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# Chapter 4. Conduct and Disclosure in the Investment Advisory Process

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## Introduction

**[4.10]** Australian Financial Services Licensees (AFSLs) and their authorised representatives must act with integrity and there must be adequate disclosure in regard to financial services and products to enable informed choices by investors. These principles are embodied in the “Conduct of Business” rules, that is to “know your client, know your product” rule and the “disclosure rule”. These rules are contained in Pt 7.7 – Financial Services Disclosure, Part 7.7A – Best Interest Calculations and Remuneration, and Pt 7.9 – Financial Product Disclosure – of the *Corporations Act 2001* (Cth) Chapter 7.

The ASIC Regulatory Guide RG 175 *Licensing: Financial Product Advisers – Conduct and Disclosure* and RG 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)* set out the conduct and disclosure requirements for the provision of financial product advice to retail clients.

In RG 175.33, ASIC (Australian Securities and Investments Commission) indicates that it will “pay particular attention to whether consumers are being provided with clear, concise and effective disclosure that satisfies their information needs and whether they are being provided

with personal advice that is appropriate”.

## Key points

[4.20] This chapter will provide a greater understanding of:

- the “rules” that apply to the investment industry in order to ensure diligence on behalf of advisers;
- the specific disclosures required to be made on the part of advisers to ensure open communication with investors;
- the format and manner in which the mandatory disclosures are to be made available to investors;
- the recourse available to investors in the event of misstatement or misinformation provided by advisers; and
- protection given to retail clients by disclosure requirements.

## Key terms

[4.30] These terms are of critical importance to an understanding of conduct and disclosure:

- Conduct of Business Rules
- Financial Services Guide (FSG)
- Product Disclosure Statement (PDS)
- Statement of Advice (SoA)
- Appropriate Advice
- Know your client
- Know your product
- Conflict of interest
- Administrative action

## Conduct of Business Rules: Corporations Act 2001, Part 7.7

**[4.40]** The conduct and disclosure obligations imposed on providing entities and on persons providing a financial service (and particularly financial product advice) provider represent the most significant obligations placed on investment advisers and go to the heart of Chapter 7 of the *Corporations Act 2001* (Cth). These laws changed recently. As the new provisions now mandatorily apply from 1 July 2013, this chapter will discuss the law current as at 1 July 2013.

Both financial service providers as well as the actual individual advisers are required to comply with conduct and disclosure obligations when providing financial product advice to retail clients.

These principles are the cornerstone of the investment advice process and support the general obligations placed upon licensees in parts of s 912A(1), including that advisers:

- (a) do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly; and
- (b) have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative; and
- ...
- (e) maintain the competence to provide those financial services; and
- (f) ensure that its representatives are adequately trained, and are competent, to provide those financial services ...

### Part 7.7A: Conduct Obligations for personal advice to retail clients

#### Definition of Advice Provider

**[4.60]** A 'provider' is an individual who provides personal advice to a retail client: s 961(1) & (2). If two or more individuals provide the advice, each is a 'provider': s 961(3). It is irrelevant whether the individual is a representative of a licensee: s 961(4). The person is a provider even if the advice is provided by means of a computer program: s 961(6). If it is not possible to identify the individual or individuals providing the advice, the person (or entity) who provides the advice will be considered to be the 'provider': s 961(5).

## Advice Providers must act in Retail Client's Best Interests: s961B

**[4.80]** When giving personal advice to retail clients, each 'provider' must act in the best interests of the client: s 961B(1). Under s 961B(2), which provides a 'safe harbour' under which advisers can operate, this duty will be satisfied where the provider has:

- '(a) identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions;
- (b) identified:
  - (i) the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and
  - (ii) the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (the client's relevant circumstances);
- (c) where it was reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate, made reasonable inquiries to obtain complete and accurate information;
- (d) assessed whether the provider has the expertise required to provide the client advice on the subject matter sought and, if not, declined to provide the advice;
- (e) if, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product:
  - (i) conducted a reasonable investigation into the financial products that might achieve those of the objectives and meet those of the needs of the client that would reasonably be considered as relevant to advice on that subject matter; and
  - (ii) assessed the information gathered in the investigation;
- (f) based all judgements in advising the client on the client's relevant circumstances;
- (g) taken any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.'

