[PS 122]
Policy Statement 122
Investment advisory services: the conduct of business rules (s849 and s851)

Chapter 7 — Securities

Issued 3/3/1997

Purpose

[PS 122.1] This Policy Statement sets out ASIC policies and guidelines on how persons making securities recommendations to investors (clients) can meet the Conduct of Business Rules in the Law.

[PS 122.2] This Policy Statement forms part of ASIC's investment advisory services series of Policy Statements and replaces Practice Notes 23 and 41.

[PS 122.3] The two key obligations in Div 3 of Pt 7.4 which are referred to as the *''Conduct of Business Rules''* are the requirements to:

(a) disclose material benefits, advantages and interests under s849 (also referred to as the disclosure of conflict of interests obligation); and

(b) have a reasonable basis for any recommendations made under s851 (also referred to as the ''know-your-client'' requirement).

[PS 122.4] The s849 and s851 obligations are referred to by ASIC as the *''Conduct of Business Rules''*. ASIC considers that the Conduct of Business Rules are applicable only when a personal securities recommendation is made to a client and not when general securities advice is provided to a client (see Part I [PS 122.9] for definitions of personal securities recommendations and general securities advice).

[PS 122.5] A person who is in the business of making personal securities recommendations must be appropriately licensed (ie hold a dealers licence when giving advice to induce persons to enter into securities transactions, or, hold an investment advisers licence, see Policy Statement 116 [PS 116.30−116.36] for details of this distinction). If a recommendation is made in a representative capacity, then that person must hold a proper authority from the relevant licensee (ie the principal in the course of whose securities or investment advice business the recommendation is provided, see s806 and s94(3), see also Policy Statement 117).

[PS 122.6] Persons who conduct a securities or investment advice business in the course of which investment advisory services are provided to

retail investors must, in addition to meeting the Conduct of Business Rules, meet other licensing obligations. These include giving an Advisory Services Guide to retail investors (see Policy Statement 121 for details of retail investor protection requirements.)

[PS 122.7] ASIC policies and interpretative guidelines set out in this Policy Statement on the Conduct of Business Rules are not a comprehensive statement of the legislation and therefore must be read together with the Law. They should be used only as guidance on key aspects of the relevant legal obligations.

[PS 122.8] The Policy Statement is structured as follows:

Part I Definitions [PS 122.9]

Part II Requirements that are common to the Conduct of Business Rules [PS 122.10−122.42]

Part III Disclosure of conflict of interest obligation under s849 [PS 122.43−122.96]

Part IV Know-your-client obligation under s851 [PS 122.97−122.119]

Part V Record keeping standards [PS 122.120−122.131]

Part VI Execution related telephone advice by dealers [PS 122.132−122.146]

Part VII Proposed exclusion for sophisticated investors [PS 122.147−122.155]

Part I: Definitions

[PS 122.9] In this Policy Statement:

(a) ‘‘advice’’ means personal securities recommendations or general securities advice (details in [PS 122.31−122.36]);

(b) ‘‘adviser’’ means a natural person who provides advice relating to securities and includes both a licensee and a representative of a licensee;

(c) ‘‘ASG’’ means an Advisory Services Guide;

(d) ‘‘Conduct of Business Rules’’ means the obligations under s849 (the disclosure of conflict of interests obligation) and s851 (the know-your-client obligation);

(e) ‘‘general securities advice’’ means advice or reports on securities provided to a person without any express or implied (direct or indirect) recommendations that any particular transaction in those securities is appropriate to the particular investment objectives, financial situation or particular needs of that person (see [PS 122.34] for details);

(f) ‘‘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’’;

(g) ‘‘investment products’’ means securities (eg shares, bonds and unit trusts) and superannuation products;

(h) ‘‘Law’’ means the Corporations Law;

(i) ‘‘licensee’’ means a holder of a dealers or an investment advisers licence under the Law;

(j) ‘‘licensing provisions’’ means the requirements in Pt 7.3 to 7.7 of the Law and the relevant Corporations Law regulations;

(k) ‘‘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;

(l) ‘‘personal securities recommendation’’ means an express or implied (direct or indirect) recommendation made to a person (a client) that certain securities transactions are appropriate to that client, having regard to that client’s investment objectives, financial situation and particular needs (see [PS 122.34] for details);

(m) ‘‘representative’’ means a ‘‘securities representative’’ as defined in s94 of the Law;

(n) ‘‘securities adviser’’ has the meaning given to it in s9 and is also referred to as an ‘‘adviser’’; and

(o) ‘‘securities recommendation’’ means a personal securities recommendation.

