services[194]. This includes the business of selling, managing, valuing or otherwise dealing with property (including businesses) that is subject to licensing, registration or regulation under the *Property, Stock and Business Agents Act 1941*[195].

The New South Wales Department of Fair Trading has advised ASIC that generally, the Statutory Interest Account funds the regulatory institutions provided for by the *Property, Stock and Business Agents Act 1941*, including licensing, compliance, mediation and advice and determination of reviews of commissions. Funds from the account may also be used for other purposes including licensing education, professional development for agents and community education programs for consumers of agents' services. The Department further advised that the account also partly funds the operation of the Residential Tribunal and the Tenants Advice and Advocacy Program.

13.5 No exclusion of relief for fraudulent misrepresentation

Agreements for the sale and purchase of land may not exclude a purchaser's rights to damages or other relief in relation to any fraudulent misrepresentation in connection with the sale or purchase[196].

13.6 Civil remedies

The availability of any civil remedies is not affected by any proceedings against a person for an offence under the *Property, Stock and Business Agents Act 1941*[197].

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[192] *Consumer Claims Act 1998*, section 14 and *Consumer Claims Regulation 1999*, regulation 6
[193] Clause 36 and Schedule 3 of the *Fair Trading Regulations 1999* set out the range of filing fees which are applicable.
[194] *Property, Stock and Business Agents Act 1941 (NSW)*, section 63D
[195] *Fair Trading Act 1987 (NSW)* section 25I
[196] *Property, Stock and Business Agents Act 1941 (NSW)*, section 85
[197] *Property, Stock and Business Agents Act 1941 (NSW)*, section 90

13.7 1997 issues paper

The paper notes that the Department of Fair Trading is responsible for investigating complaints about agents. Complaints are received by the Customer Services Division of the Department and the aim is to achieve their resolution through self help. If complaints remain unresolved, they are then referred to the Marketplace Performance Division of the Department for investigation. The paper states that complaints may be referred to the court for disciplinary proceedings or may result in a Departmental hearing under section 42A of the Act to review the amount of commissions paid[198].

While the Department collects data relating to complaints, the paper found that interpretation of the data was complicated and it was therefore difficult to draw conclusions about the main causes of the complaints and whether or not the incidence of complaints is increasing.

13.7.1 Review of commissions

The paper notes that there is an issue as to whether section 42A hearings are an appropriate venue for dealing with complaints about the amount of commission and that there is concern that the section 42A committee deals only with the issue of the amount of the fee and not entitlement issues. Consumers wishing to have entitlement issues resolved must do so through the courts[199]. However, section 42A of the Act has recently been amended[200] to delete provisions relating to review of commissions by the Director-General. The provision now refers to available remedies under the *Consumer Claims Act 1998.*

In 1995-96, 147 applications were made for the review of agents' commissions. The paper notes that if this function were transferred to a quasi-judicial body, then both the issues of quantum and entitlement could be considered simultaneously. Mediation is another method which could be used to resolve disputes relating to fees. The Public Interest Advocacy Centre suggested that there is scope in this area for expansion of the dispute resolution process. While the Real Estate Institute provides a dispute resolution service and operates quasi-judicial tribunals in relation to disputes involving their members, including disputes about commissions, there is not a large volume of work in this area. The paper questions how dispute resolution mechanisms in relation to disputes about agents' fees could be improved[201].

The paper also referred to the fact that industry representatives considered the power to review commissions was unreasonable, because an agent could lose an entire fee due to

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[198] Review of the *Property, Stock and Business Agents Act 1941,* Issues Paper, September 1997, page 35. It should be noted, however, that section 42A of the Act has recently been amended to delete provisions relating to review of commissions by the Director-General. The provision now refers to available remedies under the *Consumer Claims Act 1998*.

[199] Review of the *Property, Stock and Business Agents Act 1941,* Issues Paper, September 1997, page 35

[200] *Fair Trading Tribunal Act 1998,* Schedule 4

[201] Review of the *Property, Stock and Business Agents Act 1941,* Issues Paper, September 1997, page 39

non compliance with a technicality (for example, where an agency agreement was not properly executed) and there is no provision for an appeal[202].

[202] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 61

CHAPTER 14: COMPARISON - COMPLAINTS RESOLUTION AND CONSUMER REMEDIES

14.1 Comparative table

The following table outlines and compares some of the main features of the regulatory regimes applicable to dispute resolution and consumer remedies.

Investment advisers	Real estate agents
External complaints resolution	**External complaints resolution**
Licensees giving investment advice to a retail investor must be a member of an ASIC approved external complaints resolution scheme.	Disputes are heard by the Fair Trading Tribunal.
Internal complaints handling	**Internal complaints handling**
Licensees must have internal complaints handling procedures in place in accordance with AS 4269-1995.	No comparable requirement for internal complaints handling mechanism.
Unlicensed persons	**Unlicensed persons**
Where an unlicensed person provides investment advice, the client has a range of remedies available, including rescission of contracts and recovery of any brokerage, commissions or other fees paid. Such contracts and any obligations to pay brokerage, commissions and other fees are not enforceable against the clients.	Commissions or fees may not be claimed in court proceedings where services were not performed by a licensed person or employee.
Conduct of business standards	**Conduct of business standards**
Where any recommendations provided to a client by a securities adviser do not satisfy the conduct standards (eg no reasonable basis for the recommendation or failure to disclose conflicts of interest), the client who acts on reliance of that recommendation and suffers loss can recover that loss from the representative who made the recommendation or the principal licensee.	As there are no comparable conduct standards, there are no specific civil remedies available to intending purchasers who act on recommendations made by estate agents/salespersons.
Other remedies	**Other remedies**
A range of other remedies are available to deal with breaches of prohibitions in the *Corporations Law* regarding conduct in relation to securities, for example, prohibitions against misleading and deceptive conduct.	The *Property Stock and Business Agents Act* provides that agreements for the sale or purchase of land may not exclude a purchaser's rights to relief in respect of fraudulent misrepresentations. The Act also provides that the availability of civil remedies is not affected by any proceedings in respect of an offence under the Act.

CHAPTER 15: DISCIPLINARY PROCEDURES APPLICABLE TO INVESTMENT ADVISERS AND REPRESENTATIVES

15.1 Revocation of licences

ASIC may revoke a licence without a hearing if the licensee[203]:

- becomes an insolvent under administration;
- is convicted of serious fraud;
- becomes incapable, through mental or physical incapacity, of managing his or her affairs; or
- asks ASIC to revoke the licence.

ASIC may revoke a licence held by a body corporate if[204]:

- the body ceases to carry on business;
- the body becomes an externally-administered body corporate;
- the body asks ASIC to revoke the licence; or
- a director, secretary or executive officer of the body contravenes Chapter 7 of the *Corporations Law* because he or she does not hold a licence or a licence held by him or her is suspended.

ASIC may revoke a licence after a hearing if[205]:

- the application for the licence contained matter that was false or misleading;
- there was an omission of material matter from the application;
- the licensee contravenes a securities law;
- the licensee contravenes a condition of the licence;
- ASIC believes that the licensee is not of good fame and character;
- the licensee is a body corporate and ASIC is satisfied that the educational qualifications or experience of a person who is an officer of the body, and was not an officer of the body when the licence was granted, are inadequate having regard to the officer's duties;
- the licensee is a body corporate and ASIC is satisfied that an officer of the body performs in connection with the holding of the licence, duties that include duties ("different duties") other than those having regard to which ASIC was satisfied, before granting the licence, that the officer's educational qualifications and experience were adequate and the officer's educational qualifications or experience are inadequate having regard to the different duties;
- the licensee is a body corporate and a licence held by a director, secretary or executive officer of the body is suspended or revoked, or an order is made

[203] *Corporations Law*, section 824
[204] *Corporations Law*, section 825
[205] *Corporations Law*, section 826

under section 830 of the *Corporations Law* against the director, secretary or executive officer; or

- ASIC believes that the licensee has not or will not perform efficiently, honestly and fairly the duties of a holder of an investment advisers licence.

15.2 Suspension of licences

Where ASIC is empowered to revoke a licence it may instead suspend a licence for a specified period or prohibit the licensee, either permanently or for a specified period, from doing certain acts in connection with carrying on an investment advice business or a securities business[206].

15.3 Banning orders

Where ASIC revokes or suspends a licence held by an individual on certain grounds, it may also make a banning order against the person[207].

ASIC may make a banning order against an unlicensed individual if[208]:

- he or she becomes an insolvent under administration;
- he or she is convicted of serious fraud;
- he or she becomes incapable, through mental or physical incapacity, of managing his or her affairs;
- he or she contravenes a securities law;
- ASIC has reason to believe that he or she is not of good fame and character;
- ASIC has reason to believe that he or she has not performed or will not perform efficiently, honestly and fairly the duties of a representative of an investment adviser.

Where ASIC makes a banning order against a person, it prohibits the person from doing an act as a representative[209].

ASIC may not grant a dealers licence or an investment advisers licence to a person if a banning order prohibits the person from doing an act as a representative of a dealer or of an investment adviser as the case may be[210].

15.4 Disqualification by the Court

Where ASIC revokes a licence held by a person or makes a banning order that is to operate otherwise than only for a specified period, ASIC may apply to the Court for the following orders[211]:

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[206] *Corporations Law*, section 827
[207] *Corporations Law*, section 828
[208] *Corporations Law*, section 829
[209] *Corporations Law*, section 830
[210] *Corporations Law*, section 836
[211] *Corporations Law*, section 838

- an order disqualifying the person, permanently or for a specified period, from holding a dealers licence and/or an investment advisers licence;
- an order prohibiting the person from doing an act as a representative of a dealer and/or of an investment adviser;
- such other order as it thinks fit.

ASIC may not grant a dealers licence or an investment advisers licence to a person whom a court order disqualifies from holding a dealers licence or an investment advisers licence, as the case may be[212].

15.5 CLERP

The consultation paper[213] states that ASIC's power to revoke or suspend a licence and to ban a natural person, a corporate licensee or responsible officer of a corporate licensee from providing financial services will be modelled on the *Corporations Law*. It also states that ASIC will have power to ban persons from acting in the capacity of representative of a licensee.

[212] *Corporations Law*, section 839
[213] *Financial Products, Service Providers and Markets – An Integrated Framework,* Implementing CLERP 6, Consultation Paper, March 1999, page 31

CHAPTER 16: DISCIPLINARY PROCEDURES APPLICABLE TO REAL ESTATE AGENTS AND SALESPERSONS

16.1 Cancellation of licences

Following a complaint by a member of the police force or by the Director-General of the Department of Fair Trading, a real estate agent may be summonsed to appear before a court to show cause why a licence should not be cancelled and why the licensee should not be disqualified either permanently or temporarily on the ground[214]:

- that the licence was improperly obtained contrary to the provisions of the *Property, Stock and Business Agents Act 1941*;
- that the licensee is not a fit and proper person to continue any longer to hold a licence;
- that any director or the secretary of the corporation is not a fit and proper person to be a director or the secretary, of a corporation holding a licence;
- that the licensee has been guilty of conduct as renders him or her unfit to continue to hold a licence or that the affairs of the corporation have been conducted as to render it unfit to continue to hold a licence, or
- that any director or the secretary of the corporation has been guilty of conduct as renders him or her unfit to be a director or the secretary of a corporation holding a licence.

16.2 Disqualification of former licensees

If a complaint is made against a person who, within the previous 12 months, has held a licence or has been a director or the secretary of a corporation that, has held a licence, that person may be required to show cause to a court why the person should not be disqualified either permanently or temporarily from holding a licence on the ground[215]:

- where the person is an individual, that the person is not a fit and proper person to hold a licence, that the former licensee has been guilty of conduct that renders him or her unfit to hold a licence;
- where the person is a corporation, that it is not a fit and proper person to hold a licence or that its affairs have been conducted as to render it unfit to hold a licence.

16.3 Effect of disqualification

A person who has been disqualified may not, during the period of disqualification, be a director, manager or secretary of any corporation or a partner in any partnership carrying on business in New South Wales as a real estate agent, a stock and station agent, a

[214] *Property, Stock and Business Agents Act 1941 (NSW)*, section 29
[215] *Property, Stock and Business Agents Act 1941 (NSW)*, section 29A

business agent, a strata managing agent, a community managing agent or an on-site residential property manager[216].

16.4 Cancellation of registration as a salesperson

Where a complaint is lodged by a member of the police force or by the Director-General, a real estate salesperson may be summonsed to appear before a court to show cause why his or her certificate of registration should not be cancelled and why the salesperson should not be disqualified either permanently or temporarily from holding a certificate of registration on the ground that the salesperson:

- improperly obtained his or her certificate of registration contrary to the provisions of the *Property Stock and Business Agents Act 1941(NSW*);
- is not a fit and proper person to continue to be registered; or
- has been guilty of such conduct as renders him or her unfit to continue any longer to hold a certificate of registration.

16.5 Disqualification of former salespersons

If a complaint is made against a person who, within the previous 12 months, was registered as a real estate salesperson, that person may be required to show cause to a court why the person should not be disqualified either permanently or temporarily from being registered as a salesperson on the ground that the person has been guilty of conduct which renders that person unfit to be registered[217].

16.6 Employment restrictions

A licensee may not, except with the approval of the Director-General, employ in connection with the licensee's business a person[218]:

- who is disqualified from holding a licence or whose licence has been cancelled, unless a licence has subsequently been granted;
- whose application for a licence has been refused (otherwise than for reasons relating to age, experience or technical qualifications) unless the application has been subsequently granted;
- who is disqualified from holding a certificate of registration as a real estate salesperson, a stock and station salesperson, a business salesperson or a trainee managing agent, or whose registration as such has been cancelled or refused, unless registration has been subsequently granted.

16.7 1997 issues paper

The 1997 issues paper reviewing the *Property, Stock and Business Agents Act 1941 (NSW)* points out that the Act makes no provision for penalties such as the imposition of a warning or reprimand, or orders to require a person to refrain from engaging in certain

[216] *Property, Stock and Business Agents Act 1941 (NSW)*, section 32
[217] *Property, Stock and Business Agents Act 1941 (NSW)*, section 60AA
[218] *Property, Stock and Business Agents Act 1941 (NSW)*, section 39

conduct or to recompense others and raises the issue of whether disciplinary action could be made more effective by providing for a wider range of penalties to cater for situations which do not warrant disqualification[219].

The paper points out that the Real Estate Institute disciplines its members by the use of warnings, fines, orders (for example, orders to attend training courses), suspension and expulsion.

It also points out that the disqualification of licensees is not common, so it is difficult to determine how effective this is in deterring unscrupulous behaviour[220].

However, the New South Wales Department of Fair Trading has advised ASIC that since the publication of the issues paper, provision has been made for less serious offences to be dealt with by the use of a penalty notice, which allows licensees to have a breach dealt with without the need to attend court if they so choose. The Department advised that generally, penalty notices will only be used by the Department for offences where:

- the breach, in isolation, is of a minor nature;
- the offence is of a regulatory or technical type which is least likely to cause substantial consumer detriment;
- the breach is considered to be self evident or detection of the offence does not require detailed investigation.

The Department has also pointed out that in relation to offences under the *Fair Trading Act 1987*, such as misleading and deceptive conduct, false representations or bait advertising, there are a range of enforcement mechanisms and remedies available under Part 6 of the Act. These include warnings, undertakings to refrain from engaging in certain action or orders to compensate for loss or damage.

[219] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, pages 30, 31

[220] Review of the *Property, Stock and Business Agents Act 1941*, Issues Paper, September 1997, page 53

CHAPTER 17: COMPARISON - DISCIPLINARY PROCEDURES

17.1 Comparative table

The following table compares some of the main features of the regulatory regimes relating to disciplinary procedures.