A note to that subsection makes it clear that these matters "relate to the subject matter of the advice ... and the circumstances of the client relevant to that subject matter (the client's relevant circumstances). That subject matter and the client's relevant circumstances may be broad or narrow, and so... a client may seek scaled advice and that the inquiries made by the provider will be tailored to the advice sought."

The section also prescribes the steps necessary for personal advice to retail clients on basic banking products and on general insurance products.

ASIC notes in RG175.257-260, that the 'instructions' may be contained in a series of communications, may result from clarifications sought by the advisor, and may require the adviser to exercise judgment to determine the subject matter of the advice sought. In some cases (for example client sensitivity to the cost of advice), the adviser and the client may work together to narrow or clarify the scope of the advice sought: RG 175.271-280.

Section 961B(2)(c) refers to 'where it was reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate'. According to section 961C, this means: "if it would be apparent to a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, were that person exercising care and objectively assessing the information given to the provider by the client".

Section 961B(2)(e)(i) refers to conducting a 'reasonable investigation into the financial products that might achieve those of the objectives and meet those of the needs of the client that would reasonably be considered relevant to advice on the subject matters sought by the client'. Section

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961D clarifies that this does not require an investigation into every financial product available, but must include an investigation into any financial product specified by the client.

Section 961E states that “It would reasonably be regarded as in the best interests of the client to take a step, if a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, exercising care and objectively assessing the client's relevant circumstances, would regard it as in the best interests of the client, given the client's relevant circumstances, to take that step.”

In RG175-229-231, ASIC explains:

“When assessing whether an advice provider has complied with the best interests duty, we will consider whether a reasonable advice provider would believe that the client is likely to be in a better position if the client follows the advice.

This depends on the circumstances and includes the following factors:

- (a) the position the client would have been in if they did not follow the advice, which is to be assessed at the time the advice is provided;
- (b) the facts at the time the advice is provided that the advice provider had, or should have had, if they followed their obligations. In particular, we will not examine investment performance retrospectively, with the benefit of hindsight ...;
- (c) the subject matter of the advice sought by the client;
- (d) the client's objectives, financial situation and needs. Many clients seek advice with the objective of improving their financial position. However, a client's objectives, financial situation and needs may also encompass other things, such as:
  - (i) improving a client's understanding of their financial position;
  - (ii) aligning their financial position with their appetite for risk;
  - (iii) reassuring them that they do not need to change their strategy or product holdings as a result of a review; or
  - (iv) increasing their confidence to spend or donate their money...;
- (e) where relevant, product features that the client particularly values, provided that the client understands the cost of, and is prepared to pay for, those features. For example, a client may particularly value online access to information about their investment holdings as well as understanding and being prepared to pay for the cost of this feature ...; and
- (f) that the client receives a benefit that is more than trivial....

We do not expect an advice provider to give ‘perfect advice’ to establish that the client is likely to be in a better position if the client follows the advice.”

ASIC further explains, in RG 175.238:

“We expect that processes for complying with the best interests duty will ensure that, within the subject matter of the advice sought by the client:

- (a) the scope of the advice includes all the issues that must be considered for the advice to meet the client's objectives, financial situation and needs (including the client's tolerance for risk);
- (b) if the scope of the advice changes, the change is consistent with the client's objectives, financial situation and needs;
- (c) the client's objectives, financial situation and needs are identified through inquiries or otherwise; and
- (d) the advice provider focuses on providing advice that is not product specific, or on a combination of advice that is both product specific and non-product specific, where this would better suit the client's objectives, financial situation and needs. Advice that is not product specific may include advice to do nothing.”

In RG 175.291-293, ASIC explains that for advice on financial products with an investment component, ASIC considers that:

“we consider that—depending on the subject matter of advice sought by the client—the client's relevant circumstances may include the client's:

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- (a) need for regular income (e.g. retirement income);
- (b) need for capital growth;
- (c) desire to minimise fees and costs;
- (d) tolerance for the risk of capital loss, especially where this is a significant possibility if the advice is followed;
- (e) tolerance for the risk that the advice (if followed) will not produce the expected benefits. For example, in the context of retirement advice, this may include considering longevity risk, market risk and inflation risk;
- (f) existing investment portfolio;
- (g) existing debts;
- (h) investment horizon;
- (i) need to be able to readily 'cash in' the investment;
- (j) capacity to service any loan used to acquire a financial product, including the client's ability to respond to any margin call or make good any losses sustained while investing in leveraged products; and
- (k) tax position, social security entitlements, family commitments, employment security and expected retirement age.