Part II: Requirements that are common to the Conduct of Business Rules

[PS 122.10] This Part gives guidance on the legal requirements that are common to the Conduct of Business Rules (ie the s849 and s851 obligations). The extent to which a person providing investment advisory services must comply with the Conduct of Business Rules will depend on a number of factors, most importantly whether their investment advice is a personal securities recommendation rather than general securities advice (see [PS 122.34]).

[PS 122.11] A person must comply with the Conduct of Business Rules when such a person:

(a) is a securities adviser, as defined in the Law (s9); and

(b) makes a securities recommendation to a client in circumstances when the client is reasonably likely to act on that advice.

[PS 122.12] ASIC's guidelines relating to the requirements that are common to the Conduct of Business Rules are set out in answer to the following questions:

- Who is a securities adviser who must comply with the Conduct of Business Rules?
- When must a securities adviser comply with the Conduct of Business Rules?
- When is a person exempt from complying with the Conduct of Business Rules?
- What is the distinction between personal securities recommendations and general securities advice?
- What are the common law obligations that apply when providing general securities advice? and
- What are the consequences of not complying with the Conduct of Business Rules?

Who is a "securities adviser" who must comply with the Conduct of Business Rules?

[PS 122.13] A securities adviser who makes a securities recommendation to a client must comply with the Conduct of Business Rules. Section 9 defines a "securities adviser" as "a dealer, an investment adviser or a securities representative of a dealer or an investment adviser".

[PS 122.14] 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 (see s9 definitions). 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 (s94(1) and s94(2)). Only a natural person can be a securities representative (s809).

[PS 122.15] Some persons are exempt dealers and investment advisers under s68 or are persons exempt under reg 7.3.10 to reg 7.3.15 (eg 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.

[PS 122.16] Some persons are not considered by the Law to be conducting an investment advice business when giving investment advice under exempt circumstances (eg solicitors and accountants giving merely incidental advice, see Policy Statement 119). 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.

[PS 122.17] Therefore, securities advisers who must comply with the Conduct of Business Rules when making securities recommendations are:

(a) dealers or investment advisers, exempt dealers or investment advisers (under s68) or persons exempted under reg 7.3.10 to reg 7.3.15; and

(b) securities representatives, ie 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 (see also Policy Statement 117).

Deemed persons

[PS 122.18] A partnership or body corporate may conduct (whether alone or as a part of another business) 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 (ie ‘‘deemed’’) to have been made by each partner of the partnership or by the body corporate (s848).

[PS 122.19] The above deeming requirement applies only in relation to the disclosure of conflict of interests obligation in s849 and not to the know-your-client obligation in s851. 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 s849 obligation when making the securities recommendation. 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 s849.

When must a securities adviser comply with the Conduct of Business Rules?

[PS 122.20] 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 (see Policy Statement 116 [PS 116.23−116.28] for details of the ''conduct of business'' element that must be satisfied to attract the licensing provisions).

Dealers providing execution related telephone advice

[PS 122.21] 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, see Part VI [PS 122.132−122.146] for a full discussion.

Single product providers

[PS 122.22] Some securities advisers may be single product providers, ie 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.

[PS 122.23] 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). (See Part IV [PS 122.97−122.119] on s851 obligation.) 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.

[PS 122.24] 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 s851 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 (see [PS 122.38−122.39] for the common law obligations). (See also Policy Statement 121 for details of

retail investor protection requirements such as warnings when giving general securities advice).

Investment newsletters, circulars and advertisements

[PS 122.25] 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.

[PS 122.26] 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 (see Policy Statement 121 for the nature of the required warnings).

When is a person exempt from complying with the Conduct of Business Rules?

Securities recommendations merely incidental to another business

[PS 122.27] The definition of ''securities recommendation'' (s9) 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 (eg a recommendation to buy, subscribe for, underwrite or hold securities) as well as a negative recommendation (eg to sell securities).