Investment advisers	Real estate agents
Revocation of licences	**Cancellation of licences and disqualification**
ASIC can revoke a licence on grounds such as: • insolvency of the licensee; • convictions for serious fraud; • mental or physical incapacity; • the application contains false or misleading information or omits material information; • breach of a securities law or a licence condition; • ASIC has reason to believe that a natural person licensee is not of good fame and character; • a corporate licensee's officers do not have appropriate qualifications and experience with regard to the work assigned to them; • licence held by an officer of the licensee is revoked or the officer is banned from being a representative; • ASIC has reason to believe that the licensees has not or will not perform its duties efficiently, honestly and fairly.	Cancellation and disqualification can occur on the grounds of: • licence improperly obtained ; • licensee not a fit and proper person; • officer not a fit and proper person; • conduct renders licensee unfit to hold a licence; • corporation's affairs conducted in a way to render it unfit to hold a licence; • conduct renders officer unfit to be an officer of a corporation holding a licence.
Suspension of licences	**Suspension of licences**
Licensee may be suspended for specified period on grounds such as inadequate qualifications and experience of officers. Licensees may also be prohibited permanently or for a specified period from doing certain acts.	Licensees can be disqualified temporarily.
Ineligibility to hold licence	**Ineligibility to hold licence**
A person can be banned from the securities industry for a specified period or permanently. Banning orders can be imposed on unlicensed as well as licensed persons where licence has been revoked. Grounds for imposing a banning order include: • insolvency, serious fraud or mental or physical incapacity; • contravention of a securities law; • ASIC forms the view that the person is not of good fame and character;	Licensees can be disqualified permanently. Former licensees (persons who have been licensed in the previous 12 months) can also be disqualified on the grounds of being: • not a fit and proper person; or • unfit to hold a licence.

• ASIC has reason to believe that the person has or will not perform the duties of a representative efficiently, honestly and fairly.	
Banning orders - representatives	**Cancellation of registration as a salesperson**
See above.	Cancellation and disqualification may occur on the grounds of: • registration improperly obtained • not a fit and proper person • conduct renders salesperson unfit to be registered.
Employment restrictions	**Employment restrictions**
A person subject to a banning order may not be a representative of a dealer and/or an investment adviser (as specified in the order) and is ineligible to be licensed as an investment adviser or a dealer.	Restrictions apply to the employment of persons who: • are disqualified from holding a licence or whose licence has been cancelled • have had an application for a licence refused • are disqualified from holding a certificate of registration or whose registration has been cancelled.
Administrative powers	**Administrative powers**
ASIC has administrative powers to suspend and revoke licenses and impose banning orders, subject to a hearing**.**	No equivalent
Court orders	**Court orders**
ASIC can apply to the court for banning orders.	Cancellation of licences and registration and disqualification is carried out through the court.
Fining powers	**Fining powers**
ASIC has no fining powers in this area.	State regulatory authorities can issue penalty notices.

Attachment 1 Competency, integrity and financial requirements applying to investment advisers and representatives

Licensing requirements

ASIC Policy Statements 116[221], 118[222], 119[223] and 120[224] outline the extent of the application of the licensing provisions. More detail on these requirements is contained below.

In what capacity is the service provided?

A person could provide investment advisory services in a number of capacities:

- as a person conducting a securities (dealing) or an investment advice business - these persons are fully regulated under the licensing provisions;
- as a representative of a dealer or an investment adviser - these persons do not have to be licensed but are subject to the Law through their principals;
- as a person with a limited exclusion for certain types of activities - examples of these include exempt dealers and investment advisers under section 68 of the *Corporations Law*, a superannuation trustee conducting dealing activities while managing and administering a scheme, or solicitors and accountants in public practice giving merely incidental investment advice.

Does the activity constitute "securities advice"?

There are two definitions which assist in defining what is "securities advice":

- the definition of "investment advice business"[225], that is, a business of advising other persons about securities, or a business in the course of which a person publishes securities reports; and
- the definition of "securities recommendation" [226], that is, making direct or indirect recommendations with regard to securities

There are three types of activities which would constitute "securities advice" or "investment advisory services" on securities:

- giving advice on securities;

[221] ASIC Policy Statement 116 *Investment advisory services: licensing and "independent" advisory services*
[222] ASIC Policy Statement 118 *Investment advisory services: media, computer software and Internet advice*
[223] ASIC Policy Statement 119 *Investment advisory services: merely incidental advice by solicitors and accountants*
[224] ASIC Policy Statement 120 *Investment advisory services: mere referrals and other excluded activities*
[225] *Corporations Law*, section 77
[226] *Corporations Law*, section 9

- publishing securities reports; and
- making recommendations about securities.

A securities report is an analysis or report about securities[227] . A securities recommendation means an express or implicit recommendation about securities or a class of securities[228]. On the basis of these definitions, publishing or disseminating analysis and reports about securities and making recommendations about securities are aspects of giving securities advice.

In administering the licensing provisions, ASIC draws a distinction between two types of securities advice: personal securities recommendations and general securities advice.

Exclusion for the provision of purely factual information

Because the term "securities report" is broadly defined, any person who publishes reports containing purely factual information on securities will technically be required to operate under a licence, although the report contains no element of investment advice or opinion. ASIC considers that there is no net regulatory benefit in requiring persons publishing purely factual information about securities to operate under a licence if no advice or opinion is directly or implicitly provided in their reports.

Therefore, ASIC adopts a policy of not requiring persons who publish purely factual information about securities to be licensed. They must still meet the provisions of Part 7.11 of the *Corporations Law* when publishing reports containing purely factual information on securities. (Part 7.11 deals with prohibited conduct such as misleading and deceptive conduct, false and misleading statements relating to securities and fraudulently inducing persons to deal in securities.)

As a condition of ASIC's policy of not enforcing the licensing provisions, ASIC requires persons who publish securities reports which contain only purely factual information about securities to include in the reports warnings to the effect that:

- the information is not suitable to be acted upon as investment advice; and
- it may be advisable to obtain investment advice before making any investment decisions relying on the information provided

Does the provision of securities advice satisfy the "conduct of business" test?

Not all activities that may be described as giving securities advice are regulated under the licensing provisions. The licensing provisions only apply when the advice is provided in the conduct of a securities or an investment advice business (conduct of business test). Such a business could be conducted on its own or in conjunction with another business[229].

"Conduct of business" has to be interpreted by referring to the common law principles stated in cases defining "business" and "carry on a business". According to these

[227] *Corporations Law*, section 9
[228] *Corporations Law*, section 9
[229] *Corporations Law*, section 19

principles, the conduct of business test can only be satisfied when the activities (in this case, giving securities advice) are conducted with "system, repetition and continuity" (see Taylor v White (1963) 110 CR 129, Edgelow v MacElwee (1918) 1KB 205 and Hyde v Sullivan (1956) 56 SR–NSW 113).

Although the case law includes an element of "profit" within the concept of "conduct of business" the Law states that the term "carrying on a business" also means carrying on business other than for profit[230]. Therefore, if the conduct satisfies the test of system, repetition and continuity, and even if there is no profit element, then a person engaging in that activity is "conducting a business".

ASIC considers that an isolated act or instance of giving securities advice is generally unlikely to satisfy the conduct of business element. Therefore, a person giving advice in these circumstances will not generally need to be licensed under the Law.

What activities can be conducted without a licence?

There are three classes of activities to which the licensing provisions do not apply. These are:

- activities which, according to ASIC's interpretation of the Law, do not amount to giving investment advice – an example is a person making mere referrals to a licensee;
- activities in relation to which ASIC, on policy grounds, will not enforce the licensing provisions, although they are technically investment advice - an example is publishing reports on securities which contain only purely factual information about securities. Third parties will, however, be able to enforce the licensing provisions;
- investment advisory activities which are expressly excluded by the Law - examples are the media exemption and the incidental advice exemption.

Who needs a dealers licence instead of an investment advisers licence?

The term "securities business" is widely defined to include a business of:

- acquiring, disposing of, subscribing for, or underwriting securities;
- making or offering to make agreements for or in respect of acquiring, disposing of, subscribing for or underwriting securities; or
- inducing, or attempting to induce, persons to make such agreements.

Providing securities advice (an investment advisory activity) could be part of a "securities business" if such advice is aimed at inducing persons to enter into securities transactions. The distinction between advice which is intended to induce persons to enter into securities transactions and other securities advice is not always very clear. ASIC considers that it is the disinterestedness in the outcome of a transaction resulting from the advice that is important.

[230] *Corporations Law*, section 18

For example, if an adviser obtains any economic benefit from, or has any other interest in, an investor entering into a specific securities transaction as a result of the advice they gave that investor, the adviser is likely to be inducing the investor to enter into the securities transaction. Therefore, that adviser must operate under a dealers licence, instead of an investment advisers licence.

ASIC considers that a person has an economic interest in the outcome of a securities transaction if the adviser operates under any arrangement with a product issuer or any other party interested in the outcome of the transaction under which the adviser receives financial benefits.

An example of another party interested in the outcome of a transaction is a dealer associated with a person underwriting an issue of securities. Financial benefits include commissions, agency fees or any other benefits (for example, soft dollar arrangements such as overrides, research, free seminars or trips). However, if the adviser arranges for any commissions or benefits from a source other than the client to be foregone or remitted to the client, such an adviser is unlikely to be considered to be inducing the client to enter into securities transactions.

An adviser may have a clear interest in the outcome of a securities transaction resulting from the advice although that interest may not necessarily be measurable in financial terms. These instances are not as common as economic interests which lead to inducements. However, if an adviser induces persons to enter into securities transactions as a result of such a non-financial interest, that person will need to obtain a dealers licence.

An adviser is unlikely to be inducing clients to enter into securities transactions if:

- the client pays the adviser a fee for the advice; and
- the adviser has no economic or other interest in the outcome of any securities transaction resulting from the advice (other than repeat business from the client.

Research houses

The licensing provisions may apply to research houses in two ways:

- advice or reports on securities - a securities report is broadly defined in the Law as an “analysis or report on securities”. This is wide enough to include research and ratings on securities. These publications are unlikely to fall within the exemption for media advice as they are published solely for the purpose of advising other persons about securities. Therefore, research houses which conduct a business of providing research and reports on securities must operate under a licence and comply with the relevant licensing provisions in the Law.
- direct or indirect inducements - research and ratings on securities provided to specific clients could amount to direct or indirect advice about the investment worthiness of specific securities. If a research house conducts a business of providing lists of recommended securities or research in relation to securities

of related product issuers, these activities are likely to be "inducements". This is because such a research house may have a direct or indirect economic or other interest in inducing persons to invest in securities of the related issuers. If a research house is in the business of providing such research or recommended lists of investments to induce persons to enter into securities transactions, they must operate under a dealers licence and comply with the relevant licensing provisions

Do persons providing expert reports need a licence?

Experts prepare reports such as valuation reports or profit forecasts for the purposes of the Australian Stock Exchange (ASX) Listing Rules or the Law to be used in share buy backs, selective capital reductions, schemes of arrangement, takeovers and prospectuses. A person who carries on a business of preparing such expert's reports relating to securities must operate under an appropriate licence. They must have a dealers licence if inducing persons to enter into securities transactions, or otherwise, an investment advisers licence.

Some expert reports may not relate to securities. For example, they may only be concerned with real property, mining leases or other assets. Persons providing such reports do not need a licence.

Solicitors and accountants

The body of this paper contains a brief description of how the Law applies to incidental advice given by solicitors and accountants. This section contains more detailed information.

A solicitor or an accountant conducting a business of dealing in securities cannot rely on the merely incidental exemption. This is because the exemption is provided only in relation to the conduct of an investment advice business.

For example, a solicitor or accountant may receive a fee, commission or other benefit from a securities issuer (for example, a fund manager) for giving investment advice on specific securities. In this situation, the solicitor or accountant is inducing clients to enter into securities transactions by giving that advice. Because this is a dealing activity, the solicitor or accountant conducting the business must operate under a dealers licence.

If a solicitor or accountant receives a fee, commission or other benefit from another dealer or an investment adviser, the arrangement may also amount to acting for or by arrangement with the dealer or investment adviser in relation to that licensee's securities or investment advice business.

When a solicitor or an accountant gives investment advice under such an arrangement, it amounts to an act of a securities representative. This means that they must hold a proper authority from that dealer.

When an accountant or solicitor gives general asset allocation advice to a client within ASIC guidelines in Policy Statement 120, they do not need a licence or a proper authority. This is because, although general asset allocation advice is technically

investment advice regulated under the Law, ASIC will as a matter of policy not actively enforce the relevant provisions in the Law.

If asset allocation advice goes beyond being a very general recommendation relating to securities and identifies any specific securities, unless it can be provided within the merely incidental exemption, an accountant or solicitor providing such advice needs to operate under a licence. When specific asset allocation advice which amounts to securities advice is given in the context of tax planning or superannuation structuring, an accountant or solicitor can rely on the incidental exemption if the relevant guidelines are met.

When an accountant or solicitor refers their client to a dealer or an investment adviser for a referral fee, the accountant or solicitor does not have to hold a proper authority from the dealer or investment adviser. Consequently, there is no need to rely on the merely incidental exemption when mere referrals are made. This is because if no direct or implicit securities recommendation is made when making the referral, according to ASIC's interpretation of the Law, the person making the referral is not considered to be providing investment advice.

A client may ask their solicitor for legal advice relating to the enforceability of a debenture (a security). A solicitor who provides advice in relation to the debenture in the context of its enforceability will not need to operate under a licence as this is regarded as merely incidental advice to the practice of their profession.

A client may ask their accountant to review an existing portfolio of investments and to give advice on its suitability or effectiveness. The portfolio may consist of a range of investments, including securities. If any advice is provided on the securities (for example, to hold or dispose of them), generally such advice is considered to be investment advice on securities.

In this case, the accountant must operate under an investment advisers licence. (Note: a dealers licence is not needed because payment for such service would generally come from the client and not a product issuer.) However, if the investment advice is provided in a review of the taxation consequences of the portfolio, then the accountant would not need to operate under a licence. This is because they can rely on the merely incidental exemption if they meet the relevant guidelines.

A client may ask their solicitor to review the investments in a portfolio (which contains securities) from the perspective of their relative strength in terms of security (that is, legal enforceability). The legal advice may include direct or indirect recommendations to hold or dispose of some securities in the portfolio. In this case, a solicitor can rely on the merely incidental exemption if they meet the relevant guidelines.

Any accountant who engages in a business of providing advice on investments in superannuation schemes must fully comply with the licensing requirements in the Law. Therefore, unless such superannuation advice satisfies the merely incidental guidelines the accountant must operate under a licence.

A solicitor may provide legal advice to a client in relation to the structure of a superannuation scheme. A solicitor does not need to operate under a licence to provide such advice as the advice is not about investments in superannuation interests but on the structure of the scheme.

An accountant who is in the business of preparing expert's reports on securities must operate under an appropriate licence (generally an investment advisers licence). They must have a licence unless their work is carried out within the merely incidental guidelines.

Mere referrals

Referral arrangements are an integral part of current market practices. Persons who provide various financial and related services (such as credit unions, accountants, solicitors, superannuation trustees and life insurance companies or agents) often refer their clients to licensees for advisory and dealing services.

According to ASIC's interpretation of the Law, a person who makes a referral within the guidelines set out in Policy Statement 120 (that is, a mere referral) will not be carrying out a dealing or investment advice activity. Therefore, ASIC considers that such a person does not have to hold a proper authority from the licensee to whom referrals are made. This is because that person is not acting as a representative when making mere referrals to the licensee.

Persons who make referrals to licensees often have arrangements with those licensees and they receive a fee or benefit for making the referrals. These benefits may include a referral or spotter's fee, a share of a commission, an entitlement to rent or cross referrals of clients (for example, clients of a licensee are referred for accounting or legal services).

When a person makes a referral to a licensee, the referral may be the act of a representative which is very broadly defined[231]. A person does an act as a representative of another person only if they do it in connection with the securities or investment advice business of the other person and as an employee or agent of, or otherwise on behalf of, on account of, or for the benefit of, that other person. (Note: there is an exclusion for work of a kind ordinarily done by accountants, clerks and cashiers.)

According to ASIC's interpretation of the Law, unless a person carries out any of the functions of dealing in or advising on securities in connection with a securities or investment advice business of a licensee, that person would not generally be acting as a representative and invoking section 806 or section 807. These prohibit a person from doing an act of a representative without a proper authority from the licensee.

When a person makes referrals to a licensee (or its representatives), ASIC considers that the person making the referral is not carrying out a dealing or an investment advice activity if certain guidelines are met. These guidelines are designed to ensure that the referral remains an activity which is not an act of a representative.

[231] *Corporations Law*, section 99(3)

This interpretation of the Law is based upon the reasoning that when a person does an act which does not involve a function of dealing in or advising on securities, the regulatory protection under the licensing requirements is not needed.

What is a "mere referral"?

