

[PS 120]
Policy Statement 120
**Investment advisory services: mere referrals
and other excluded activities**

Chapter 7 — Securities

Issued 3/3/1997

Purpose

[PS 120.1] This Policy Statement sets out ASIC's guidelines and enforcement policy relating to certain activities which are excluded from the licensing provisions in the Corporations Law. When a person makes a referral which is within the guidelines set out in this Policy Statement, they do not need to comply with the licensing provisions in the Law.

[PS 120.2] This Policy Statement forms part of ASIC's investment advisory services series of Policy Statements. This Policy Statement replaces Practice Note 17.

[PS 120.3] The Policy Statement is structured as follows:

- Part I Definitions [PS 120.4]
- Part II Mere referrals [PS 120.5–120.30]
- Part III Asset allocation advice [PS 120.31–120.34]

Part I: Definitions

[PS 120.4] In this Policy Statement:

- (a) “advice” means personal securities recommendations or general securities advice (details in Policy Statement 122);
- (b) “adviser” means a natural person who provides advice relating to securities and includes both a licensee and a representative of a licensee;
- (c) “agent” means a representative of a licensee;
- (d) “investment advisory services” means advice on securities whether provided with another service (eg dealing or discretionary portfolio services) or on its own. It is used interchangeably with the terms “advisory services” and “securities advice”;
- (e) “investment products” means securities (eg shares, bonds and unit trusts) and superannuation products;
- (f) “Law” means the Corporations Law;
- (g) “licensee” means a holder of a dealers or an investment advisers licence under the Law;
- (h) “licensing provisions” means the requirements in Pt 7.3 to 7.7 of the Law and the relevant Corporations Law regulations;
- (i) “operating under a licence” means conducting a securities or an investment advice business under one’s own licence or acting as a representative of a holder of a dealers or an investment advisers licence;
- (j) “PA” means a proper authority;
- (k) “Proper authority” has the meaning given to it in s88(1);
- (l) “principal” means a “licensee” under the Law and these terms are used interchangeably; and
- (m) “representative” means a “securities representative” as defined in s94 of the Law.

Part II: Mere referrals

Background

[PS 120.5] 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.

[PS 120.6] According to ASIC's interpretation of the Law, a person who makes a referral within the guidelines set out in this Policy Statement (ie 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.

[PS 120.7] ASIC has set out guidelines which it will follow when deciding whether a referral is the type of activity performed by:

- (a) a representative who must have a PA; or
- (b) a person who is not a representative.

[PS 120.8] These guidelines are set out in this Policy Statement in answer to the following questions:

- What is an act of a representative?
- What is a "mere referral"?
- Can a mere referral be made to an authorised representative?
- Can a body corporate make mere referrals?
- Can a mere referral be made to an own employee holding a proper authority from an external licensee?
- Can a licensee make mere referrals to another licensee?
- Can a business introductory service be a mere referral activity?
- What are the disclosure obligations that apply where mere referrals are made?

What is an act of a representative?

[PS 120.9] 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 (eg clients of a licensee are referred for accounting or legal services).

[PS 120.10] When a person makes a referral to a licensee, the referral may be the act of a representative which is very broadly defined in s94(3). This section says that 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, s94(3)(d)). (See Policy Statement 117 for details of what constitutes an act of a representative.)

[PS 120.11] 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 s806 or s807. Section 806 and s807 prohibit a person from doing an act of a representative without a proper authority from the licensee.

[PS 120.12] 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 (see [PS 120.15]). These guidelines are designed to ensure that the referral remains an activity which is not an act of a representative.

[PS 120.13] The above 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.

[PS 120.14] For example, training and supervision obligations of licensees for their representatives (reg 7.3.2) are designed to promote efficiency in the conduct of a licensee's securities or investment advice business. When an activity, such as a mere referral, which does not involve any dealing or advising activity, these training and supervision obligations have little relevance to that activity (although such an activity has a link with the securities or investment advice business of the licensee to whom the referral is made). Liability provisions in the Law will also be irrelevant. This is because the referring party making a mere referral does not perform any dealing or investment advice function which may give rise to a claim by a client.

What is a "mere referral"?

[PS 120.15] ASIC considers that a mere referral is made when a person:

- (a) does nothing more than merely introduce a potential investor to a licensee; and

- (b) does this merely as an incidental part of their other business.

[PS 120.16] 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.

[PS 120.17] 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 (ie promoting the services of the licensee), that person is not making a mere referral. That person may be either:

- (a) conducting a securities or investment advice business in their own right (for which they must have a licence); or
- (b) acting as a representative of the licensee (for which they must have a PA from the licensee).

[PS 120.18] 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 (eg 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?

[PS 120.19] 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.

[PS 120.20] 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 the prohibitions in s780 and s781.

Can a body corporate make mere referrals?

[PS 120.21] The Law prohibits a body corporate from acting as a securities representative of another person (s809). If the referral activity of a body corporate remains a mere referral within the guidelines set out in [PS 120.15], the corporation does not breach the prohibition in s809. Therefore, a body corporate which makes referrals to a dealer or investment adviser should operate within the mere referral guidelines to avoid a possible breach of s809.

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

[PS 120.22] 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.

[PS 120.23] 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 PA. This is a breach of s809.

[PS 120.24] However, ASIC will not enforce the prohibition in s809 when a mere referral to such a common employee is made provided:

- (a) the referring party fully complies with the guidelines set out in [PS 120.15] for making mere referrals; and
- (b) 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 PA.

Can a licensee make mere referrals to another licensee?

[PS 120.25] 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, as discussed in the previous paragraphs.

[PS 120.26] Any licensee can make a mere referral to another licensee within the mere referrals guidelines in [PS 120.15]. A corporate licensee would not breach s809 by making such a mere referral.

[PS 120.27] If the referral is not a mere referral (ie 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 s809 as they are carrying out an act of a securities representative.

Can a business introductory service be a mere referral activity?

[PS 120.28] 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 (ie persons seeking capital for expanding businesses and prospective investors in such businesses). These introductory services may lead to issuing securities to investing parties. This raises the question whether the persons providing the introductory service may also be conducting a securities or an investment advice business.

[PS 120.29] 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:

- (a) 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
- (b) 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?

[PS 120.30] ASIC considers that when referrals are made, the licensee to whom the referrals are made must disclose details of any benefits (eg commissions or fees) payable to the referring party. Therefore, ASIC will continue to impose this obligation in licence conditions.

Part III: Asset allocation advice

[PS 120.31] 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.

[PS 120.32] 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, see Policy Statement 116 [PS 116.30–116.36].) 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.

[PS 120.33] However, ASIC, on policy grounds, will not enforce the licensing provisions on persons who give general recommendations to allocate assets in a particular way (eg 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.

[PS 120.34] If asset allocation advice goes beyond being a very general recommendation on securities and identifies any specific securities (eg interests in X trust) or classes of securities (eg 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. (See Policy Statement 116 [PS 116.30–116.36] to ascertain whether a dealers or an investment advisers licence is required.)