[PS 122.28] 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''.

[PS 122.29] 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 (eg 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.

''Execution only'' services

[PS 122.30] 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.

What is the distinction between a ''personal securities recommendation'' and ''general securities advice''?

[PS 122.31] ASIC considers that the Conduct of Business Rules apply only when a personal securities recommendation and not general securities advice is provided. Therefore, the distinction between these two types of advisory services is important.

[PS 122.32] 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 s849 and s851 which envisages that a recommendation is made to a client in that client's personal capacity.

[PS 122.33] Both the disclosure of conflict of interests under s849 and the know-your-client obligation under s851 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. A similar distinction is drawn in other major jurisdictions such as the USA.

[PS 122.34] Therefore, ASIC has, in interpreting the Law, drawn a distinction between personal securities recommendations and general securities advice as follows:

(a) *Personal securities recommendation*

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 s851. However, a personal securities recommendation can be made to a person other than a natural person, eg a trustee of a prescribed interest

scheme or a company. (*Note*: ASIC proposes to exclude the application of the Conduct of Business Rules in relation to sophisticated investors (ie non-retail investors), see Part VII [PS 122.147−122.155].)

(b) *General securities advice*

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.

[PS 122.35] 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. These include ASIC's retail investor protection requirements (see Policy Statement 121 for details).

[PS 122.36] 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. Therefore, the adviser providing such advice must comply with the Conduct of Business Rules. By incorporating appropriate warnings, as set out in ASIC's guidelines in Policy Statement 121, 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?

[PS 122.37] 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 (see Policy Statement 116 [PS 116.30−116.36] as to what type of a licence is appropriate). 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.

Common law obligations

[PS 122.38] An adviser who provides general securities advice must comply with the common law obligations to:

(a) fully disclose any conflict of interests that may affect the general securities advice or reports they provide; and

(b) 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.

[PS 122.39] 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 (see s826(1)(j), s826(1)(k) and s827(1)(b)).

What are the consequences of not complying with the Conduct of Business Rules?

[PS 122.40] A breach of the disclosure of conflict of interests obligation in s849 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, see [PS 122.18]) also incur primary liability for breaching s849.

[PS 122.41] Any securities adviser who breaches the disclosure of conflict of interest obligation in s849 and/or the know-your-client rule in s851 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 (see s852).

[PS 122.42] A breach of s849 or s851 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 (see s826(1)(c), s827(1)(b) and s829). (See [PS 122.90−122.96] and [PS 122.117−122.119] for defences available to a securities adviser).

Part III: Disclosure of conflict of interests obligation under s849

[PS 122.43] The scope of the disclosure of conflict of interests obligation under s849 and how ASIC will interpret the key elements of this obligation are set out in answer to the following questions:

- What is the purpose of the disclosure obligation under s849?
- What is the scope of the general obligation under s849?
- What is a material conflict of interest?
- How should some conflict of interests be treated?
- Who is an associate?
- What is excluded from the disclosure obligation in s849?
- How much detail must be disclosed under s849?
- What is the appropriate method of disclosure under s849?
- What are the defences to a breach of s849?

What is the purpose of the disclosure obligation under s849?

[PS 122.44] The obligation in s849 requires a securities adviser to disclose both actual and potential material conflict of interests which the adviser (or an associate of the adviser) may have when making securities recommendations. This obligation serves two purposes:

(a) it assists investors to make well informed investment decisions when relying on securities recommendations made to them; and

(b) 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 s849?

[PS 122.45] Conflict of interests which must be disclosed under s849 fall into two broad categories:

(a) *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:

(i) making the recommendation; or

(ii) a dealing transaction resulting from that recommendation (s849(2)(c)).

These commissions, fees, other benefits and advantages can be direct or indirect or financial or non financial.

*The term ''receives'' is used in this Part to include benefits and advantages that a person, received in the past or, will or may receive in the future.

(b) *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 (s849(2)). These other interests can be direct or indirect or financial or non-financial interests.

[PS 122.46] The range of *benefits and advantages* which a securities adviser (adviser) must disclose under the first part of the s849 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?

[PS 122.47] 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 (s849(2)(c)). 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.