ASIC considers that a mere referral is made when a person:

- does nothing more than merely introduce a potential investor to a licensee; and
- does this merely as an incidental part of their other business

If the person making the referral provides any direct or indirect securities advice as a part of introducing the client, then this is not a mere referral. For example, if a person discusses, either in general or in particular, the merits of investing in securities or induces or attempts to induce the other person to enter into any securities transaction, then they are not making a mere referral.

Referral activities must be an incidental part of any other business conducted by the referring party. For example, when the referring party is in the business of seeking out prospective investors to refer to a licensee (that is, promoting the services of the licensee), that person is not making a mere referral. That person may be either conducting a securities or investment advice business in their own right (for which they must have a licence) or acting as a representative of the licensee (for which they must have a proper authority from the licensee).

A referring party and a licensee may have arrangements to share the profits from the securities or investment advice business generated through the referrals (as opposed to the payment of a discrete referral fee). The referring party must hold a proper authority from the licensee if such arrangements are in place because they are more involved in the conduct of the securities or investment advice business of the licensee (for example, by promoting the services of the licensee to clients) rather than just making a mere referral.

Can a mere referral be made to an authorised representative?

An authorised representative of a licensee deals in or advises on securities as an employee or agent of, or otherwise on behalf of, on account of, or for the benefit of, the licensee in connection with the licensee's securities or investment advice business. Therefore, when any referrals are made to an authorised representative of a licensee, the referral is, in fact, made to the licensee and not to the authorised representative.

However, care should be taken when referrals are made to authorised representatives to ensure that the representative does not hold out to the referred clients to be the person conducting the securities or investment advice business. In this situation the representative may be breaching sections 780 and 781 (the requirements to hold a licence before carrying on a securities or investment advice business).

Can a body corporate make mere referrals?

The Law prohibits a body corporate from acting as a securities representative of another person. If the referral activity of a body corporate remains a mere referral within the relevant guidelines the corporation does not breach this prohibition.

Can a mere referral be made to an own employee holding a proper authority from an external licensee?

A practice adopted by some types of financial service providers (such as credit unions) is to make referrals to an employee who holds a proper authority from a related licensee. This amounts to a sharing of employees. They have these arrangements because they build better customer relations by assisting clients to obtain dealing and advisory services under one roof or better utilise resources and expertise available within a group structure.

ASIC considers that the use of common employees within group structures may raise a possibility that the referring party is acting for or by arrangement with the licensee within the group which issues the proper authority. This is a breach of section 809.

However, ASIC will not enforce the prohibition in section 809 when a mere referral to such a common employee is made provided:

- the referring party fully complies with the guidelines for making mere referrals, and
- the contractual arrangements relating to the supervision and control of the in-house employee clearly provide for complete control and supervision of the employee's dealing and investment advice functions by the licensee within the group which issued the proper authority.

Can a licensee make mere referrals to another licensee?

Referrals can be made by one licensee to another. This generally occurs so that resources in a single financial group can be rationalised or because of limited expertise. This situation is different from when a referral is made to a common employee

Any licensee can make a mere referral to another licensee within the mere referrals guidelines.

If the referral is not a mere referral (that is, if it involves dealing in or advising on securities, such as directing an investor to specific investments or classes of investments by providing preliminary advice), a corporation which is the referring party will contravene the prohibition in section 809 as they are carrying out an act of a securities representative.

Can a business introductory service be a mere referral activity?

Business introductory services are another similar service available in the financial markets. Generally these services are conducted through special purpose publications which give information about prospective business partners (that is, persons seeking

capital for expanding businesses and prospective investors in such businesses). These introductory services may lead to issuing securities to investing parties.

ASIC considers that a person who is in the business of providing business introductory services (which may involve issuing shares at some future stage of negotiations) is not conducting a securities or an investment advice business if:

- they do not provide any investment advice on securities that may be issued as a part of any negotiations between the parties who are to be brought together. For example, a mere reference in the introductory information to a possible equity ownership being offered by a party seeking venture capital would not be considered by ASIC as providing advisory services on securities, and
- they do not receive any fee or other benefit from any securities transactions resulting from the negotiations. Any fee received for bringing the parties together on the completion of an agreement between the parties which includes a securities transaction is not such a fee unless it is a specific payment for arranging the securities transaction

What are the disclosure obligations where mere referrals are made?

ASIC considers that when referrals are made, the licensee to whom the referrals are made must disclose details of any benefits (for example, commissions or fees) payable to the referring party. Therefore, ASIC will continue to impose this obligation in licence conditions.

Asset allocation advice

Asset allocation advice may be provided by a range of professionals including accountants and actuaries. Although the current Law does not expressly deal with asset allocation advice, the licensing provisions in the Law apply if it includes advice on securities.

Any advice on securities falls within the definition of securities advice because the term is very broadly defined and includes advising other persons about securities. (This may also amount to a dealing activity if such advice is given to induce persons to enter into securities transactions.) In this sense, technically, any asset allocation advice containing some advice on investments in securities attracts the licensing provisions in the Law. This means that a person giving such advice must operate under an appropriate licence.

However, ASIC, on policy grounds, does not enforce the licensing provisions on persons who give general recommendations to allocate assets in a particular way (for example, in securities, life insurance and tangibles). This is because, although technically investment advice, the advice on securities in the general asset allocation context is too general and insignificant to warrant the application of the licensing provisions to persons giving that advice.

If asset allocation advice goes beyond being a very general recommendation on securities and identifies any specific securities (for example, interests in X trust) or classes of securities (for example, income or growth funds, franked or unfranked securities, mining shares or property trusts), the advice is more than general asset allocation advice. A

person who conducts a business of providing such advice must operate under an appropriate licence.

Media advisers

Although media advisers play a significant role in securities markets, they may not need a licence and are not regulated in the same way as other investment advisers. Media advisers do not need to hold a licence if they meet the requirements of section 77(6). Section 77(6) applies to persons who provide advice, analyses or reports on securities which are published in newspapers and periodicals, transmissions or recordings when these are:

- generally available to the public (for example, in the case of newspapers and periodicals, not made available only on subscription); and
- not intended solely or principally for the purpose of advising other persons about securities or publishing securities reports.

Media advisers do not need a licence if they are advising other persons about securities or publishing securities reports (or holding out as engaging in such an activity) in the following situations:

- When they are the proprietor or publisher of a newspaper or periodical containing the advice or report. To be eligible for this exemption their newspaper or periodical must be generally available to the public (for example, available not only on subscription)[232];
- When they give advice or publish securities reports in the course of, or by means of, a transmission made by means of an information service. To be eligible for this exemption they must make the transmission using an information service which is generally available to the public. The person may be a user, owner, operator or provider of the information service. An "information service" includes a broadcasting, teletext or on-line database service[233]; or
- When they give advice or publish reports in sound, video or data recordings which they make generally available to the public. This means that they supply copies to, or allow the recording to be heard or seen by, the public[234].

The above exemption does not apply to newspapers, periodicals, transmissions and sound, video and data recordings, the sole or principal purpose of which is to advise other persons about securities or to publish securities reports[235].

Employee media advisers do not have to hold proper authorities if they contribute securities advice or prepare securities reports for publication in newspapers and periodicals which:

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[232] *Corporations Law*, section 77(6)(a)
[233] *Corporations Law*, sections 9 and 77(6)(b)
[234] *Corporations Law*, section 77(6)(c)
[235] *Corporations Law*, section 77(7)

- are generally available to the public (that is, other than only on subscription), and
- do not have as their sole or principal purpose advising other persons on securities or publishing securities reports.

This is because the principals of these media advisers, that is, the proprietors or publishers of the newspapers and periodicals, do not have to be licensed. (A similar exclusion may apply to employees who contribute advice or prepare securities reports for publication by means of transmissions using an information service, or sound, video or data recordings, which are generally available to the public.)

However, these employee media advisers, being "financial journalists" must maintain a register of interests[236].

The term "financial journalist" is defined in the Law as an unlicensed person who in the course of their business or employment contributes advice or prepares analyses or reports about securities for publication in newspapers or periodicals, in the course of, or by means of, an information service or in sound, video or data recordings[237].

ASIC considers that media advisers will lose the benefit of the media exemption when:

- they give investment advice intended to induce persons to enter into securities transactions;
- they give direct or indirect personal securities recommendations in newspapers and periodicals; or
- they make direct or indirect personal securities recommendations in transmissions using an information service, or in sound, video or data recordings.

When a media adviser receives commissions or other benefits from an issuer of securities, or any other person who has an economic or other interest in the outcome of the transaction (for example, a dealer underwriting a share issue), the media adviser is dealing in securities. This is because investment advice which induces people to enter into securities transactions is considered to be a dealing activity, to which the exception in section 77(6) does not apply. Therefore, the media adviser must operate under a licence.

When a person publishes direct or indirect personal securities recommendations in a newspaper or periodical which is generally available to the public, ASIC considers that they must operate under a licence. This is because such recommendations, being reasonably likely to be considered by their intended readers as solely or principally intended for use as advice on securities, will fall within the underlying policy of section 77(7) (Note: employee media advisers who contribute such recommendations for publication must hold a proper authority).

[236] *Corporations Law*, section 880
[237] *Corporations Law*, section 879(1)

To avoid this possibility, and also the difficulty in complying with the know-your-client requirement in section 851 in relation to advice intended for broad circulation, these persons should only publish or contribute general securities advice.

When a media adviser gives direct or indirect personal securities recommendations in a transmission made in the course of or by means of an information service, or in a sound, video or data recording which is made available to the public, ASIC considers that the person giving such recommendations should operate under a licence (for example, this type of advice may be given by a talk-back radio host). This is because such recommendations, being reasonably likely to be considered by their intended users as solely or principally intended for use as advice on securities, fall within the underlying policy of section 77(7).

Media advisers have to comply with the licensing provisions of the Law when they lose the benefit of the media exemption and are in the business of providing investment advice.

Internet advisers

As the Internet has become more accessible to the public, there has been an increase in the number of persons providing investment advice on securities using the Internet. Internet advice may take a number of forms including investment advice on a homepage or investment advice sent by electronic mail ("e-mail").

ASIC considers that most of the licensing provisions apply to investment advice on the Internet in much the same way as they apply to investment advice on any other medium.

A person who places information about securities on the Internet may require a dealers or an investment advisers licence if they are in the business of providing direct or indirect securities recommendations, general securities advice or publishing analysis or reports on securities.

The common law requirements of system, continuity and repetition need to be satisfied for a person to be considered as carrying on a securities or an investment advice business using the Internet. Whether there is such a business will be a question of fact in each case. The Law expressly states that a business may be carried on otherwise than for profit[238]. Therefore, even if the Internet adviser does not get paid for giving the advice, the activity may still amount to a business if it is done with system, continuity and repetition.

A person's activities on the Internet may be just one part of their overall business activities. A reference to a business of a particular kind includes a reference to a business of that kind that is part of, or carried on with, any other business[239]. Therefore, the person's business does not have to be carried on wholly on the Internet.

A person's activities on the Internet may be just one part of their overall securities or investment advice business. For example, a stockbroker may have a homepage with

[238] *Corporations Law*, section 18
[239] *Corporations Law*, section 19

reports about securities or tips on securities. In this case, the licensing requirements, including the Conduct of Business Rules will apply to all of the securities or investment advice business including the Internet advice in much the same way.

If a person holds out on the Internet that they are an investment adviser or that they carry on a securities business, they must have a licence. They will need a licence regardless of whether or not they are in fact carrying on a business.

A person who is in the business of providing investment advice or reports or analysis on securities on the Internet may need a dealers licence instead of an investment advisers licence if the Internet adviser receives commissions or other benefits from product providers for providing that advice, recommendation or report.

A person publishing purely factual information about securities on the Internet does not have to be licensed. To come within this exclusion, such a person must not provide any direct or implicit advice or opinion on securities and provide warnings.

ASIC considers that it is generally difficult for a person to come within the media exemption to be exempted from the licensing provisions in the Law when giving investment advice on the Internet.

To come within the media exemption, the Internet advice should be made, by means of a transmission using an information service which must:

- be generally made available to the public[240], and
- not be solely or principally for the purpose of advising other persons about securities or publishing securities reports[241].

An "information service" is defined[242] as a broadcasting service; an interactive or broadcast videotext or teletext service or a similar service; an online database service or a similar service; or any other prescribed service (no other services have been prescribed). The Internet does not fit neatly into any of these descriptions although it has elements of each of them.

Although a transmission on the Internet containing investment advice on securities may be generally available to the public, in many cases the sole or principal purpose of the transmission will be to advise other persons about securities or publish securities reports. Therefore, ASIC considers that it will be generally difficult for an Internet adviser to establish that they do not need a licence because they come within the media advice exemption in section 77(6).

The licensing provisions will apply to investment advice sent by overseas Internet advisers using e-mail addresses of Australian investors. The provisions of the Law may also apply to investment advice provided on an Internet site (for example, a homepage outside Australia) that is accessible in Australia.

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[240] *Corporations Law*, section 77(6)(b)
[241] *Corporations Law*, section 77(7)
[242] *Corporations Law*, section 9

The provisions of the Law may also apply to persons who place investment advice on the Internet in Australia for use by persons outside Australia.

ASIC recognises that it can be difficult to enforce the Law fully in relation to persons who provide investment advice on the Internet who are located in overseas jurisdictions.

To overcome this difficulty, ASIC will work closely with other regulators to ensure that the interests of Australian investors are protected and that confidence in the integrity of the Australian securities market is maintained.

Competency and integrity standards

ASIC Policy Statement 138[243] outlines the competency standards ASIC expects of applicants and how ASIC assesses whether an applicant has integrity.

Who must meet competency standards

The types of persons who must meet ASIC competency standards when applying for a licence are as follows:

- A natural person giving securities or public offer superannuation funds advice - that person;
- Partnership giving securities or public offer superannuation funds advice - each partner;
- Natural person or corporate body giving securities or public offer superannuation funds advice - that person or, in the case of a corporate body, the responsible officers;
- Trustee of a public offer superannuation fund subject to APRA regulation - responsible officers;
- Responsible entity of a managed investment scheme giving advice on securities other than the interests in their own scheme - responsible officers giving investment advice. (From 1 July 2000, responsible officers of responsible entities giving investment advice on interests in their own schemes will have to meet the education and experience criteria set out in policy statement 138[244].)

The underlying principle is that it is important that persons providing investment advisory services relating to all securities (including superannuation interests) are subject to the same standards of personal competencies. Applying the same standards of personal competencies promotes investor confidence and also promotes a level playing field among persons providing investment advisory services.

ASIC considers that the directors and key senior staff of the licensee who are responsible for making decisions about the investment advisory business should be the persons nominated as responsible officers. They are the persons ASIC holds responsible for the performance of the licensee's duties.

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[243] ASIC Policy Statement 138 *Investment advisory services: Personal competencies for licensees*
[244] ASIC Policy Statement 138 *Investment advisory services: Personal competencies for licensees*

Education and experience requirements

ASIC's objective is to only license applicants who demonstrate competency to perform the duties of a licensee at a professional level. Persons will meet ASIC education and experience requirements if they, or an adequate number of their responsible officers, satisfy either Option 1 or Option 2.

Under Option 1, a person must have:

- one of the full industry qualifications listed below; and
- the equivalent of three years relevant industry experience over the immediate past five years.

Full industry qualifications comprise one of these qualifications:

- Graduate Diploma in Applied Finance and Investment (Securities Institute of Australia);
- Graduate Diploma in Financial Planning (SIA);
- Diploma in Financial Markets (SIA);
- Master of Commerce (Financial Planning) (University of Western Sydney, Hawkesbury);
- Diploma of Financial Planning (Financial Planning Association);
- Master of Applied Finance (Macquarie University);
- Diploma of Advanced Financial Planning (Australian Society of Certified Practising Accountants); or
- any other full industry qualification recognised by ASIC.

Under Option 2, a person must have:

- one of the qualifications listed below; and
- one of the following short industry qualifications listed below; and
- the equivalent of three years relevant industry experience over the immediate past five years.

Qualifications comprise one of the following:

- a university degree or equivalent in a financial discipline for example, economics, commerce, business, accounting, or equivalent; or
- a university degree or equivalent in a discipline relevant to the duties the person will be undertaking for example, geology, science or another technical qualification; or
- a recognised similar overseas qualification.