... This is not an exhaustive list.... The client's relevant circumstances include any other matter that would reasonably be considered relevant to the advice, based on the advice provider's obligations in s961B. This would normally encompass any matter that the client indicates is important.

Advice providers must form their own view about how far s961B requires inquiries to be made into the client's attitude to environmental, social or ethical considerations. Advice providers may need to ascertain whether environmental, social or ethical considerations are important to the client and, if they are, conduct inquiries about them."

To rely on the safe harbour, advice providers must assess whether they have sufficient expertise to provide advice on the matter. If not, they must not provide the advice: s 961B(2)(d). In making this assessment, ASIC states in RG175.301 that advice providers must consider:

- “(a) for individual advice providers, any specific requirements for, or limitations on, providing advice that are imposed on them by their AFS licensee or authorised representative and the basis for these requirements or limitations;
- (b) for individual advice providers, their professional qualifications and training. This includes the extent to which their qualifications and training cover determining the strategy the advice is based on;
- (c) for individual advice providers, their knowledge and skills in relation to the strategy and financial product(s) they are advising the client on (as relevant). This includes understanding the features of any financial products they recommend to clients; and
- (d) the AFS licence authorisations of their licensee, or of the advice provider if the advice provider is the licensee. The AFS licence authorisations are relevant because AFS licensees have an obligation to:
  - (i) ensure that they are competent to provide the financial services they are authorised to provide;
  - (ii) maintain the competence to provide those financial services; and
  - (iii) ensure that their representatives are adequately trained, and are competent, to provide those financial services: s912A(1).

To rely on the safe harbour, ASIC also states at RG 175.335 that advice providers:

“must base all judgements they make in advising the client on the client's relevant circumstances: s961B(2)(f). This includes the judgements that the advice provider makes about:

- (a) the scope of the advice;
- (b) the extent of the inquiries they make into the client's relevant circumstances;
- (c) the strategies, and types of financial product and specific financial products they investigate;
- (d) the strategies, types of financial product and specific financial products the advice provider makes recommendations about; and
- (e) how the client should acquire financial products, where relevant – for example, whether the client should acquire the products directly or through a platform”.

On pages 63-67 of RG175, ASIC gives the following examples of compliance with the s961B duty:

**Example 1: No 'retrospective testing'**

**Scenario**

An advice provider gives advice recommending that a client invest in an Australian equities fund. This advice is appropriate for the client. The client invests in the fund and loses money because of a fall in unit prices for the fund caused by a downturn in the performance of equity markets.

**Commentary**

Losses caused by a downturn in financial markets are irrelevant in considering whether the best interests duty has been complied with. The best interests duty is concerned with what occurred at the time the advice was provided—not the performance of the client's investment.

**Example 2: A 'health check' on a client's financial affairs**

**Scenario**

A client seeks personal advice to get a 'health check' on the state of their financial affairs in light of their long-term financial goals.

The advice provider reviews the client's financial situation and provides them with advice that they are on track to meet these goals. The advice provider does not recommend that the client acquire or dispose of any financial products, and the client does not do so.

**Commentary**

In this situation, a reasonable advice provider would believe that the client is likely to be in a better position if the client follows the advice (i.e. by taking the advice into account). This is because the client has received reassurance that they are on track to meet their goals, is better informed and is less likely to make a change that would be adverse to their interests.

The advice provider has complied with the best interests duty.

**Example 3: Advice to a client on providing for a relative**

**Scenario**

A client seeks and obtains personal advice from an advice provider on how to restructure their financial arrangements so that they can pay for the medical expenses of a sick relative.

**Commentary**

This advice does not involve any ongoing improvement in the client's financial situation. However, a reasonable advice provider would believe that the client is likely to be in a better position if the client follows the advice. This is because following the advice would result in meeting the client's objective to pay for their relative's medical expenses.

The advice provider has complied with the best interests duty.



**Example 4: Advice that the client's expectations are unrealistic**

**Scenario**

A 60-year-old asks an advice provider for advice on whether they will have enough money to retire at age 65. They give the advice provider details on the lifestyle they expect to have in retirement.

Based on the client's finances and their expected lifestyle in retirement, the advice provider tells the client that they will not have enough money to provide the income they expect for their planned retirement at age 65. The advice provider gives the client advice that is not product specific on:

- the advantages and disadvantages of different options for saving for and living in retirement, such as working for longer, increasing superannuation contributions, downsizing to a smaller property or travelling less after retirement; and
- how much superannuation income the client can afford in retirement, given the size of their superannuation balance.