[PS 122.48] 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 (s849(2)(d)). Therefore, a materiality element is implicit in this part of the obligation.

[PS 122.49] However, ASIC considers that materiality is relevant when deciding whether any benefit, advantage or interest should be disclosed under s849. 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.

[PS 122.50] It is not always easy to decide when a benefit, advantage or interest is a disclosable interest under s849. 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 under s849.

[PS 122.51] Therefore, ASIC cannot give comprehensive guidelines for every possible type of conflict of interest that may exist. However, the following guidelines in [PS 122.52−122.68] give some assistance on some areas of practical difficulty.

How should some conflict of interests be treated?

Own holdings

[PS 122.52] 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, s843.) A holding of shares in the same company would not generally need to be disclosed under s849 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.

[PS 122.53] ASIC's Chant Link Survey (June 1995) indicated 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 s849.

[PS 122.54] 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 ([PS 122.40−122.42] on administrative actions which ASIC can take in such situations).

Commissions

[PS 122.55] 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, see [PS 122.72−122.77], and insignificant amounts, see [PS 122.47−122.49]) must be disclosed under

s849. They must be disclosed in a manner which is easy for the client to understand.

[PS 122.56] Disclosing the ''method of charging'' in an Advisory Services Guide (see Policy Statement 121) does not meet the disclosure obligation under s849. This is because the information in an ASG is generally very basic information on the method of charging by the licensee. However, more specific and detailed disclosure of material benefits, advantages and interests of the securities adviser (and their associates) is needed under s849.

Commission splits

[PS 122.57] 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.

[PS 122.58] 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 ASG.

Trailing commissions

[PS 122.59] 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 (eg providing favourable research or reports on the investments).

[PS 122.60] 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 (s849(2)(c)) (except where it is insignificant, see materiality in [PS 122.47−122.49]).

[PS 122.61] The trailing commissions paid to a dealer following an ''execution only'' service (ie when a client's order has been executed without any advice) does not have to be disclosed under s849. This is because no securities recommendation is made.

[PS 122.62] 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 (see [PS 122.38–122.39] for details of common law obligations).

Commission rebate arrangements

[PS 122.63] 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 s849 as well as a breach of the prohibition against misleading and deceptive conduct (s995).

Soft dollar arrangements

[PS 122.64] 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 data bases, advertising rebates and subsidies or training facilities from a fund manager or a securities issuer. All these benefits and advantages must be disclosed under s849 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

[PS 122.65] 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.

[PS 122.66] 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.

[PS 122.67] 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 s849. 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

[PS 122.68] 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 s849.

Who is an ''associate''?

[PS 122.69] Benefits, advantages and other interests of a securities adviser making recommendations, or any *associate* of that adviser, must be disclosed (s849).

[PS 122.70] The definition of the term ''associate'' in Div 2 of Pt 1.2 of the Law applies when determining who is an associate. This is subject only to the specific variations in s849(4)(a) and s849(6). Some of the more obvious associates whose benefits, advantages and interests must be disclosed under s849 include:

(a) if the securities adviser is a body corporate:

  (i) any directors and secretaries of the securities adviser;

  (ii) any related body corporate of the adviser;

  (iii) the directors and secretaries of a related body corporate (s11);

(b) the securities adviser's partners in a firm carrying on a securities business (s13(a));

(c) 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 (s13(c));

(d) when a securities adviser acts as a representative of another person when making a recommendation, that other person (s849(4));

(e) any other person who acts jointly, or otherwise acts together, or under an arrangement, with a securities adviser in relation to making securities recommendations.

[PS 122.71] Employees of a securities adviser, or members of their family, are associates if they fall within one of the general paragraphs in Div 2 of Pt 1.2 (as varied by s848 and s849). In practice, this may often be the case.

What is excluded from the disclosure obligation in s849?

[PS 122.72] A securities adviser does not have to disclose the following benefits under s849:

(a) a commission or fee that the securities adviser receives directly from the client (s849(3)); or

(b) 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 (s849(4)(b)).

[PS 122.73] The underlying reasons for these exclusions appears to be that if a client makes a direct payment of commissions or fees to the securities adviser making the recommendation (or their principal licensee), the client is fully aware of that payment. This excludes the need for any further disclosure. ASIC has taken into account this underlying objective when developing the following guidelines on the extent of the exclusions.