Short industry qualifications to augment industry specific knowledge comprise one of the following:

- Introduction to Financial Planning course (Australian Society of Certified Practising Accountants and Institute of Chartered Accountants);

- Financial Planning Principles and Practice subject (Securities Institute of Australia);
- successful completion of two units of the SIA or FPA courses set out in Option 1;
- Associate level of the Institute of Actuaries of Australia plus Part III Subject I 'Investment Management';
- Diploma of Financial Services (APM Training Institute); or
- any other short industry qualification recognised by ASIC.

A third option is currently being developed. Under this option, persons who do not have the formal qualifications required under Options 1 or 2 will be able to demonstrate that they have the appropriate competencies by:

- having the equivalent of five years relevant industry experience over the immediate past eight years; and
- satisfying a competency assessment process, for example a comprehensive examination process, which will demonstrate knowledge, skill and ethics at a professional level.

This option will enable applicants with considerable experience in the securities industry but no formal qualifications to be eligible for a licence if all other criteria are satisfied.

To ensure that all three options produce the equivalent professional standard, ASIC will review Options 1 and 2 against the standard set for Option 3 when it is settled.

Generally, an applicant or its responsible officers will have gained their relevant industry experience while acting as an authorised representative of a licensee. Applicants can use overseas experience towards meeting the experience requirement, providing that the experience was, at least, at an equivalent level to that of an authorised representative and that ASIC is satisfied they also have sufficient experience in the Australian securities industry.

Generally, ASIC prefers applicants to have a university degree in a financial discipline for example, economics, commerce or business, or equivalent. This gives them a broad understanding of the economic and business environment and, in particular, the Australian financial markets and system.

However, there will be instances when an applicant with a responsible officer holding a non-financial degree could qualify for Option 2. Some duties might be better performed if a responsible officer has an appropriate technical qualification for example, a geologist advising on resource equities. Such officers must also have a qualification and experience relevant to the securities industry. The applicant's case would be assisted if there were other responsible officers within the business with financial qualifications.

Foreign qualifications which have been agreed to by the National Office of Overseas Skills Recognition as comparable with the relevant Australian university degree or equivalent are acceptable.

If a person or a responsible officer holds an industry qualification not listed in above. that course may be nominated for approval. The application must set out details of the course, including a description of and the number of subjects, method of examination or assessment, contact hours and entry level. The list of approved courses will be updated from time to time in the ASIC Dealers and Investment Advisers Licensing Kit.

Representatives

A body corporate may not be a representative of an investment adviser or a dealer[245].

A licensee can require a person to return a proper authority where the person is not employed by nor authorised to act for the licensee. A person may also be required to give up an invalid securities authority[246].

Where ASIC has reason to believe that a person holds a proper authority from a licensee or has done an act as a representative of another person, then ASIC may require the production of any proper authority or any invalid securities authority[247].

ASIC Policy Statement 117[248] outlines when a person who provides investment advisory services must hold a proper authority from a licensee. Information contained in the policy statement is set out below.

When must a person have a proper authority?

A natural person can only act as a representative of a dealer or an investment adviser (other than an exempt dealer or an investment adviser) if:

- the dealer or investment adviser is appropriately licensed; and
- the natural person holds a proper authority from the dealer or investment adviser.

If these two requirements are not met, the person faces a fine of $2500 and/or imprisonment for six months. It is a defence if the representative was unaware, and in all the circumstances it was reasonable for the representative to be unaware, of the suspension or revocation of the principal's licence.

Licensee's obligations in relation to representatives

Licensees who provide services through representatives must:

- authorise representatives by issuing proper authorities to them;
- take responsibility for the acts of their representatives. This means that a licensee must compensate a client who suffers a loss as a result of what a representative does as if the act was carried out by the licensee;
- maintain registers of holders of proper authorities and give ASIC information about where the register is kept and what it contains; and

[245] *Corporations Law*, section 809
[246] *Corporations Law*, section 816
[247] *Corporations Law*, section 814
[248] ASIC Policy Statement 117 *Investment advisory services: acting as a representative*

- adequately train and supervise representatives in relation to the work given to them.

When does a person not need to hold a proper authority?

There are two types of situations where an employee or agent of, or a person otherwise acting on behalf of, on account of, or for the benefit of, a licensee, does not need to hold a proper authority:

- when making a mere referral to a licensee. This is an activity which, according to ASIC's interpretation of the Law, is not a function of dealing in or giving advice on securities, and
- when performing the type of work normally done by accountants, clerks and cashiers who are working for a dealer or an investment adviser. This is an express exclusion provided in the Law.

ASIC considers that accountants, cashiers and clerks (including counter staff) undertaking the following tasks will be within the express exclusion in the Law and therefore do not generally need a proper authority:

- answering routine administrative inquiries (for example, minimum investment amounts of funds accepted, or whether a particular offer is still open);
- giving purely factual information about securities to a client on the client's request (for example, the nature of investments made by a specific trust);
- handing out an advisory services guide and explaining what is in it;
- collecting payments (for example, subscription moneys) and issuing of receipts;
- placing prospectuses on display, or merely handing them out or posting them; and
- performing other activities which do not involve a judgment about what investments are appropriate or should be considered by a client.

Although the licensee does not have to issue a proper authority to persons such as counter staff, cashiers and clerks who carry out the activities listed in the previous paragraph, the licensee remains generally responsible for the conduct of those persons. This means if there is any misconduct or negligence of staff in carrying out these activities which causes damage or loss to clients, the licensee is liable to compensate the clients. For example, if inaccurate explanations are given or any payments made by a client go astray, the licensee is responsible to the client.

Staff performing the following activities will require proper authorities:

- any activity that leads to directing customers to specific investments or classes of investments in response to general enquiries. For example, if a customer service officer makes enquiries about a client's investment needs in order to be able to point out to the client available products which may suit the client's investment needs, such activities are not within the exclusion for answering merely routine administrative inquiries or providing purely factual information;

- making representations regarding the investment advisory or dealing services on offer. For example, if a counter staff explains to a customer how well investments recommended by them have performed in the past, such representations are not within the exclusion for providing very general information about the nature of services on offer; and
- any other investment advisory activity which requires judgment on the part of the staff. For example, if a customer service officer highlights features of specific investments and why they may suit particular investment needs of a customer, such activities will not fall within the exclusions previously mentioned.

An activity which generally does not require a proper authority (such as making a mere referral) may, in some circumstances, become an activity which requires a proper authority. The activity and its purpose, rather than its mere form, will be relevant in deciding whether or not it is a routine administrative activity which does not require a proper authority.

If a staff member carries out both excluded activities and activities which require a proper authority, such an employee needs to hold a proper authority.

How should a representative be authorised?

A proper authority issued by a licensee to a representative must be in the form set out in section 88 of the *Corporations Law*.

When only one principal is involved, a proper authority must be a copy of the principal's licence which is endorsed by the licensee with:

- a statement certifying that the copy is a true copy of the licence;
- a statement that the named person is employed by, or acts for, or by arrangement with, the principal; and
- the signature of the principal.

When a representative acts for more than one licensee, the representative must obtain a proper authority from each licensee for whom they act. Each proper authority must comply with the requirements previously outlined and be endorsed by every other principal for whom the representative acts with:

- the name of the other principal;
- a statement that the representative is employed by, or acts for or by arrangement with, the other principal;
- a statement that the other principal consents to the representative being employed by, or acting for or by arrangement with, the licensee who issued the authority; and
- the other principal's signature.

Although a proper authority does not need to be dated, ASIC considers that as a matter of best practice, a licensee should date the proper authority when signing it. Failing to date a proper authority does not make it invalid.

If the authority issued to a representative is not a true and complete copy of the licence or is not properly endorsed, then it is an invalid authority. For example, if the required endorsements are not made on a complete current licence held by the licensee, it is not a valid authority.

A proper authority becomes invalid if there is any change to the content of the original licence. For example, if the conditions to which the licence is subject are modified (for example, by addition of new conditions other than by prescribed licence conditions in the regulations), a copy of the original licence will not be a "true copy" of the current licence. If this happens, the proper authority becomes invalid.

If there is a change in the status of the licensee, any proper authority issued by the licensee becomes invalid. For example, if the principal's licence is revoked or suspended, then any proper authority issued by the principal becomes invalid because there is no current licence[249].

When should a representative get their own licence?

A corporation cannot act as a representative of a licensee. Therefore, where a person holding a proper authority uses a company structure (for tax or other purposes), that person must take care to avoid the use of the company or its name in such a manner as to give rise to an inference that the company, and not the person holding the proper authority, is acting for or by arrangement with the licensee.

ASIC considers that while there is no objection to a licensee entering into a franchise agreement with a representative, both licensees and representatives should take care to avoid arrangements that allow a franchisee to hold out that it conducts its own business or operate without adequate supervision by the licensee. ASIC will examine the substance of the franchise arrangement rather than its form in deciding whether it is inconsistent with the licensing requirements in the Law which are premised upon the licensee only, and not the representative, carrying on a securities or an investment advice business.

Is a licensee who acts on behalf of another licensee a representative of that other licensee?

Acting as a representative of another person (the principal) is widely defined to encompass acts done as an employee or agent of, or otherwise on behalf of, on account of, or for the benefit of the principal[250]. As a result, the issue arises whether a licensee who carries out an act on behalf of another licensee is acting as a representative of that other licensee. This is particularly important as many licensees are corporations and a corporation is prohibited from acting as a representative of a licensee[251].

An act done on behalf of a person by the holder of a dealers licence or an exempt dealer will be disregarded for the purposes of deciding whether the first person is conducting a

[249] See section 827(3) of the *Corporations Law* for the deemed effect of a suspension of a licence
[250] *Corporations Law*, section 94(3) (c)
[251] *Corporations Law*, section 809

securities business[252]. This exclusion generally has the effect that when a person engages the services of a licensed or exempt dealer, that person is not considered to be conducting a securities business by obtaining those dealing services. (Note: there is no similar exclusion in the definition of investment advice business in section 77.)

Where a licensee carries out an act on behalf of another licensee, the first licensee will be carrying out that act under its own licence. The first licensee will be fully accountable to the other licensee as a principal in relation to the acts undertaken on behalf of the other licensee which is its client. For example, if Fund Manager X obtains the services of Dealer Y to carry out execution of its orders, Dealer Y will be executing orders for Fund Manager X who is its client. Fund Manager X who obtained Dealer Y's services will be no different to any other client who has obtained the services of Dealer Y.

A body corporate may not be a representative of an investment adviser or a dealer[253].

A licensee can require a person to return a proper authority where the person is not employed by nor authorised to act for the licensee. A person may also be required to give up an invalid securities authority[254].

Where ASIC has reason to believe that a person holds a proper authority from a licensee or has done an act as a representative of another person, then ASIC may require the production of any proper authority or any invalid securities authority[255].

[252] *Corporations Law*, section 93(5)
[253] *Corporations Law*, section 809
[254] *Corporations Law*, section 816
[255] *Corporations Law*, section 814

Attachment 2 Disclosure obligations applicable to investment advisers and representatives

Register of licence holders

The following details are entered in the register:

- the name of the licensee;
- if the licensee is a body corporate - the name of each director and secretary, of the body;
- the day on which the licence was granted;
- in relation to each business to which the licence relates, the addresses of the principal place and other places at which the business is carried on, and if the business is carried on under a name or style other than the name of the holder of the licence - that name or style;
- particulars of any suspension of the licence; and
- any other prescribed matters.

The register is open for inspection and copies or extracts may be taken from it.

The holder of a licence must notify ASIC within 21 days if he or she ceases to be an investment adviser, if the licensee ceases to carry on a business to which a dealers licence relates, or if there is a change in a matter which is required to be entered in the register[256].

Register of holders of proper authorities

The register must contain:

- a copy of the proper authority;
- the person's name;
- the person's current residential address;
- unless the person's current business address is the same as the licensee's - the person's current business address;
- any other prescribed information - the date of birth of each person holding a proper authority has been prescribed in the regulations[257].

Within two business days after the person begins to hold a proper authority:

- this information is required to be entered in the register (or within two business days after the licensee receives the information, whichever happens later);
- a copy of a proper authority of a person from the licensee is required to be included in the register;
- the licensee must lodge a copy of the proper authority and a written notice stating that the person began to hold that proper authority on that day.

[256] *Corporations Law*, section 790
[257] *Corporations Regulations*, Regulation 7.3.08

Within fourteen days after establishing a register, the licensee must lodge written notice of where the register is kept. As soon as practicable after changing the place where a register is kept, the licensee must lodge written notice of the new place where the register is kept[258].

Within the period during which the information is required to be entered in the register, the licensee must lodge a written notice setting out the information that the register is required to contain and stating that the information has been, or is to be, entered in the register.

Within two business days after a person ceases to hold a proper authority:

- the licensee must remove the proper authority from the part of the register where they are kept and include it in a separate part of the register;
- unless, at the end of those two business days, the person again holds a proper authority from the licensee, the licensee must remove the relevant information from the part of the register where the information is kept and enter it in a separate part of the register;
- the licensee must, unless at the end of those 2 business days the person again holds a proper authority from the licensee, lodge a written notice stating that the person has ceased to hold a proper authority.

Register of interests in securities

An application for a licence must include notice of where the applicant intends to keep the register. Within 14 days after beginning to keep the register, a representative must lodge notice of where the register is kept and the name and business address of each licensee from whom the person holds a proper authority[259].

ASIC must be notified where there are changes in the where the register is kept, or where there are changes in the particulars required to be entered in the register[260].

ASIC may require a person to supply it with various information, including the name and address of the person who contributed or prepared specified advice or a specified analysis or report [261].

Information about representatives

ASIC may give information to a licensee where it believes that a person holds, or will hold, a proper authority from the licensee, that ASIC should give to the licensee particular information about the person, and that the information is true[262].

[258] *Corporations Law*, section 811
[259] *Corporations Law*, section 882
[260] *Corporations Law*, section 883
[261] *Corporations Law*, section 886
[262] *Corporations Law*, section 815

There are restrictions on the use to which such information may be put and restrictions are imposed on the extent to which the information may be given to a court.

Publication of orders

Orders by ASIC excluding persons from the securities industry are required to be published in the Gazette[263].

Annual statement

Each year a licensee must lodge a statement which sets out the number of persons who hold proper authorities from the licensee and contains any other prescribed information.

A person who has been, but is no longer, a licensee is required to lodge, in respect of each year or part of a year during which the licence was in force, a statement which sets out the number of persons who, when the person ceased to be a licensee, held proper authorities from the licensee and contains any other prescribed information[264].

Advisory services guide

There are time limits during which the guide must be given. Where advice is given in person the guide must be given at that time. In the case of an execution-related telephone advice, the guide must be given at the earliest practicable opportunity after the advice was given – which must not be later than three days after the trading following the advice. In any other case the guide must be given at the earliest practicable opportunity after the advice is given.

The advisory services guide must contain information that a retail investor reasonably requires to:

- clearly understand the nature of the investment advice service being offered;
- compare the services with similar services offered by others;
- clearly identify the licensee; and the representative of the licensee, responsible for the investment advice to be given to the investor;
- clearly understand the nature of, and method of calculating, in relation to the service all charges payable to the licensee by the investor; or any other amount payable to the licensee, including a commission payable by a third party;
- clearly understand the basic rights of the investor in relation to the licensee, and any representative, giving investment advice to the investor; and
- use available complaints procedures if dissatisfied with a service received from the licensee.

Updated advisory services guides must be given to investors where changes occur in the information contained in the guides.

[263] *Corporations Law*, section 834
[264] *Corporations Law*, sections 791, 792 and 793

ASIC Policy Statement 121[265] provides guidance in relation to the advisory services guide in the following terms.

What is the purpose of an advisory services guide?

Products and services available in the financial markets are increasingly complex. As a result, it is often not easy for retail investors to understand the nature of the services offered to them, particularly on a comparative basis. Therefore, ASIC considers that retail investors must be given clear key information on the nature of the advisory services offered.

Who should be given an advisory services guide?

A licensee must give an advisory services guide to every retail client to whom investment advisory services are offered. Investment advisory services include providing personal securities recommendations and general securities advice.

Generally, a client only needs to be given one advisory services guide, unless there is a long lapse of time between the first issue of an advisory services guide and the subsequent provision of investment advisory services.

In the case of a group of retail clients (such as family members), in most circumstances giving one advisory services guide to the person who is generally in contact with the adviser is adequate. However, it may be appropriate for the adviser to tell the client that the information in the advisory services guide is important to every member of the group and that they should all read it.