**Commentary**

In this situation, a reasonable advice provider would believe that the client is likely to be in a better position if the client follows the advice. This is despite the fact that the advice provider has advised the client that their financial circumstances will not allow them to achieve their goals or meet their needs. Instead, the advice provider has advised the client on how to change their goals and needs in retirement so that these are more realistic.

The advice provider has complied with the best interests duty.

**Example 5: Advice that is likely to leave the client in a better position**

**Scenario**

A client holds a portfolio of products through a platform. They have told their advice provider that they find the consolidated reporting generated by the platform difficult to understand and they want to be able to understand these reports. They would be prepared to pay more for better quality reporting if they feel the increase in fees is commensurate with the value they place on receiving better quality reporting.

The advice provider recommends that the client switch to another platform because the format of its consolidated reports on the client's holdings will be easier for the client to follow. Compared with the fees the client is currently paying, the fees for this other platform are higher by 0.1% of the value of the client's assets administered by the platform.

The client views a sample consolidated report from the other platform, says that they find this format of reporting easier to understand and indicates that they are prepared to pay the higher fees for this better quality reporting.

**Commentary**

In this scenario, we would consider that a reasonable advice provider would believe that the client is likely to be in a better position if the client follows the advice.

The advice provider has complied with the best interests duty.

**Example 6: Advice that is unlikely to leave the client in a better position**

**Scenario**

A client holds a portfolio of products through a platform. They have told their advice provider that they believe their current platform is providing an acceptable service and they can understand the reporting provided but they are concerned about the fees they are paying for using the platform.

The advice provider discusses the reports with the client and believes that the client understands them, even though they are presented in a complex manner.

The advice provider recommends that the client switch to another platform because the format of its consolidated reports on the client's holdings will be easier for the client to follow. Compared with the fees the client is currently paying, the fees for this other platform are higher by 0.1% of the value of the client's assets administered by the platform.

**Commentary**

In this scenario, we would not consider that a reasonable advice provider would believe that the client is likely to be in a better position if the client follows the advice. This is because the client was concerned about costs but was switched to a platform with higher costs.

The advice provider has not complied with the best interests duty.

**Example 7: Providing advice that is not product specific**

**Scenario**

A client who is 33 years old approaches an advice provider for advice on wealth accumulation strategies. The client has recently received a promotion and has considerable surplus income. On assessment, the advice provider establishes that, because of the high level of income the client receives, they have limited ability to add more funds to superannuation through 'salary sacrifice' concessional contributions. The client's mortgage is significant, but manageable, given their current income and personal circumstances.

The advice provider provides recommendations to salary sacrifice up to the maximum limit for concessional contributions, and to use the surplus funds to repay the mortgage.

**Commentary**

The subject matter of advice sought by the client is wealth accumulation strategies. The advice provider has complied with the best interests duty because they have provided the client with advice that is not product specific and is consistent with the subject matter of the advice sought by the client.

ASIC does not consider this duty to be inconsistent with, or require, the use of approved product lists that have been specified by licensees for use by their advice providers (RG175.328). ASIC notes at RG175.329-332:

“In some cases, an advice provider can conduct a reasonable investigation into financial products under s961B(2)(e) by investigating the products on their AFS licensee's approved product list. In other cases, an advice provider will need to investigate and consider a product that is not on their AFS licensee's approved

product list to show that they have acted in the best interests of the client when providing them with personal advice - for example:

- (a) if the client's existing products are not on the approved product list of the advice provider's licensee and these products might be able to meet the client's relevant circumstances;
- (b) if an approved product list used by an advice provider is restricted to one class of product and there are products that are not in that class that would better meet the client's relevant circumstances, considering the subject matter of the advice sought by the client; or
- (c) if the client requests the advice provider to consider a specified financial product that is not on the approved product list of the advice provider's licensee.

Advice providers are expected to exercise judgement in determining whether s961B(2)(e) requires them to consider products that are not on their AFS licensee's approved product list. If an advice provider recommends a product that is not on their AFS licensee's approved product list, they must ensure that they have the appropriate authorisations and approvals from their licensee to provide the advice. Their AFS licensee must ensure that the advice is provided in a way that complies with the relevant legal and regulatory requirements (e.g. the requirement for AFS licensees to have adequate professional indemnity insurance)."