[PS 122.74] ASIC considers that the exclusions in [PS 122.72] do not apply if a licensee pays a share of commission or fee it receives to the representative (including commission split arrangements, see [PS 122.57−122.58]). 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.

[PS 122.75] 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).

[PS 122.76] Disclosing interests in the register of interests which a securities adviser must keep under s881 is a separate legal obligation and is not a substitute for the disclosure obligation under s849. Disclosing the method of payment in an ASG is also not a substitute for the disclosure obligation under s849.

How much detail must be disclosed under s849?

[PS 122.77] 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 s849 obligation:

(a) commissions might be paid by fund managers from time to time;

(b) commissions range from, for example, 0−6%, depending on the amounts invested; or

(c) the adviser may or will receive a benefit in connection with a dealing by a client.

[PS 122.78] 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.

[PS 122.79] For example, 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 s849 and will also amount to a failure to conduct business efficiently and fairly under the licence:

(a) giving a complex formula or process for calculating commissions or fees to a less sophisticated client; or

(b) overwhelming a client with unnecessary detail which detracts from the key information.

What is the appropriate method of disclosure under s849?

Method of disclosure when making oral recommendations

[PS 122.80] 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 (s849(2)(a)) (see Part V [PS 122.120−122.131] below for record keeping requirements).

[PS 122.81] A securities adviser may make an oral securities recommendation to a client to whom they have already disclosed material benefits, advantages and interests in accordance with s849(2)(a) or s849(b). ASIC considers that they do not need to repeat their disclosure if the following requirements are met:

(a) the previous disclosure remains up to date, comprehensive and accurate (ie there are no changes or additions to the material benefits, advantages and interests disclosed previously); and

(b) 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:

  (i) whether or not there is a long lapse of time between the first disclosure and the current recommendation; and

  (ii) whether the client is reasonably likely to draw an inference that the previous disclosure no longer applies to the current recommendation.

[PS 122.82] 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 the disclosure obligation under s849(2).

Method of disclosure when making written recommendations

[PS 122.83] 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 (s849(2)(b)). Generally, any disclosure of method of remuneration in an ASG will not be a substitute for s849 disclosure. This is because of the detailed nature of information required under s849.

[PS 122.84] 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 under s849(2)(b).

[PS 122.85] ASIC's interpretation of s849(2)(b) 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 s849(2)(b). This is because disclosing this information in written recommendations is very specific and s849 requires the relevant disclosure to be ''set out'' in the same writing in which the recommendation is made.

[PS 122.86] In contrast, the disclosure requirement when an oral recommendation is made is to ''disclose'' to the client, which means to reveal something not previously known to the client. As a result, when the previous disclosure (whether made in writing or orally) remains up to date, comprehensive, accurate and within the knowledge of the client the disclosure does not have to be repeated for oral recommendations.

[PS 122.87] However, ASIC considers that s849(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:

(a) the previous disclosure was given to the client in writing;

(b) the previous disclosure remains up to date, comprehensive and accurate; and

(c) the incorporating document, ie 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.

[PS 122.88] ASIC considers that incorporating the previous disclosure by reference, satisfies the objectives of s849(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.

[PS 122.89] The above approach gives flexibility and cost efficiency for securities advisers complying with their legal obligation in s849 without reducing the level of investor protection intended by s849 disclosure.

What are the defences to a breach of s849?

General defences

[PS 122.90] Section 850(1) provides a defence to a securities adviser for a breach of s849. 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.

[PS 122.91] There is no positive obligation under s849 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 s850(1) not being available.

[PS 122.92] 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.

Chinese walls

[PS 122.93] 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 (known as Chinese wall arrangements) which the licensee had in place throughout the relevant period to ensure that:

(a) the securities representative who made the decision to make the recommendation knew nothing about the benefit, advantage or interest during the relevant period; and

(b) 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.

[PS 122.94] Chinese walls are internal rules and procedures developed by an organisation to prevent certain information that one part of the organisation possesses (eg corporate advisory areas providing advice on takeovers) from being communicated to another part of the firm (eg broking areas advising clients about buying shares).