Some retail investors may not have an adequate understanding of the English language. If this is the case, given the importance of the information provided in an advisory services guide, ASIC considers it appropriate for a licensee to provide such clients with suitable interpreter services.

Information included in an advisory services guide

Policy Statement 121 provides detailed guidelines describing the type of information which should be included in an advisory services guide. There are pro formas at in the policy statement which include this information. A licensee can use the pro formas (with appropriate modifications to include their individual details). If the pro formas are unsuitable for a licensee's individual business and circumstances, a licensee can prepare their own advisory services guide by following the guidelines set out in the policy statement.

An advisory services guide must give a retail investor information which clearly identifies the licensee who is responsible for the investment advisory services offered. This is particularly important because advisory services are offered mostly through representatives of a licensee.

Therefore, an advisory services guide should contain the following information:

[265] ASIC Policy Statement 121 *Investment advisory services: retail investor protection requirements*

- name of the licensee and their ACN number (if the licensee is a corporation);
- registered address of the licensee. If it is an interstate address, it may be appropriate to give an office address in the State or Territory where the advisory services guide is distributed;
- if the licensee is a member of a financial group, the name of the group.

In addition to the above information, a licensee may include more information about themselves, such as their membership of professional or industry associations.

An investor must be able to identify the identity of the adviser from the information in an advisory services guide. ASIC considers that the identity of the adviser is important because the adviser plays a very significant role as the direct contact service provider. This information is particularly important when a licensee has representatives located outside its central place of business.

The adviser's identity should be disclosed in the advisory services guide in a manner which will not give the impression that it is the adviser (that is, the representative), and not their principal (that is, the licensee), who is carrying on the business of providing investment advisory services. Such an impression may be a breach of section 780 and section 781. Sections 780 and 781 prohibit a person from holding out as conducting a securities or investment advice business unless they are licensed in their own right. To avoid breaching these sections, ASIC considers that the advisory services guide must clearly:

- identify the licensee responsible for the advisory services; and
- indicate that the adviser is acting in a representative capacity

A licensee may wish to include additional information about representatives who act as advisers, such as their qualifications and experience.

A licensee will not always be able to pre-determine which representative will provide investment advisory services to a particular retail client. Therefore, ASIC considers that it is appropriate for a licensee to either:

- leave a blank space in the advisory services guide for the identity (and other information about the adviser) to be filled in; or
- include an insertion in the advisory services guide with the details of the adviser. (This insertion should be cross referred to in the advisory services guide.)

This approach gives flexibility for a licensee to include, if desired, the individual details about the adviser.

A retail investor should be able to identify key features of the investment advisory services offered from the information in the advisory services guide. The type of information that is relevant includes:

- the range of securities for which investment advisory services are offered. For example, if advice is offered only on securities of a particular issuer, the range of the products should be identified. Similarly, if advice is offered only on a certain class of securities, for example shares, this should be disclosed;
- whether personal securities recommendations or general securities advice or any combination of them are offered;
- whether or not execution services are offered; and
- whether any portfolio monitoring services are offered. This may include monitoring and reporting on specific investments held in the portfolio or general advice on securities provided in periodic circulars.

The nature of the investment advisory services offered by a licensee can vary. For example, some advisory services may cover a wide range of securities but other services may be confined to a particular range of products. Such limitations may arise from the restricted nature of the licence or other contractual arrangements under which a licensee operates. For example, a licensee may have a contractual arrangement with a product provider and therefore only provides advisory services on the products of that provider. An advisory services guide should include information about these limitations.

An investor should be able to clearly understand how the advisory services are paid for from the information in an advisory services guide. The type of information that is relevant includes:

- whether the licensee charges fees for the investment advisory services and, if so, how the fees are calculated (for example, hourly rate or a performance based fee);
- whether the licensee is remunerated by commission (including trailing commissions) and/or other benefits (for example, soft dollar arrangements such as subsidised research) provided by product providers. If they are remunerated in these ways, the extent of those commissions and the method of deduction should be included; and
- whether the licensee receives any combination of fees and commissions as above and, if so, how they are calculated/deducted.

This information is important for retail investors when choosing the type of advisory services they obtain. ASIC's surveillance data indicates that there are many consumer complaints about how advisory services are paid for. Therefore, clear information given very early in a client adviser relationship would minimise the possibility of subsequent client disputes and dissatisfaction.

Including this information in an advisory services guide is not a substitute for disclosing specific conflict of interests under section 849 of the Law, which requires an adviser to disclose any commissions, fees, or any other benefit or advantage that the adviser will or may receive in connection with a particular securities recommendation.

An investor should be able to clearly understand their basic rights from the information in an advisory services guide. Some of these rights are expressly stated in the Law and others arise under common law obligations of an adviser as a fiduciary. Additional rights may be created by contract between the licensee and the client (for example, allowing a

client to examine the information maintained by the licensee in the client file on request). These contractual rights can also be included in an advisory services guide.

The type of information that is relevant includes that clients:

- have a right to be told of any material benefits and interests of the adviser which may influence the advice provided (conflict of interests);
- have a right to receive advice that is suitable to their individual investment objectives, financial circumstances and particular needs;
- should ask about the risks associated with any investment products or strategies recommended;
- can give instructions to the licensee on a range of matters such as whether confirmation of any oral recommendations made are needed and how they wish to instruct the licensee (for example, in writing or by telephone).

ASIC considers that this information is important because retail investors using investment advisory services are not always clearly aware of their rights and about other information they can obtain. Therefore, it is important that they are made aware of their basic rights and the key information which they should be given so that they can form realistic expectations about the services and products offered.

An investor should be able to find out from the information in an advisory services guide how they can use the available complaints procedures when they are dissatisfied with the advisory services obtained. ASIC considers this information to be important because many retail clients are not aware of the complaints procedures they can follow. Therefore, the information in an advisory services guide should help a retail investor clearly understand:

- the nature of complaint resolution procedures available to clients (internal and any external procedures and ASIC's free Infoline service 1300 300 630); and
- how clients can use those procedures (for example, the name, position and the telephone number of the contact person in the licensee's organisation to whom a complaint can be made, whether the complaint should be made in writing or orally, and if it is not resolved to a client's satisfaction, what further steps they can take).

What is the format of an advisory services guide?

ASIC does not wish to be prescriptive about the format of an advisory services guide. This gives a licensee the flexibility in developing its own advisory services guide to suit the particular nature and circumstances of its own business. When a licensee develops its own advisory services guide, ASIC expects the licensee to carry out user testing of their advisory services guide before using it. User testing may be carried out by the licensee following the procedures set out in the policy statement. ASIC will expect licensees to maintain adequate records of “user testing” procedures they have followed.

However, some licensees may not want to incur the additional expense of developing their own advisory services guide. ASIC has therefore developed a number of pro forma advisory services guides in conjunction with the Communication Research Institute of

Australia. These have been user tested by the Communication Research Institute of Australia. A licensee may use these pro formas by following the guidelines set out in the policy statement. A licensee may make any necessary minor modifications and adjustments to adapt the pro formas to their own business.

Could a representative prepare their own advisory services guide?

When a multi-agent provides mixed advisory services in life insurance products and securities they can prepare a single advisory services guide for all the advisory services they provide. The general guidelines that apply when a representative prepares and issues an advisory services guide are set out below.

A representative may prepare the advisory services guide they issue, if:

- their conduct does not suggest that the representative is conducting a securities or an investment advice business in their own right; and
- it meets ASIC's information requirements

A representative who prepares and issues an advisory services guide does this as either an agent or employee of the licensee in connection with that licensee's securities or investment advice business. The licensee is accountable for the content of the advisory services guide even though it is prepared by the representative. Therefore, it is prudent for a licensee to take reasonable steps to ensure that the information in the advisory services guide meets ASIC's guidelines and does not contain information that is likely to mislead or confuse investors.

If a representative creates the impression when they are preparing and issuing an advisory services guide that they, rather than their principal, carry on the business, the representative may be conducting or holding out as conducting a securities or investment advice business. Because a representative does not have an appropriate licence in their own right, this amounts to a breach of sections 780 or 781.

However, ASIC considers that a representative who prepares and issues an advisory services guide may not, by doing that act alone, be seen as conducting the advisory service on their own behalf. This is because their advisory services guide and the business documents they use must clearly identify the licensee on whose behalf the representative works.

What are the possible legal consequences of the information in an advisory services guide?

The legal effect of the information in an advisory services guide depends on a range of factors, particularly the intention of the parties involved (that is, the licensee and the retail investor who is given the advisory services guide).

Generally, ASIC considers that the information in an advisory services guide is not an offer that a retail investor can accept and thereby create a contract straight away. It gives key information on the advisory services of the licensee allowing a retail investor to make a well informed decision in choosing the service. This approach gives licensees flexibility

to negotiate detailed terms of any contractual arrangement with a retail client who is given their advisory services guide.

A retail investor induced to enter into a contract to obtain investment advisory services from a licensee because they relied on misleading information in the advisory services guide would be able to invoke civil remedies. These would be based on liability for misrepresentation. In addition, statutory remedies would also be available to a retail client. These remedies are based on misleading and deceptive conduct (for example, section 995 of the *Corporations Law*) and contractual remedies (to the extent the information in the advisory services guide forms part of any subsequent contract).

Benefits and conflicts of interest

Contravention of the disclosure obligation may result in liability to pay damages to the client.

A failure to disclose a matter where a person was not, and could not reasonably be expected to have been, aware of that matter when making the recommendation is not prohibited[266].

Where a dealer or an investment adviser, or a representative fails to disclose a matter it is not a contravention of the Law if[267]:

- in the case of a representative - by making the recommendation, the representative does an act as a representative of the dealer or investment adviser;
- the dealer or investment adviser had in operation throughout a period beginning before the decision to make the recommendation was made and ending after the recommendation was made, arrangements to ensure that the person who made the decision knew nothing about that matter before the end of that period; and no advice with respect to the making of the recommendation was given to the person by anyone who knew anything about that matter; and
- the person in fact knew nothing about that matter before the end of that period; and no such advice was given.

ASIC Policy Statement 122[268] sets out the scope of this obligation and the appropriate method of disclosure. It sets out who must comply with the rules relating to disclosure of conflicts of interests. It states that ASIC considers that the rules apply only when a personal securities recommendation and not general securities advice is provided. It also sets out the scope of the obligation to disclose and the appropriate method of disclosure. It also deals with record keeping standards. Information set out in the policy statement is outlined below.

[266] *Corporations Law*, section 850
[267] *Corporations Law*, section 850
[268] ASIC Policy Statement 122 *Investment advisory services: the conduct of business rules (s 849 and s 851)*

Who is a "securities adviser" who must comply with the Conduct of Business Rules?

A securities adviser who makes a securities recommendation to a client must comply with the Conduct of Business Rules. A "securities adviser" is defined [269] as "a dealer, an investment adviser or a securities representative of a dealer or an investment adviser".

The terms "dealer" and "investment adviser" are defined as persons who alone or together with other persons carry on a securities or an investment advice business. The term "securities representative" is defined as a person who is employed by, or acts for or by arrangement with, another person in connection with a securities or investment advice business conducted by that other person and includes a person who holds a valid or an invalid proper authority. Only a natural person can be a securities representative.

Some persons are exempt dealers and investment advisers under section 68 of the *Corporations Law* or are persons exempt under regulation 7.3.10 to regulation 7.3.15 (for example, superannuation trustees, Australian banks, life companies, persons dealing in interests of unregulated prescribed schemes). This means that they can operate without a licence. However, these exempt persons must comply with the Conduct of Business Rules when providing securities recommendations to their clients.

Some persons are not considered by the Law to be conducting an investment advice business when giving investment advice under exempt circumstances (for example, solicitors and accountants giving merely incidental advice). These persons do not have to comply with the Conduct of Business Rules even if they provide personal securities recommendations. They also do not have to operate under a licence.

Therefore, securities advisers who must comply with the Conduct of Business Rules when making securities recommendations are:

- dealers or investment advisers, exempt dealers or investment advisers[270] or persons exempted under regulation 7.3.10 to regulation 7.3.15; and
- securities representatives, that is, persons who are employed by, or act for or by arrangement with dealers, investment advisers, exempt dealers or exempt investment advisers or persons holding a valid or invalid proper authority from a licensee or other person.

A partnership or body corporate may conduct a securities or investment advice business. A securities recommendation made by a partner of the partnership or a director, executive officer or secretary of the body corporate is considered under the Law to have been made by each partner of the partnership or by the body corporate.

The above deeming requirement applies only in relation to the disclosure of conflict of interests obligation in section 849 and not to the know-your-client obligation in section 851. This means that the person deemed to have made the securities recommendation incurs primary liability for that recommendation along with the securities adviser who breached the section 849 obligation when making the securities recommendation.

[269] *Corporations Law*, section 9
[270] *Corporations Law*, section 68

Therefore, it is in the interest of the deemed persons to have policies and procedures for ensuring that advisers meet the disclosure of conflict of interest obligation in section 849.

When must a securities adviser comply with the Conduct of Business Rules?

A securities adviser only needs to comply with the Conduct of Business Rules when a securities recommendation is made to a client in the course of a securities or an investment advice business.

Dealers provide execution related telephone advice on quoted securities which often includes personal securities recommendations. These recommendations call for a modified application of the Conduct of Business Rules.

Some securities advisers may be single product providers, that is, they only provide advice on products of one product provider. An example of a single product provider is a representative of a fund manager holding a restricted dealers licence. ASIC considers that such an adviser, to the extent they provide personal securities recommendations about the securities of the fund, must fully comply with the Conduct of Business Rules.

This means that to be able to give personal securities recommendations which are appropriate to a client's investment objectives, financial circumstances and particular needs, the adviser must make a full analysis of the client's needs and undertake reasonable product research (including research relating to a reasonable range of comparable and alternative investments). If the adviser finds the available securities inappropriate to the client's needs and circumstances, then the adviser must not recommend the products to the client.

Some securities advisers may consider it uneconomical or beyond their competence to undertake a full needs analysis and conduct adequate product research to be able to provide personal securities recommendations which comply with the section 851 obligation. If an adviser considers that this is the case then they can confine their advisory services to general securities advice and not provide personal securities recommendations. When providing general securities advice, although the know-your-client obligation does not apply, the common law obligations of due care and diligence continue to apply.

Investment newsletters, circulars or advertisements are more suited to providing general securities advice rather than personal securities recommendations. This is because they are often directed at a range of investors with varying investment objectives, financial circumstances and particular needs. If such documents do contain advice which is either a personal securities recommendation or reasonably likely to be acted on by readers as a personal securities recommendation, the adviser who issues such documents must fully comply with the Conduct of Business Rules.

A securities adviser could avoid the likelihood of readers relying on advice in a newsletter, circular or advertisement (and therefore the advice being construed as a personal securities recommendation) by including appropriate warnings.

When is a person exempt from complying with the Conduct of Business Rules?

The definition of "securities recommendation" refers to "a recommendation with respect to securities or a class of securities, whether made expressly or by implication." This definition is wide enough to include both a positive recommendation relating to securities (for example, a recommendation to buy, subscribe for, underwrite or hold securities) as well as a negative recommendation (for example, to sell securities).

A recommendation can be made either directly or by implication. For example, a recommendation may be made to buy real estate which implies that a client should not buy securities or should sell securities in order to buy the real estate. This would be a securities recommendation made "by implication".

ASIC considers that it would generally be difficult to establish that a person who makes negative securities recommendations of the kind referred to in the previous paragraph is conducting a securities or an investment business. It would be especially difficult if they are implicit recommendations made merely as incidental to the conduct of another business (for example, a real estate business). Therefore, the licensing provisions of the Law including the Conduct of Business Rules may not apply to persons making such negative securities recommendations.

When a dealer provides "execution only" services without any advisory service on those securities, the dealer does not have to comply with any advisory obligations including the Conduct of Business Rules. An "execution only" service is when a dealer carries out instructions by a client to buy or sell specific securities without giving any advice in relation to those securities.

ASIC considers that the Conduct of Business Rules apply only when a personal securities recommendation and not general securities advice is provided. The distinction between personal securities recommendations and general securities advice is not expressly contained in the Law. However, ASIC considers that the difference is implicit in the Law because of the specific language used in section 849 and section 851 which envisages that a recommendation is made to a client in that client's personal capacity.