## **Advice Providers must only give 'appropriate advice' to Retail Clients**

**[4.100]** Financial product advice that is personal advice must only be provided to a retail client if it would be reasonable to conclude that the advice is appropriate to the client, had the provider satisfied the duty under s 961B to act in the client's best interests: section 961G.

Note that this obligation does not apply to the giving of general advice.

ASIC considers that advice is appropriate if, at the time, following the advice would likely satisfy the client's relevant circumstances, and the client is likely to be in a better position if they followed the advice (RG 175.346).

If the giving of the advice requires consideration of tax considerations, the adviser refer the tax questions to a person with appropriate expertise, such as a registered tax agent: RG 175.361.

## **Advice Providers must warn Retail Clients of incomplete or inaccurate information**

**[4.110]** Pursuant to section 961H(1), if it is reasonably apparent that information relating to the objectives, financial situation and needs of the retail client is based is incomplete or inaccurate, the provider must warn the retail client that the advice is, or may be, based on incomplete or inaccurate information relating to the client's relevant personal circumstances, and because of that, the client should consider the appropriateness of the advice, having regard to the client's objectives, financial situation and needs, before acting on the advice.

This warning must be given at the same time as the advice and by the same means: s 961H(2). If a Statement of Advice is given, the Statement of Advice must this warning (947B(2)(f) and 947C(2)(g)) and can in fact include it (s 961H(3)). If there are multiple advice providers in relation to a single piece of advice, the warning need only be given by one of them: s 961H(4).

In RG175.377 ASIC notes its expectation that:

“that the more material the conflict of interest between the client and the advice provider or their related party, the more the advice provider will need to do to prioritise the client’s interests.”

## **Advice Providers must prioritise the interests of the client**

**[4.120]** Under section 961J, if the provider knows, or ought to know, that there is a conflict between the interests of the client and the interests of the provider, or the licensee, or an authorised representative who authorised the provision of the service (or an associate of any of these), the provider must give priority to the client’s interests. This does not apply if the subject matter of the advice is solely a basic banking product and the provider is employed by, or acting under the name of the bank or Australian ADI offering that basic banking product product, or if the subject matter of the advice is solely a general insurance product.

At RG175.381, ASIC notes that this rule means:

(a) an advice provider must not recommend a product or service of a related party to create extra revenue for themselves, their AFS licensee or the related party, where additional benefits for the client cannot be demonstrated;

(b) where an advice provider uses an approved product list that only has products issued by a related party on it, the advice provider must not recommend a product on the approved product list, unless a reasonable advice provider would be satisfied that it is in the client’s interests to recommend a related party product rather than another product with similar features and costs;

Note: One way that an advice provider may be able to do this is by benchmarking the product against the market for similar products to establish its competitiveness on key criteria such as performance history, features, fees and risk. The benchmarking must be reasonably representative of the market for similar products that are offered by a variety of different issuers.

(c) an advice provider must not ‘over-service’ the client to generate more remuneration for themselves or one of their related parties. This means that the advice provider must provide a level of service commensurate with the client’s needs. For example, they must not recommend an unduly complex strategy if the client is unlikely to seek ongoing advice; and

(d) an advice provider must recommend non-financial product solutions relevant to the client’s situation, where appropriate, even if this means the client is less likely to need financial advice in the future (e.g. advice on debt reduction, estate planning and/or Centrelink benefits).

## **Licensee obligations & liability**

**[4.130]** Section 961L obliges licensees to take reasonable steps to ensure that the licensee’s representatives comply with sections 961B, 961G, 961H and 961J.

The licensee will breach s 961K, which is a civil penalty provision, if either the licensee, or a representative other than an authorised representative of the licensee, contravenes any of these sections. In these circumstances, the client also has the legal right to pursue the licensee for compensation for the amount of loss or damage suffered by the client as a result of the breach: s 961M.

## Authorised representative obligations & liability

**[4.140]** An authorised representative of a licensee will breach s 961Q, which is also a civil penalty provision, if the authorised representative contravenes any of sections 961B, 961G, 961H and 961J, unless the failure to comply occurred solely because of the authorised representative's reasonable reliance on information or instructions provided by the licensee.