[PS 122.95] 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.

Onus of proof

[PS 122.96] Anyone who wants to rely on any of the defences listed in the preceding paragraphs bears the burden of proving, on the balance of probabilities, the various elements of the relevant defence.

Part IV: "Know-your-client" obligation under s851

[PS 122.97] The scope of the ''know-your-client'' obligation under s851 and how ASIC will interpret the key elements of this obligation are set out in answers to the following questions:

- What is the purpose and scope of the ''know-your-client'' obligation?
- What inquiries should an adviser make about the client's investment objectives, financial situation and particular needs?
- What should an adviser do when a client refuses to give full personal information?
- What is adequate product research?
- How should an adviser comply with the s851 obligation when providing limited recommendations?
- What defences are available to a securities adviser when a breach of s851 is claimed?

What is the purpose and scope of the "know-your-client" obligation?

[PS 122.98] The purpose of the know-your-client obligation 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.

[PS 122.99] A securities adviser must have a reasonable basis for making a securities recommendation to a client. To do this, the adviser must:

(a) have regard to the information the securities adviser has about the client's investment objectives, financial situation and particular needs;

(b) conduct reasonable investigations about the securities recommended; and

(c) prepare their recommendation in light of the previous two considerations.

[PS 122.100] 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?

[PS 122.101] The obligation under s851 is to have regard to the information the securities adviser has about a client's investment objectives, financial situation and particular needs (''client's needs and circumstances''). 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:

(a) have in their possession adequate information about the client's individual needs and circumstances; or

(b) make reasonable inquiries to obtain that information from the client.

[PS 122.102] 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 s851 obligation and the general law obligations of the securities adviser as a fiduciary.

[PS 122.103] 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.

[PS 122.104] ASIC considers that the following information would generally be needed when making a full needs analysis of a retail client (see Policy Statement 121 for the definition of a retail client):

(a) the client's needs and objectives for income, capital growth, security, retirement income, liquidity, and the time period the client is planning for;

(b) 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);

(c) the client's individual investment preferences and aversion or tolerance to risk; and

(d) any other relevant client information such as employment security, family commitments and expected retirement age.

Previously obtained information

[PS 122.105] 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 s851 obligation.

What should an adviser do when a client refuses to give full personal information?

[PS 122.106] 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. A client may be reluctant to give personal information to a securities adviser for a variety of reasons. These include the clients' need for privacy or a fear that the information may be put to unintended uses (eg to pressure the client to make unwanted investments). There is a risk that some retail clients may refuse to give personal information without fully appreciating the risk that any personal recommendation made without full information may not be appropriate to their particular needs and circumstances.

[PS 122.107] Therefore, it is important that securities advisers take reasonable steps to make retail 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. (See Part V of Policy Statement 121 for details of the warnings requirement.)

What is adequate product research?

[PS 122.108] 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:

(a) adequate personal information about the client as described in the previous paragraphs; and

(b) adequate product knowledge gained through reasonable investigations of the securities recommended.

[PS 122.109] When deciding if a securities adviser has satisfied the s851 obligation to conduct adequate product research, some of the matters which ASIC will take into account include:

(a) *Products 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.

(b) *Factors concerning securities that should be considered*

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.

(c) *Comparable investments*

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.

Use of external research

[PS 122.110] A securities adviser may either conduct their own research or use external product research. A securities adviser is primarily accountable under s851. 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.

[PS 122.111] 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 s851 obligation when providing limited recommendations?

[PS 122.112] A securities adviser may make limited personal securities recommendations for two reasons:

(a) when dealing with a limited range of products (eg a single product provider, see [PS 122.22−122.24]); or

(b) when providing recommendations for a limited purpose.

Advice on a limited range of products

[PS 122.113] The Conduct of Business Rules continue to apply to a securities adviser who makes personal securities recommendations on a limited range of products. Therefore, the adviser must take appropriate steps to ensure that a full needs analysis and adequate product research are conducted along the guidelines set out in this Part.

[PS 122.114] 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.

Advice for a limited purpose

[PS 122.115] 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 s851 obligation varies depending on the limited purpose for which the client seeks the recommendation.

[PS 122.116] 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.