Both the disclosure of conflict of interests under section 849 and the know-your-client obligation under section 851 apply to a recommendation made to a client when the client is reasonably likely to rely on it. The know-your-client obligation envisages that a securities adviser formulates the recommendation in light of the client's known investment objectives, financial situation and particular needs. These give rise to a strong implication that the recommendation is of a personalised nature.

ASIC has, in interpreting the Law, drawn a distinction between personal securities recommendations and general securities advice as described below.

A personal securities recommendation is a recommendation made expressly or by implication to the effect that some action in relation to certain securities or classes of securities is appropriate for a client in light of that client's individual investment objectives, financial situation and particular needs. Although the term "client" may technically encompass more than one person, it is generally unlikely that personal

securities recommendations could be made to a diverse group of persons (except to a group with common interests). This is because of the personal nature of the obligation envisaged in section 851. However, a personal securities recommendation can be made to a person other than an individual.

General securities advice is advice on specific securities (such as the nature or effect of the securities) without any express or implicit recommendation that any particular action in relation to those securities is appropriate for certain persons in light of their individual investment objectives, financial situation and particular needs. Such advice may be provided to a specific person (who could be a client), a group of persons or a wider group of persons such as subscribers to a stockbrokers' circular or newsletter. This is because there is no need to tailor that advice to any investor's individual circumstances and needs.

The Conduct of Business Rules apply only when a personal securities recommendation, and not when general securities advice, is provided. However, most of the other licensing provisions of the Law will apply equally to a business of providing both personal securities recommendations and general securities advice. A securities adviser may give a person investment advice which the adviser does not intend that person to use as a personal securities recommendation. However, if it is reasonably likely to be relied on by that person as a personal securities recommendation, the advice will be treated by ASIC as a personal securities recommendation. By incorporating appropriate warnings, a person providing investment advice intended to be used only as general securities advice may exclude the possibility of attracting the Conduct of Business Rules.

What are the common law obligations that apply when providing general securities advice?

Although the Conduct of Business Rules do not apply to securities advice or reports containing only general securities advice, a person who is in the business of providing such advice (or providing such reports in the course of another business) must operate under an appropriate licence. They are also subject to the general obligation in the Law to conduct their securities or investment advice business “efficiently, honestly and fairly” and the common law obligations of fiduciaries in conducting that business.

An adviser who provides general securities advice must comply with the common law obligations to:

- fully disclose any conflict of interests that may affect the general securities advice or reports they provide, and
- adopt due care, diligence and competence in preparing advice or reports to ensure that they are suitable for the purpose for which the investors to whom they are provided are reasonably likely to use them.

Failing to comply with these obligations is a breach of the common law duties of a fiduciary and failure to conduct their securities or investment advice business “efficiently, honestly and fairly”. This may give ASIC the grounds for exercising its administrative powers to revoke or suspend a licence after a hearing.

What is the purpose of the disclosure obligation under section 849?

The obligation in section 849 serves two purposes:

- it assists investors to make well informed investment decisions when relying on securities recommendations made to them; and
- it minimises the opportunity for advisers to place their self interest ahead of the interests of the client.

What is the scope of the general obligation under section 849?

Conflict of interests which must be disclosed under section 849 fall into two broad categories:

- Benefits and advantages resulting from the recommendation . These are any commission, fee, or other benefit or advantage which the securities adviser or any associate of the adviser receives from making the recommendation or a dealing transaction resulting from that recommendation. These commissions, fees, other benefits and advantages can be direct or indirect or financial or non financial.
- Other interests likely to influence the recommendation. These are other interests of the securities adviser or any associate of the adviser which are reasonably capable of influencing the adviser in making the recommendation. These other interests can be direct or indirect or financial or non-financial interests.

The range of benefits and advantages which a securities adviser must disclose under the first part of the section 849 obligation is very broad. Disclosure must be made if such benefits and advantages arise from a recommendation or a dealing transaction following a recommendation. The other interests which a securities adviser must disclose arise only if the interests are reasonably capable of influencing the recommendation. They form a "catch-all" disclosure requirement to augment the first part of the disclosure obligation.

What is a material conflict of interest?

A securities adviser must disclose all benefits and advantages which the adviser or their associates obtain as a result of a securities recommendation or a securities transaction following a recommendation. This is because the Law does not expressly distinguish between significant and insignificant benefits measured in terms of monetary size or qualitative considerations. Therefore, technically, all benefits and advantages resulting from a recommendation should be disclosed regardless of whether they are significant or not.

A securities adviser must only disclose other interests of the adviser or any associate of the adviser if these interests are reasonably capable of influencing the recommendation. Therefore, a materiality element is implicit in this part of the obligation.

However, ASIC considers that materiality is relevant when deciding whether any benefit, advantage or interest should be disclosed under section 849. For example, any benefit,

advantage or interest which is so insignificant that it cannot reasonably be capable of influencing an adviser is unlikely to influence their recommendation.

It is not always easy to decide when a benefit, advantage or interest is a disclosable interest under section 849. This is because there are complex and varied remuneration arrangements for securities advisers. It is very much a question of fact and the adviser is best placed to assess whether or not a particular benefit, advantage or interest should be disclosed.

While ASIC cannot give comprehensive guidelines for every possible type of conflict of interest that may exist, the following guidelines in give some assistance on some areas of practical difficulty.

Own holdings

Market research conducted by ASIC (June 1995) indicates that sometimes clients view their adviser holding shares in the same company as an indirect endorsement of the worthiness of the shares. When the adviser tells the client about their own holdings as an endorsement of the investment recommended, this is generally not part of the disclosure that must be made under section 849.

A securities adviser may disclose their own holdings, either in response to a client's query or on the adviser's own volition. However, in doing so, the adviser must take care to avoid the possibility of unwarranted assumptions about the suitability of the recommended investment being drawn by the client. If information on the adviser's own holdings is given in a manner which is reasonably likely to induce a client to make an unwarranted assumption, this conduct may be a failure to conduct business efficiently, honestly and fairly.

Commissions

Commissions may take many forms: direct or indirect, flat rate or percentage based or up front or trailing. All these commissions (except those directly paid by the client and insignificant amounts) must be disclosed in a manner which is easy for the client to understand.

Disclosing the “method of charging” in an advisory services guide does not meet the disclosure obligation under section 849. This is because the information in an advisory services guide is generally very basic information on the method of charging by the licensee. More specific and detailed disclosure of material benefits, advantages and interests of the securities adviser (and their associates) is needed under section 849.

Commission splits

A licensee who gets a flat rate commission from a number of fund managers may have different arrangements to split this commission with their representatives who make recommendations on the securities of those funds. For example, a licensee may be paid a 3% flat rate commission from two fund managers. The licensee may split this commission with their representatives at the rate of 1% to the licensee and 2% to the representative for one fund and 2% to the licensee and 1% to the representative for the other fund.

In this case, splitting the commission more favourably for the representative in relation to the first fund may influence the adviser to push the sale of interests in the first fund harder than for the sale of interests in the second fund. Therefore, if a representative recommends investing in the first fund (with the higher commission) they must disclose the actual commission split arrangements. This sort of information is generally too detailed to include in an advisory services guide.

Trailing commissions

When a fund manager pays trailing commissions to a licensee, it is paid as long as an investor holds an investment in the fund. The fund manager may pay a trailing commission with or without a discrete on-going service being given by the licensee to induce the client to hold the investment (for example, providing favourable research or reports on the investments).

Even if there is no discrete service provided to the client, the adviser may be tacitly encouraged to let the client hold the investment if trailing commissions are paid. Therefore, ASIC considers that regardless of whether or not a client receives any discrete on-going service, a securities adviser receiving trailing commissions must disclose this information when recommending products which pay trailing commissions except where it is insignificant.

The trailing commissions paid to a dealer following an “execution only” service (that is, when a client's order has been executed without any advice) does not have to be disclosed under section 849. This is because no securities recommendation is made.

If the execution service follows general securities advice on those securities, the adviser must disclose these benefits under the common law obligations of a fiduciary.

Commission rebate arrangements

A licensee's contract with a client may specify that the licensee is only paid by fees from that client. In this case the licensee must take care to rebate to the client all commissions and benefits including any indirect or trailing commissions and other benefits and advantages from any other party. If the licensee fails to do this, it may be a breach of contract as well as a failure to conduct business efficiently, fairly and honestly under the licence. If the licensee receives any benefits and advantages which are not disclosed, then this is a breach of section 849 as well as a breach of the prohibition against misleading and deceptive conduct in section 995.

Soft dollar arrangements

A securities adviser (or an associate) may receive non-cash economic benefits as an incentive to promote the sale of securities of a particular fund or issuer. These benefits may include subsidised office space, computer access to research and databases, advertising rebates and subsidies or training facilities from a fund manager or a securities issuer. All these benefits and advantages must be disclosed under section 849 unless they are insignificant. An example of a benefit which can generally be regarded as insignificant is a one-off business lunch or a free seminar given to advisers by a product issuer.

Cumulative rewards

Sometimes a securities adviser may be given the opportunity to win an overseas trip or a specific cash reward when investments resulting from their recommendations reach a certain level. Such rewards are generally provided by fund managers and issuers as an incentive to encourage the adviser to promote the sale of their products.

ASIC considers that generally such benefits and advantages must be disclosed to a client except where the adviser is not reasonably likely to be influenced by those rewards.

For example, the reward may be for selling a large volume of specified securities. If the adviser has no reasonable likelihood or expectation of reaching that limit in the foreseeable future, that reward is unlikely to influence their recommendation. Therefore, disclosure of that reward is not needed under section 849. However, the extent to which such a reward is reasonably likely to influence the adviser is a question of fact in each case. The adviser must disclose such rewards when they are likely to influence the recommendations.

Affiliations with issuers and underwriters

A securities adviser (or the licensee) may be affiliated to an issuer or an underwriter. Such affiliations may occur when the securities adviser works for a member of a financial group which comprises a fund manager or another securities issuer. Also, a member of a financial group may act as an underwriter of a share issue. When such affiliations are reasonably likely to influence a securities adviser to make favourable recommendations on the securities of the affiliated party, the affiliations must be disclosed by the adviser to the client under section 849.

Who is an “associate”?

Benefits, advantages and other interests of a securities adviser making recommendations, or any associate of that adviser, must be disclosed.

The definition of the term “associate” in Division 2 of Part 1.2 of the Law applies when determining who is an associate. This is subject only to the specific variations in section 849(4)(a) and section 849(6). Some of the more obvious associates whose benefits, advantages and interests must be disclosed under section 849 include:

- if the securities adviser is a body corporate - any directors and secretaries of the securities adviser, any related body corporate of the adviser, the directors and secretaries of a related body corporate;
- the securities adviser's partners in a firm carrying on a securities business;
- the trustee of a trust in relation to which the securities adviser benefits or is capable of benefiting other than by reason of transactions entered into in the ordinary course of business in connection with the lending of money;
- when a securities adviser acts as a representative of another person when making a recommendation, that other person;

- any other person who acts jointly, or otherwise acts together, or under an arrangement, with a securities adviser in relation to making securities recommendations.

What is excluded from the disclosure obligation in section 849?

A securities adviser does not have to disclose the following benefits under section 849:

- a commission or fee that the securities adviser receives directly from the client; or
- if a securities adviser acts as a representative of another person when making the recommendation, any commission or fee which the other person receives from the client.

ASIC considers that these exclusions do not apply if a licensee pays a share of commission or fee it receives to the representative, including commission split arrangements. This is because the exclusions apply only to those payments which clients make directly to their adviser or licensee (which are clearly identifiable by the client). Disclosing this information is particularly important because sometimes the representative's share of the commission or fee paid by the principal varies between different products. This results in a material benefit, advantage or interest which is likely to influence the recommendations given by a representative.

ASIC considers that any charges deducted from the investment funds of a client must be disclosed. This is because the exclusions are intended to apply only to commissions and fees which the client pays directly to the adviser or licensee (which are easily identifiable payments).

Disclosing interests in the register of interests which a securities adviser must keep under section 881 is a separate legal obligation and is not a substitute for the disclosure obligation under section 849. Disclosing the method of payment in an advisory services guide is also not a substitute for the disclosure obligation under section 849.

How much detail must be disclosed under section 849?

If the client is unlikely to be familiar with the concept of percentages, it is advisable to disclose information in dollar terms. The following types of information may not meet the disclosure requirements under section 849 and will also amount to a failure to conduct business efficiently and fairly under the licence:

- giving a complex formula or process for calculating commissions or fees to a less sophisticated client; or
- overwhelming a client with unnecessary detail which detracts from the key information.

What is the appropriate method of disclosure under section 849?

If a securities adviser makes an oral recommendation to a client, the adviser must orally disclose to the client their material benefits, advantages and interests when making the recommendation.

A securities adviser may make an oral securities recommendation to a client to whom they have already disclosed material benefits, advantages and interests. ASIC considers that they do not need to repeat their disclosure if the following requirements are met:

- the previous disclosure remains up to date, comprehensive and accurate, and
- the adviser can reasonably expect the client to be fully aware of their previous disclosure. The matters that the adviser needs to take into account include whether or not there is a long lapse of time between the first disclosure and the current recommendation; and whether the client is reasonably likely to draw an inference that the previous disclosure no longer applies to the current recommendation.

ASIC considers that it is prudent for a securities adviser to draw a client's attention to the previously disclosed material benefits, advantages and interests if the adviser relies on their previous disclosure to meet their disclosure obligation.

If a securities adviser makes a written securities recommendation, the adviser must disclose material benefits, advantages and interests in writing in the same document containing the recommendation. The disclosure must be as legible as the other material set out in that document. Generally, any disclosure of method of remuneration in an advisory services guide will not be a substitute for section 849 disclosure. This is because of the detailed nature of information required under section 849.

A securities adviser might try to bury material information about benefits, advantages and interests in a long list of immaterial information, or put their disclosure where it has to be “discovered” in a prospectus accompanying a financial plan. This method of disclosure may not be sufficient to comply with the standard of legibility and form of disclosure required.

ASIC's interpretation is that when a securities adviser makes a written recommendation to a client, that adviser cannot generally rely on any previous disclosure of benefits, advantages and interests to satisfy section 849(2)(b). This is because disclosing this information in written recommendations is very specific and section 849 requires the relevant disclosure to be “set out” in the same writing in which the recommendation is made.

However, ASIC considers that section 849(2)(b) does not prevent the previous disclosure from being incorporated by reference into a later written recommendation. ASIC considers that this could be done if:

- the previous disclosure was given to the client in writing;
- the previous disclosure remains up to date, comprehensive and accurate; and
- the incorporating document, that is the current recommendation, makes clear reference to the incorporated document and offers to make available to the client copies of the previous disclosure upon request and free of charge.

ASIC considers that incorporating the previous disclosure by reference, satisfies the objectives of section 849(2)(b) if ASIC's guidelines are met. This is because this

approach minimises the risk that the client's attention will not be drawn to the necessary disclosure.

The above approach gives flexibility and cost efficiency for securities advisers complying with their legal obligation in section 849 without reducing the level of investor protection intended by section 849 disclosure.

What are the defences to a breach of section 849?

Section 850(1) provides a defence to a securities adviser for a breach of section 849. This defence is available when the adviser was not, and could not reasonably be expected to have been, aware of a benefit, advantage or interest when making the securities recommendation.

There is no positive obligation under section 849 for a securities adviser to undertake investigations to identify all possible benefits, advantages and interests that may influence their recommendation. Securities advisers must disclose those material benefits, advantages and interests which are reasonably within their knowledge. However, if a securities adviser does not disclose a material benefit, advantage or interest which a court considers they should reasonably have been aware of, the adviser runs the risk of the defence in section 850(1) not being available.

Section 852(3) provides a defence against civil liability. The defence is that if a reasonable person would have relied on the recommendation and done or omitted to do an act, even if the securities adviser had made the necessary disclosure, then the adviser is not liable.

Section 850(2) provides the defence known as the “Chinese wall” defence. This defence is available if a securities representative making a securities recommendation was unaware of any material benefit, advantage or interest, because of internal arrangements which the licensee had in place throughout the relevant period to ensure that:

- the securities representative who made the decision to make the recommendation knew nothing about the benefit, advantage or interest during the relevant period, and
- no advice with respect to the making of the recommendation was given to that representative by anyone who knew anything about the benefit, advantage or interest.

Chinese walls are internal rules and procedures developed by an organisation to prevent certain information that one part of the organisation possesses (for example, corporate advisory areas providing advice on takeovers) from being communicated to another part of the firm (for example, broking areas advising clients about buying shares).