What defences are available to a securities adviser when a breach of s851 is claimed?

[PS 122.117] A securities adviser who does not comply with the s851 obligation is liable to compensate clients who act or omit to do an act, by

relying on a recommendation. When a 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 s851 (s817).

[PS 122.118] A securities adviser has a defence against an alleged breach of s851 (under s852(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.

[PS 122.119] 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 s851.

Part V: Record keeping standards

[PS 122.120] 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.

[PS 122.121] This Part sets out ASIC guidelines and best practice standards on record keeping relating to the Conduct of Business Rules under the following headings:

- Records of oral recommendations made and disclosure of material benefits, advantages and interests;
- Records of client profiles and product research; and
- Records of warnings when full personal information is not given by a retail client.

[PS 122.122] Record keeping requirements and standards for execution related telephone advice provided by dealers are set out in Part VI, see [PS 122.132−122.146].

Records of oral recommendations and disclosure of material benefits, advantages and interests

[PS 122.123] Section 849 specifically sets out how to disclose material benefits, advantages and interests when making oral and written securities recommendations (see [PS 122.80−122.89]). When oral recommendations are made, there is no legal requirement that the recommendation or oral disclosure be recorded or confirmed in writing.

[PS 122.124] However, ASIC considers that as a matter of best practice it is highly desirable that securities advisers who make personal securities recommendations:

(a) 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;

(b) confirm to the client in writing the oral recommendations and disclosure unless:

(i) the client has expressly waived the need for confirmation (see [PS 122.125]); or

(ii) the disclosure has already been given in writing.

Client's right to waive written confirmation

[PS 122.125] 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.

Records of client profiles and product research, s851

[PS 122.126] 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 (see [PS 122.108−122.111] for what is adequate product research).

[PS 122.127] However, according to ASIC's interpretation of the Law, a securities adviser cannot satisfy the s851 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 s851 obligation.

[PS 122.128] 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.

[PS 122.129] 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.

[PS 122.130] Such records may be kept electronically or in hard copy and must be accessible to ASIC and the client on request.

Records of warnings

[PS 122.131] When a retail client does not give full personal information, that client must be given certain warnings (see Part V of Policy Statement 121 [PS 121.85–121.96]). Although these warnings can be given orally when oral personal securities recommendations are given (see Policy Statement 121 [PS 121.80–121.83]), ASIC considers that as a matter of best practice, records of such warnings should be kept in the client's file.

Part VI: Execution related telephone advice by dealers

[PS 122.132] 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.

[PS 122.133] 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:

(a) the recommendation, investment decisions and trade execution generally occur within a very short period, making them an integrated transaction; and

(b) the type of investors who seek this kind of service generally have expectations that match the type of service being offered.

[PS 122.134] 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 (eg providing portfolio management services and issuing circulars and investment newsletters) are regulated in the same manner as any other investment advisory services.

[PS 122.135] ASIC's guidelines on how the Conduct of Business Rules apply to execution related telephone advice are set out under the following headings:

- Scope of execution related telephone advice
- Applying the s849 obligation
- Applying the s851 obligation
- Applying the retail investor protection requirements
- Applying record keeping requirements and standards.

Scope of execution related telephone advice

[PS 122.136] 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:

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

(b) 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 (Policy Statement 65 and Policy Statement 72); and

(c) no discrete fee for the related telephone advice is charged (ie no fee is charged in excess of the commission for the execution service).

[PS 122.137] 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.

Applying the s849 obligation

[PS 122.138] The obligation to disclose material benefits, advantages and interests under s849 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 (see [PS 122.80−122.89]).

[PS 122.139] The dealer must also satisfy the product knowledge aspect of the s851 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.

Applying the s851 obligation

[PS 122.140] Section 851 also applies to execution related telephone advice. However, 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.

Applying the retail investor protection requirements

[PS 122.141] The following ASIC retail investor protection requirements apply when execution related telephone advice is provided to a retail client (see the definition of a retail client in Policy Statement 21 [PS 121.17]). When such advice is provided to institutional clients of the kind excluded from the definition of retail investor (eg banks and life companies), the following requirements do not apply.

Advisory Services Guide

[PS 122.142] A dealer must give their client an Advisory Services Guide within three days after the trading following the advice.