ASIC considers that when establishing “Chinese wall” procedures, licensees providing advisory services should follow any guidelines and requirements of relevant industry and professional organisations, such as the ASX. ASIC also expects organisations which have “Chinese walls” to have adequate management policies and controls to effectively implement these arrangements.

Anyone who wants to rely on any of the defences referred to above bears the burden of proving, on the balance of probabilities, the various elements of the relevant defence.

Record keeping standards

The Conduct of Business Rules do not impose any specific record keeping standards on securities advisers providing personal securities recommendations to clients. However, ASIC considers that record keeping is important, especially for surveillance and enforcement activities and for handling clients' complaints efficiently. This is because records play a critical role in establishing whether a securities adviser has complied with the Conduct of Business Rules. A securities adviser can also use their records to defend a claim by a client that the adviser did not disclose material benefits, advantages or interests or made inappropriate recommendations.

The following sets out ASIC guidelines and best practice standards on record keeping relating to the Conduct of Business Rules.

Section 849 specifically sets out how to disclose material benefits, advantages and interests when making oral and written securities recommendations. When oral recommendations are made, there is no legal requirement that the recommendation or oral disclosure be recorded or confirmed in writing.

However, ASIC considers that as a matter of best practice it is highly desirable that securities advisers who make personal securities recommendations:

- keep records of any oral recommendations and disclosure of material benefits, advantages and interests. Such records may be kept electronically or in hard copy and should be accessible to the client and ASIC on request;
- confirm to the client in writing the oral recommendations and disclosure unless the client has expressly waived the need for confirmation or the disclosure has already been given in writing.

Written confirmation of all oral recommendations and disclosures is likely to add costs to advisory services or may not be considered important by a particular client. Therefore, a client may not wish to have written confirmation. ASIC considers that a securities adviser who obtains instructions that a client does not want written confirmation should, as a matter of best practice, keep a record of that waiver in the client file.

In the case of execution related telephone advice by dealers, ASIC considers that as a matter of best practice, a record of telephone recommendations in the form of either tapes of the telephone conversations or a short summary of the recommendation and any disclosure (for example a note on the client order forms of the type that some stockbrokers currently use) should be kept.

The nature of the specific records and the length of period for keeping these records is best determined by the dealers providing such services. This should be decided by taking into account considerations such as:

- the nature of the client involved. If the client is likely to later dispute any recommendations or associated representations made by a dealer, it is prudent to keep comprehensive records at least for a reasonable length of time;
- membership standards of the ASX, if applicable; and
- the individual needs and nature of the dealer's business.

Execution related telephone advice by dealers

The general statutory and fiduciary obligations of advisers to act diligently, prudently and in the best interests of the client when providing advice and the prohibitions against misleading and deceptive conduct also apply to dealers who provide execution related telephone advice on quoted securities. Any other advisory service offered by dealers other than execution related telephone advice (for example, providing portfolio management services and issuing circulars and investment newsletters) are regulated in the same manner as any other investment advisory services.

Disclosure by representatives

ASIC Policy Statement 117[271] gives the following guidance on how a representative should disclose their capacity and the identity of the principal in business documents and other promotional materials.

The term “business document” includes letterheads, business cards and financial plans as well as any promotional material relating to an investment advisory or dealing service and includes material provided using electronic transmissions (for example, the Internet).

How should a principal's identity be adequately disclosed in business documents?

The key principles are that:

- a representative must disclose in clear and easy to understand terms that they act on behalf of their principal and the identity of the principal in the business documents used;
- the materials should not create the impression that the representative is conducting a business in their own right; and
- the content of the materials should not be confusing or misleading to investors.

A representative must disclose their capacity and the identity of their principal in key business documents used (including the Advisory Services Guide) and all promotional materials (written and electronic).

Key business documents in which disclosure must be made are letterheads, financial plans and business cards. ASIC considers that it is unnecessary for the representative to disclose these matters in minor business documents such as “with compliments” slips or any standard form used to obtain routine information from clients (for example, change of address). If there has been adequate disclosure in key business documents, the client should already be aware of the adviser's representative capacity and the identity of their principal.

[271] ASIC Policy Statement 117 *Investment advisory services: acting as a representative*

The identity of the principal must be disclosed in all promotional materials relating to the investment advisory services offered. This includes written promotional materials such as brochures, circulars, flyers, newspaper advertisements, counter displays and external signs. It also includes promotional materials on any electronic medium such as the Internet (for example, on a homepage), television, radio or audio or videotape.

These requirements do not extend to any promotional material of a product issuer which is distributed by a representative and which does not refer to either the principal or the representatives.

Can more than one principal be disclosed in a business document?

A representative may act for more than one principal. A representative may disclose more than one principal in a business document if the representative is duly authorised by each principal and the identity of each principal is described in a clearly understandable way.

If any material contains the name of more than one principal, each of those principals may be jointly and severally liable to investors for those materials. This raises the issue of whether principals may wish to vet common documents. However, ASIC considers that this is a matter essentially between the principals and their representative.

When can a business name or logo be used in a business document?

A principal may have a registered business name. In some cases that name will be more recognisable to investors than the principal's legal name. Therefore, using the principal's business name may in certain circumstances assist investors to identify the principal.

A representative may include the business name of a principal in a business document if:

- the principal's name is also stated;
- the business name is clearly stated to be trading name of the principal (for example, “ABC Pty Ltd trading as XYZ”); and
- it is done in such a way that it is not likely to confuse or mislead investors.

Some representatives have their own registered business names. Other representatives are directors of companies which have a registered business name. ASIC considers that a representative may use their own registered business name in the business documents when:

- the use of that name does not create the impression that the representative is conducting a business in their own right (that is, acting as a principal); and
- the display of the business name is not confusing or misleading to investors.

For example, ASIC considers that the use of a representative's business name would create the impression that the representative was conducting a business in their own right if the representative's business name was displayed in such a way that it was more prominent than the name of the principal. This would happen if it was larger or in a more prominent typeface or in a more prominent location on the materials. If such an

impression is reasonably likely to be created by the way in which the business name is used, the representative will need to obtain their own licence.

A representative may want to use the business name of a company in which the representative is a director. The use of that name may indicate that the company, rather than the representative, is acting for or by arrangement with the licensee who issued the authority. This would amount to a breach of section 809 which prohibits a body corporate from doing an act as a representative. ASIC therefore considers that it will be difficult for a representative to use a business name belonging to a company in which he or she is a director.

The use of a principal's logo by a representative has the capacity to assist investors to identify the principal because the logo may be more recognisable than the legal name of the principal. A representative may use the logo of its principal in any business documents if:

- the principal's name is also clearly stated, and
- the display of the logo is not confusing or misleading to investors

What are the legal consequences of failing to adequately disclose the principal in business documents?

There is no specific obligation under the Law for a representative to disclose their representative capacity and the identity of their principal in business documents. The obligation arises because without these disclosures the representative might be seen to be:

- holding themselves out as conducting business as a principal without a licence;
- engaging in misleading or deceptive conduct; or
- failing to act efficiently, honestly and fairly.

If a representative fails to clearly disclose their capacity and the identity of their principal in business, ASIC may take action under sections 826 or 827. ASIC may revoke or suspend the licence of the relevant principal or it may issue a banning order against the representative. This would be on the basis that the licensee or representative has breached a securities law or has failed to perform its duties efficiently, honestly or fairly.

Attachment 3 Rules of conduct applicable to investment advisers and representatives

Warnings

Information contained in ASIC Policy Statement 121[272] relating to the requirement to give warnings is outlined below.

Warnings when general securities advice is given

Warnings must be given when general securities advice and not a personal securities recommendation is given to a retail client. ASIC draws a distinction between general securities advice and a personal securities recommendation.

The conduct of business rules apply to any person who provides a personal securities recommendation. These rules include the requirement in section 851 to ensure that the recommendation is appropriate to the investment objectives, financial situation and particular needs of the particular investor.

The conduct of business rules do not apply to general securities advice, although the common law obligations of a fiduciary continue to apply where general securities advice is given.

Many retail investors do not readily appreciate the difference between general securities advice and personal securities recommendations. As a result, investors may rely on general securities advice without making any further inquiries about its suitability to their own individual investment objectives, financial situation and particular needs. Therefore, ASIC considers that it is important that licensees giving general securities advice to retail investors include adequate warnings about the limited nature of the general securities advice.

There are no mandatory words for warnings. However, after receiving the warning an investor must clearly understand that:

- the advice has not been prepared taking into account their particular investment objectives, financial situation and particular needs, and
- the investor should assess whether the advice is appropriate to their individual investment objectives, financial situation and particular needs. They should do this before making an investment decision on the basis of that general advice. They can either assess the advice themselves or seek the help of an adviser

Warnings must be given to a client at the same time as they are provided with general securities advice. For example, if general securities advice is in a newsletter or circular, the warning must appear in the newsletter or circular immediately after that advice. If general securities advice is provided on the Internet, a warning must be placed on the Internet immediately after that advice.

[272] ASIC Policy Statement 121 *Investment advisory services: retail investor protection requirements*

General securities advice may be provided either orally or in writing. ASIC considers that the warning should generally be given in the same form as the advice.

If general securities advice is provided orally, the warnings may also be given orally. One warning given to a particular retail client is generally adequate when general securities advice is provided orally and the client is reminded of the previous warnings. However, when there is a long lapse of time between the first advice and the subsequent advice, it is prudent for the adviser to repeat the warnings. If oral advice given to a retail client consists of both personal securities recommendations and general securities advice, it may be prudent for the adviser to remind the client of the warnings when general securities advice is provided later.

An adviser may give oral general securities advice face to face or using a communication service such as the telephone. The warning must still be given regardless of the context of the oral advice.

Oral general securities advice may also be given using a mass communication service such as television or radio. ASIC considers that persons using such mass communication services would not normally be in a position to provide any investment advice other than general securities advice. This is because these communication services reach a vast number of potential investors whose investment needs and circumstances vary widely.

Even if the mass communication service used is an interactive one (for example, talk-back-radio), it does not give enough time with any individual investor to undertake a full needs analysis. Therefore, only general securities advice, which does not require a full needs analysis, could be provided using such services. When mass communication services are used to provide general securities advice, the warnings must still be given.

When an adviser gives written general securities advice, warnings must be set out in the same document in which the advice is provided. Previous warnings given to that client are not considered adequate. This is because, when general securities advice is provided in newsletters or circulars which have a wide circulation (rather than a group of specific subscribers), the advice may be read by persons who may not have had the benefit of any previous warnings. Therefore, ASIC considers that for the benefit of all readers, warnings must accompany the written advice.

Warning when full personal information is not given

When making personal securities recommendations, an adviser must have a reasonable basis for that recommendation. To properly comply with this obligation, an adviser must get full personal information from a client about their investment objectives, financial situation and particular needs.

Not all retail clients may want to disclose full personal information to their adviser. Some retail investors may only want to give limited information about their personal needs and circumstances. However, ASIC is concerned that sometimes retail investors may decline to give personal information without fully appreciating the limitations of the advice that may be provided as a result.

Therefore, it is important that retail investors are given some warning about the limitations of personal recommendations they receive if they do not supply full personal information to the adviser.

If a personal securities recommendation is provided orally, the warnings may also be given orally. Such warnings may be given either:

- at the time when the retail client refuses to give full personal information in response to the adviser's request; or
- at the time of providing personal securities recommendations

One warning to a particular retail client is generally adequate. However, when there is a long lapse of time between providing the first oral advice and the subsequent advice it may be prudent for the adviser to remind the client about the previous warnings.

Oral personal securities recommendations may be provided either face to face or using a communication service such as the telephone. The adviser is still required to do a full needs analysis when making personal recommendations using such communication services. Therefore, a warning must also be given with that advice.

ASIC has adopted an approach which is consistent with the underlying objectives of sections 849 and 851 when applying these obligations to execution related telephone advice (which are personal securities recommendations) provided by a dealer on quoted securities. An adviser providing execution related telephone advice must undertake a needs analysis only initially to ensure that the advice is not unsuitable to a specific retail client in light of that client's investment needs and financial circumstances. If the client refuses to give full personal information during this process, the warnings must be given at that point. ASIC does not consider it necessary to repeat warnings when subsequent telephone advice is provided to such a client.

If a personal securities recommendation is provided in writing, it is appropriate to also give the warnings in writing. The warnings may be given either:

- at the time when the retail client declines to give full personal information in response to the adviser's request; or
- at the time of providing personal securities recommendations.

One warning to a particular retail client is generally adequate unless there is a long lapse of time between providing the first recommendations and the subsequent recommendations. In this case it may be prudent for the adviser to remind the client about the previous warnings.

Record keeping standards

ASIC Policy Statement 122[273] refers to the fact that when a retail client does not give full personal information, that client must be given certain warnings. Although these warnings can be given orally when oral personal securities recommendations are given,

[273] ASIC Policy Statement 122, *Investment advisory services: the conduct of business rules (s 849 and s 851)*

ASIC considers that as a matter of best practice, records of such warnings should be kept in the client's file.

Use of the term "independent"

ASIC Policy Statement 116[274] contains guidelines on when a person can call their advisory services "independent". Further details on the content of the policy statement are outlined below.

Some investors may in fact prefer particular brands of products. Such products are often distributed through tied distribution networks. ASIC is not implying that advice given by persons who are part of tied distribution networks is of lesser quality than advice given by "independent" advisers. These guidelines are only intended to ensure that advisers who belong to tied distribution networks do not use the word "independent" or any other word which has similar connotations. They also assist investors to have clear expectations when obtaining the type of service they prefer.

When do commissions and other benefits create a bias?

A licensee may receive a range of commissions and benefits from product providers. These include:

- upfront commissions paid by product providers;
- trailing commissions - these are on-going periodic payments made by a product provider to the dealer who sold the product for as long as the investment is held by the investor;
- soft dollar benefits - these are non-cash benefits such as subsidised office space, computer access to research and databases, advertising rebates and subsidies or training facilities paid for by a product provider; and
- cumulative awards - these are awards such as an overseas trip or a cash prize payable to an adviser if the adviser sells a certain amount of investments.

A licensee will not be able to use the word "independent" if any commissions or other benefits of the kind referred to above may tend to influence the advice in favour of particular products or product providers.

The Law recognises that payment of commissions or other benefits from a person other than the client can influence advice given by an adviser. For example, s849(2)(d) requires the disclosure of benefits and interests of the adviser or an associate which may reasonably be capable of influencing a securities recommendation by the adviser.

However, ASIC considers that just because a licensee receives commissions or other benefits, it does not prevent the licensee using the word "independent". The key issue is whether the payment arrangements as a whole may tend to create a bias in favour of particular products or particular product issuers. This is a question of fact which each licensee must address. The following are general guidelines to help licensees to decide

[274] ASIC Policy Statement 116 *Investment advisory services: licensing and "independent" advisory services*

when commissions or other benefits they receive from product providers may tend to create a product or other bias which may affect their advice.

Insignificant commissions or other benefits

If the commissions or other benefits received by an adviser are insignificant, they will not prevent the adviser using the word "independent" because such benefits may not tend to create a product bias. Commissions and benefits are insignificant if they are not capable of influencing the recommendations of the adviser. What is an insignificant benefit is a question of fact in each case. Such benefits may include benefits of low financial value (for example, a business lunch or a free seminar) as well as benefits of higher monetary value which are nevertheless insignificant in terms of the overall value and size of the business conducted.

Same level of commission

A licensee is likely to be biased in favour of particular products unless they receive a similar level of commission for similar products or classes of products they recommend. This could also be the case if the level of commission received is similar, but the licensee receives significant other additional benefits for particular products (for example, free research or training).

If there are any significant differences in the rate of commissions payable for different classes of securities, such differences may create a bias in favour of the class of products that pay the higher commission. What is a significant difference is a question of fact in each case. Matters such as the volume of the business transacted will be relevant in determining whether a difference is significant.

Commission splits

In some cases, licensees may have arrangements to split the commission payable between the licensee and the representative in different ways. Significant differences in the commission splits for different products may tend to create a bias in favour of certain products when representatives recommend those products. This may happen even though the overall commissions paid by product providers to the licensee may be similar. In such a case, a representative may have an inducement to promote a product that entitles them to a higher commission split rather than a lower commission split unless the difference is insignificant.

When commissions are split in different ways to be capable of creating a product bias, licensees should ensure that its representatives do not use the word "independent" when providing advisory services on their behalf.

Trailing commissions

The payment of a trailing commission to a licensee or representative may tend to create a bias in one of two ways:

- it may give an added incentive to recommend a particular product that pays the trailing commission; and

- once the product has been sold, it may provide an incentive to the adviser to directly or implicitly encourage the client to hold that investment.

ASIC considers that generally trailing commissions which generate a significant level of ongoing income to a licensee are likely to create a product bias in favour of those products. This may not be the case if the overall commissions (including trailing commissions) and other benefits paid by one product provider are comparable to the overall commissions and benefits paid by other product providers whose products the licensee can recommend.

Other benefits from product providers

Significant additional benefits such as soft dollar arrangements or cumulative awards may tend to create a bias in favour of the products offering these benefits.

Remuneration by both fees for service and commission

Some advisers are paid partly by fees for service and partly by commission. In these situations it is necessary to look at the overall effect and see whether the arrangements may tend to create a bias in favour of particular products or issuers which influence the advice.

Payment on “fee for service” basis

Some advisers are only paid by their client on a “fee for service” basis. They do not receive any commission or benefit from a product provider or they rebate all commissions and other benefits to their client. This method of payment is unlikely to lead to any bias in favour of a particular product or product issuer. Such advisers, if they operate without any product restrictions or ownership links can call their services “independent”.

What product restrictions may adversely affect the independence of advice?

A licensee may operate under contractual arrangements which restrict the range of products it recommends. For example, if a licensee has a contract with a fund manager to only recommend that manager's fund, then this affects their independence.

An indirect restriction may exist where a licensee has arrangements to obtain research only in relation to certain products. In this case, the advice provided by that licensee is likely to be dependent on the availability of the research. This restricts the ability of the adviser to select appropriate products from a broad range of products available in the market.

ASIC considers that a person who has any type of direct or indirect restriction relating to the securities in relation to which advice is provided should not promote their services as being “independent”.

When do ownership links adversely affect the independence of the advice?

Many licensees are either:

- financial product providers themselves (for example, a bank, fund manager or life company), or
- associated with a financial product provider.

For example, a licensee may be wholly or substantially owned by a product provider or the licensee may be the advisory arm of a financial group that includes fund managers. ASIC statistics show that licensees who are product providers or associated with product providers generally have the highest number of representatives.

An adviser should not use the word "independent" if there are such ownership links which may tend to create any bias in favour of certain product or product providers. When deciding whether these links may tend to create a product bias, it is necessary to look at the overall ownership structure of the licensee and then the products on which advice is provided. This generally needs to be decided on a case by case basis.

For example, a licensee may be a subsidiary of a fund manager or a member of a financial group. If that licensee advises on the products of the fund manager or a member of the group, then there is likely to be a product bias in favour of the products of the associated fund manager or group member. ASIC considers that such a licensee is likely to be engaging in misleading or deceptive conduct if it describes its services as "independent".

Misuse of similar words such as "impartial" and "unbiased"

Although these guidelines specifically refer to the word "independent", ASIC considers that similar considerations apply to the use of other words such as "impartial" or "unbiased". This is because these words carry connotations for investors which are similar to the use of the word "independent". As a result, the same legal consequences that apply for the misuse of the word "independent" will apply to the misuse of these words.

"Know your client" rule

Contravention of the "know your client" rule may result in liability to pay damages to the client[275].

ASIC considers that the "know your client" rule applies only when a personal securities recommendation is provided[276]. Policy Statement 122 sets out what inquiries an adviser should make about a client, and what is adequate product research. Further details on the content of the policy statement are set out below.

What is the scope of the "know-your-client" rule?

A securities adviser must have a reasonable basis for making a securities recommendation to a client. To do this, the adviser must:

[275] *Corporations Law*, section 852
[276] ASIC Policy Statement 122 *Investment advisory services: the conduct of business rules (s 849 and s 851)*

- have regard to the information the securities adviser has about the client's investment objectives, financial situation and particular needs;
- conduct reasonable investigations about the securities recommended; and
- prepare their recommendation in light of the previous two considerations.

As a matter of best practice, a securities adviser giving a personal securities recommendation to a client should explain to that client why the recommendation is considered appropriate to the investment objectives, financial situation and particular needs of the client. ASIC considers it important that the adviser tells their client about any significant risks associated with the investment and any investment strategies recommended to the client.

What inquiries should an adviser make about the client's investment objectives, financial situation and particular needs?

Section 851 does not expressly require reasonable inquiries to be made of the client's needs and circumstances. However, ASIC considers that this is implicit in the underlying purpose of the obligation and the general law obligations of the securities adviser as a fiduciary.

The level of personal information needed from each client for making a personal securities recommendation of the kind expected by that client varies from one client to another. The securities adviser is best placed to make an assessment of what is adequate personal information for each client.

ASIC considers that the following information would generally be needed when making a full needs analysis of a retail client:

- the client's needs and objectives for income, capital growth, security, retirement income, liquidity, and the time period the client is planning for;
- the client's personal financial circumstances such as liabilities and potential liabilities, nature of any assets held and any retirement benefits expected (including that of a partner, when relevant);
- the client's individual investment preferences and aversion or tolerance to risk, and
- any other relevant client information such as employment security, family commitments and expected retirement age.

A securities adviser may use information obtained from a client on a previous occasion where advisory services were provided to that client. In using such information, the securities adviser must take care to ensure that the information is up to date and comprehensive. If the previous information was obtained a long time ago or if the client's circumstances have clearly changed, the securities adviser is required to update the personal information of the client to be able to satisfy the section 851 obligation.

What is adequate product research?

The ability of a securities adviser to make a personal securities recommendation which is appropriate to a client's investment objectives, financial situation and particular needs, depends on the adviser having:

- adequate personal information about the client as described in the previous paragraphs; and
- adequate product knowledge gained through reasonable investigations of the securities recommended.

An adviser should have adequate knowledge about the products they recommend. To have adequate knowledge, the investigations they conduct should generally include relevant information available in the market. Such information includes prospectuses, annual reports, reports to the ASX or ASIC by disclosing entities, fund manager's information releases and any reports and analyses made by specialists.

When assessing the appropriateness of any investment products, a securities adviser should generally consider such matters as market and industry risks, the economic and political environment, the issuer's track record, the nature of the underlying investments and assets and any other factors which may directly or indirectly impact on risk return and growth prospects of the recommended securities.

An adviser should also have adequate knowledge about a reasonable range of other comparable investment products. Because an adviser must provide appropriate recommendations and not “best advice”, knowing about comparable products does not mean knowing about every comparable investment product available in the market. What is a reasonable range varies from case to case, but does, at a minimum, include a couple of comparable products.

A securities adviser may either conduct their own research or use external product research. A securities adviser is primarily accountable under section 851. Therefore, if external research is used, the adviser should take reasonable steps to ensure that it is reliable and adequate. For example, a securities adviser may use product research issued by a research house which is known to be affiliated with a fund manager or securities issuer. When using this research, an adviser must take reasonable further steps to assess the quality of the research in terms of its impartiality and accuracy.

Licensees are liable for the conduct of their representatives. Therefore, it is in the interest of licensees to ensure that any representatives who provide personal securities recommendations on their behalf conduct adequate product research or use only reliable external product research.

How should an adviser comply with the section 851 obligation when providing limited recommendations?

A securities adviser may make limited personal securities recommendations for two reasons:

- when dealing with a limited range of products (for example, a single product provider, or
- when providing recommendations for a limited purpose.

The Conduct of Business Rules continue to apply to a securities adviser who makes personal securities recommendations on a limited range of products. A securities adviser who has a limited range of products may find that the products available are not appropriate to a particular client's investment objectives, financial situation and particular needs. In this case, the adviser should advise the client that the products available are inappropriate. The adviser may refer the client to another adviser who is able to recommend appropriate products.

A securities adviser may be asked by a client to provide securities recommendations for a limited purpose. The Conduct of Business Rules still apply to such recommendations. However, the extent of product research needed to comply with their section 851 obligation varies depending on the limited purpose for which the client seeks the recommendation.

For example, if a client wants a recommendation only for a specific class of securities such as property trusts, the product research need not extend beyond this class of securities. If a client instructs an adviser that they want to obtain recommendations relating to capital growth funds, the adviser need not conduct product research beyond this class of securities. However, the adviser must still consider whether these products are appropriate to the stated investment objectives, financial situation and particular needs of the client.

Exclusion of liability

An agreement between a client and a securities adviser to limit or exclude the liability of the adviser (and if the adviser is a representative, the licensee) for any inappropriate advice is unenforceable. This is because such an agreement is contrary to section 851.

Record keeping standards

Section 851 does not impose a specific obligation on a securities adviser to keep a record of a client's investment objectives, financial situation and particular needs (client profile) or the product research carried out.

However, according to ASIC's interpretation of the Law, a securities adviser cannot satisfy the section 851 requirement to have a reasonable basis for making a securities recommendation unless adequate product research is conducted in light of the client's investment objectives, financial situation and particular needs. An adviser needs to keep records of the client's profile and product research conducted or used to formulate the recommendations. This should be kept as evidence that the adviser has in fact complied with their section 851 obligation.

Similarly, ASIC considers that a securities adviser who provides personal securities recommendations to a client should keep a record of that client's profile which contains information that was accurate and up to date when making their personal securities recommendations. The records also should include any product research conducted or used in formulating the recommendations. Unless a client is given on-going advisory services, the client profile would not generally need to be updated.

An adviser should, as a matter of best practice, record the reasons why certain products were considered appropriate for a particular client and any information on risks of investments and strategies recommended to the client.

Such records may be kept electronically or in hard copy and must be accessible to ASIC and the client on request.

When execution related telephone advice is given to a client, a dealer should keep comprehensive and adequate records of the client profiles. Without such records, it will be difficult for a securities adviser to prove that they have complied with their section 851 obligation. Although records of product research on recommended securities (including comparable investments) need not be kept in individual client files, a securities adviser should be able to demonstrate adequate product knowledge through other means (for example, their training).

Media, computer software and internet advice

ASIC Policy Statement 118[277] sets out ASIC's guidelines and enforcement policy in relation to a person providing investment advice in the media, in computer software and books, and on the Internet. This includes guidance on what warnings should be included in these cases. Information contained in the policy statement is outlined below.

Media advice

Persons who give investment advice on securities or publish securities reports using the media (for example, newspapers, periodicals and information services such as radio or television which are generally available to the public) are referred to as media advisers. (Media advisers include publishers and proprietors of newspapers and periodicals as well as persons who contribute advice or prepare securities reports for publication in the media.)

Media advisers provide an important service to the markets by making the public aware of issues relating to securities and issuers. ASIC research indicates that media advisers are a significant source of information about securities and issuers for potential investors.

ASIC recognises that retail investors may not always realise that securities advice and reports in the mass media may not be suitable for their own individual investment needs and financial situation. As a result, retail investors may act on advice in the mass media without assessing if it is really suitable for their own needs and circumstances.

ASIC considers that when media advisers operate within the media exemption and provide advice or reports containing general securities advice, the advice should include clear warnings about the limitations of the advice. ASIC also considers that media advisers are required under the common law to disclose any material conflict of interest they may have when providing advice or reports on securities

[277] ASIC Policy Statement 118 *Investment advisory services: media, computer software and Internet advice*

There is no requirement in the Law for unlicensed media advisers to include such warnings. ASIC encourages unlicensed media advisers to include appropriate warnings and disclosures in their media advice as a matter of best practice.

Computer software and books

ASIC will not require persons who provide computer software and books which contain either purely factual information about securities or investment guidelines and formulae generally made available to the public and are not intended to be updated or supplemented to be licensed. As a condition of not requiring a licence, ASIC will require these persons to include in the computer software and books warnings which make it clear to users that:

- the information is not suitable to be acted upon as investment advice, and
- it may be advisable to obtain investment advice before making any investment decisions relying on the information provided

Internet investment advice

In addition to being licensed, or operating as a representative of a licensee, an Internet adviser is required to comply with the following requirements:

- the Conduct of Business Rules[278] when making personal securities recommendation on the Internet;
- ASIC's retail investor protection requirements such as the requirement to provide an advisory services guide, provide warnings where general securities advice is given.

As the Internet advice will generally be made available to users who have varying needs and circumstances (except in the case of advice by e-mail), ASIC considers that Internet advisers will generally only be able to provide general securities advice and not personal securities recommendations on the Internet. Therefore, it is particularly important that a person providing general securities advice on the Internet provides the required warnings to the effect that:

- the advice has not been prepared taking into account the particular investment objectives, financial situation and needs of any particular investor, and
- as a result, investors using the Internet advice should assess whether it is appropriate in light of their own individual circumstances before acting on the advice.

Liability of principal for representatives

Where it is proved, for the purposes of a court proceeding, that a person engaged in particular conduct, while the person was a representative of only one person (the "indemnifying principal") or two or more persons (the "indemnifying principals) then, unless the contrary is proved it is presumed that the representative engaged in the

[278] *Corporations Law*, sections 849 and 851

conduct as a representative of the indemnifying principal or as a representative of some person among the indemnifying principals.

Where, for the purposes of establishing in a court proceeding that section 819 of the *Corporations Law* applies, it is proved that a person did, or omitted to do, a particular act because the person believed at a particular time in good faith that certain matters were the case, then, unless the contrary is proved for those purposes, it is presumed for those purposes that it is reasonable to expect that a person in the first-mentioned person's circumstances would so believe and would do, or omit to do, as the case may be, that act because of that belief[279].

With some exceptions, a principal may not contract out of liability for representative's conduct[280].

ASIC Policy Statement 117[281] outlines in the following terms the circumstances where a licensee is liable to third parties for acts of its representatives.

Liability to third parties

Where a person engages in conduct as a representative of another person (the principal), the principal is liable for the conduct of the representative in the same manner, and to the same extent, as if the principal had engaged in that conduct[282]. Therefore, the principal is responsible for paying compensation to any client who suffers loss as a result of reasonably relying on the acts of, or representations made by, the representative[283].

Where a representative acts for more than one principal and it cannot be proved which principal they were acting for, the principals bear joint and several liability to any client who suffers loss as a result of reasonably relying on the conduct of the representative[284].

If a representative acts beyond their actual authority the principal is still responsible to clients for its representative's actions[285]. A principal is also responsible for the actions of a representative who holds a revoked authority until it is recalled[286].

A licensee can only avoid becoming liable for acts of another person to whom an authority has been issued by revoking and recalling it. Similarly, a person could recall an invalid authority issued by that person. Where an authority is recalled in writing, the person who holds the authority must return it within two business days[287].

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[279] *Corporations Law*, section 820
[280] *Corporations Law*, section 821
[281] ASIC Policy Statement 117 *Investment advisory services: acting as a representative*
[282] *Corporations Law*, section 817
[283] *Corporations Law*, section 819
[284] *Corporations Law*, section 819
[285] *Corporations Law*, section 819(1)
[286] *Corporations Law*, section 94(2)
[287] *Corporations Law*, section 816

Restricted authorities

The Law prohibits contracting out of responsibility for acts of representatives, or for the principal to be indemnified in respect of liability for acts of a representative (except in limited circumstances such as indemnity insurance)[288]. Therefore, any endorsement on an authority which directly or indirectly restricts the principal's liability for acts of a representative to third parties (clients) is invalid.

This raises the issue of whether a licensee can confine the operations of a representative to specific activities within its securities or investment advice business (for example, allowing a representative to provide investment advice on only some of the products which are within the principal's range of investments).

ASIC considers that a licensee cannot endorse an authority issued to a representative so as to confine the activities of the representative within the licensee's securities or investment advice business. This is because such a restriction:

- is not contemplated within the terms of the required endorsement under section 88(1), and

- is likely to have the effect of an attempt by the licensee to contract out of liability for the conduct of a representative and therefore be invalid under section 821(2).

However, a licensee may as a matter of its internal management restrict the scope of activities of a representative. ASIC will take into account such restrictions in assessing whether the licensee has effectively discharged its training and supervision responsibilities to its representatives.

Any restrictions imposed by ASIC on a licensee will extend to the representatives of that licensee. However, if a representative acts beyond such a restriction and a client reasonably relies on the acts of the representative, the licensee is still liable to the client for the acts of the representative although the acts are beyond authority[289].

[288] *Corporations Law*, section 821
[289] *Corporations Law*, section 819(1)