Warnings where a retail client refuses to provide full personal information

[PS 122.143] 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 (see Policy Statement 121 [PS 121.95]) 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.

Applying record keeping requirements and standards

Record keeping best practice standards, s849 obligation

[PS 122.144] 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.

[PS 122.145] 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:

(a) 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;

(b) membership standards of the ASX, if applicable; and

(c) the individual needs and nature of the dealer's business.

Record keeping requirements, s851 obligation

[PS 122.146] 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 s851 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 (eg their training).

Part VII: Proposed exclusion for sophisticated investors

Why draw a distinction between retail and sophisticated investors?

[PS 122.147] The licensing provisions in the current Law apply regardless of the type of investor receiving investment advisory services. ASIC considers, as a matter of policy, it is appropriate to draw a distinction between retail investors and sophisticated investors when applying some of the licensing provisions of the Law. This is because sophisticated investors who have the necessary levels of resources, expertise and experience are better able to choose and monitor the quality of advisory services than retail investors. They therefore need a lower level of regulatory protection. The fundraising and takeovers provisions in the Law draw a similar distinction between different types of investors.

[PS 122.148] Sophisticated investors have different and more complex advisory service needs than retail investors. For example, sophisticated investors such as banks and life companies are subject to stringent prudential guidelines and these may have a direct bearing on the type of investment management and advisory services they obtain. Therefore, the terms of contracts and arrangements between sophisticated investors and their service providers are better left to individual negotiation rather than being prescribed in the Law. The greater flexibility for negotiation will also result in cost savings to the parties involved.

[PS 122.149] Drawing such a distinction also means that ASIC can focus its regulatory attention on retail advisory services where a higher level of regulatory intervention is needed. Retail investors' need for a higher level of regulatory protection is evident from ASIC's market survey and from the consultative process ASIC undertook to develop the *Good Advice*[1] proposals.

What are the measures proposed by ASIC to implement a sophisticated investor exclusion?

[PS 122.150] ASIC proposes the following measures to draw a regulatory distinction between sophisticated and retail investors:

(a) seek Law reform to obtain an exemption and modification power; and

1 Australian Securities Commission (1996) *Good Advice.* ASIC, Sydney

(b) develop appropriate policies on when advisers can give investment advice to sophisticated investors without complying with the licensing provisions.

Proposed exemption and modification power

[PS 122.151] ASIC has sought Law reform to obtain an exemption and modification power. If ASIC is given this power, it will be able to provide greater flexibility in relation to advisory services provided to sophisticated investors. It will also be able to apply the licensing provisions in a more flexible manner taking into account the regulatory needs and varied circumstances in which investment advisory services are provided. Such flexibility is particularly significant because advisory services and markets are constantly evolving.

[PS 122.152] ASIC is unsure if and when this Law reform measure will be implemented. However, it is hopeful that the necessary Law reform will be made.

ASIC policy

Licensing

[PS 122.153] ASIC proposes that persons who provide investment advisory services to sophisticated investors should continue to be licensed. This will ensure that all advisers operate with appropriate levels of competency, efficiency, integrity and probity. This approach acknowledges the difficulty even sophisticated and well resourced investors may have in accessing the type of information which a regulator has the power to obtain and minimises unnecessary costs to the industry if each sophisticated investor was required to ascertain this information independently (ie economies of scale).

Conduct of Business Rules

[PS 122.154] ASIC does not consider that the Conduct of Business Rules (ie the disclosure of conflicts of interest and know-your-client obligations in s849 and s851) should apply to sophisticated investors. However, the common law fiduciary obligations of licensees and the misleading or deceptive conduct provisions in the Law still apply when advisers provide investment advisory services to sophisticated clients.

[PS 122.155] Technically, ASIC is not able to give any exemptions from the Conduct of Business Rules in the absence of a formal exemption and modification power. Therefore a securities adviser must comply with the Conduct of Business Rules when they make personal securities recommendations to a person, who is reasonably likely to rely on them. They must comply with the Rules regardless of whether the person is a retail investor or a sophisticated investor. However, in the absence of any specific complaints from investors, ASIC will focus its surveillance

activities on the Conduct of Business Rules on persons providing investment advisory services to retail investors.