## ASIC's approach

**[4.150]** In RG175.218, ASIC explains the policy principles that will guide its administration of these obligations:

“The following basic policy principles will guide our administration of the best interests duty and related obligations in Div 2 of Pt 7.7A:

- (a) the provisions are intended to enhance trust and confidence in the financial advice industry;
- (b) increased trust and confidence in the financial advice industry should lead to more consumers accessing financial advice;
- (c) the provisions should lead to a higher quality of advice being provided compared to the general standard of advice being provided under s945A and 945B;
- (d) a reasonable advice provider should believe that the client is likely to be in a better position if the client follows the advice ...; and
- (e) the best interests duty in s961B, the appropriate advice requirement in s961G and the conflicts priority rule in s961J are separate obligations that operate alongside each other and apply every time personal advice is provided.”

Furthermore, in RG175.222-223, ASIC explains that:

“We consider that any process of giving good quality financial advice has some or all of the following features:

- (a) a clearly defined scope that is appropriate to the subject matter of advice sought by the client and the client's relevant circumstances;
- (b) an investigation of the client's relevant circumstances;
- (c) assistance given by the advice provider to the client, if required, to set prioritised, specific and measurable goals and objectives;
- (d) where relevant, consideration of potential strategies and options that are available to the client to meet their objectives and needs;
- (e) where relevant, consideration of all aspects of the impact of the advice—for example, tax or social security consequences;
- (f) good communication with the client. This includes:
  - (i) providing an SOA that is logically structured and easy to understand, if one is required; and
  - (ii) if appropriate, depending on how the advice is provided, verbal interactions that aim to ensure that the advice and recommendations are understood; and
- (g) where relevant, strategic and product recommendations that are appropriate for the client's relevant circumstances.

If an advice provider makes a product recommendation, we consider it is good practice to articulate clearly how the strategy of the advice is linked to, or might be achieved by, the recommendation.”

## Secondary Services

**[4.160]** The above obligations will also apply to a person who indirectly provide financial product advice, by means of a secondary service. Such persons will need to take care to ensure that they do not fall within these obligations. ASIC explains the distinction in Appendix 2 of RG 175:

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**Table 9: Examples of secondary services and how to avoid providing them**

Example	Explanation
<p>B1 A stockbroker provides advice to a financial planner for the financial planner's client</p>	<p>A financial planner seeks advice from a stockbroker about what share purchases should be made for a particular retail client. What can the stockbroker do to ensure that they do not provide a secondary service to the retail client?</p> <p>The stockbroker could give advice to the financial planner, taking reasonable steps to prevent it from being passed on to the retail client as the stockbroker's advice. The stockbroker could achieve this by meeting the three requirements listed in RG 175.121. The financial planner could then formulate their own advice, taking into account what the stockbroker has said.</p> <p>Alternatively, if the stockbroker allows the financial planner to pass on the stockbroker's advice to the retail client, the stockbroker would need to meet all the retail client requirements, including arranging for an FSG to be provided by the financial planner to the retail client on their behalf. This would be necessary because, by allowing the financial planner to pass on their advice, the stockbroker is providing a secondary service to the retail client. However, if the advice is not attributed to the stockbroker, the stockbroker will not be providing a secondary service to the retail client and will not be obliged to give their FSG to that retail client.</p>
<p>B2 An underwriting agency recommends insurance products for an insurance broker's client</p>	<p>A general insurance broker discusses particular details of the insurance needs of their retail clients with an underwriting agency. The general insurance broker then asks the underwriting agency what particular products the underwriting agency might recommend for those clients' circumstances.</p> <p>The underwriting agency could avoid providing a secondary service to the retail clients by taking the three reasonable steps listed in RG 175.121. The general insurance broker could then formulate their own advice, taking into account what the underwriting agency has said.</p> <p>Alternatively, if the underwriting agency allows the general insurance broker to pass on the underwriting agency's advice to the retail client, the underwriting agency would need to meet all the retail client requirements, including arranging for an FSG to be provided by the general insurance broker to the retail client on its behalf. This would be necessary because, by allowing the general insurance broker to pass on its advice, the underwriting agency is providing a secondary service to the retail client. However, if the advice is not attributed to the underwriting agency, the underwriting agency will not be providing a secondary service to the retail client and will not be obliged to give its FSG to that retail client.</p>

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Example	Explanation
<p>B3 A research house issues research that includes advice to licensee clients and those clients post the research on their websites</p>	<p>A research house issues a piece of research that includes general financial product advice to its various clients that are AFS licensees (licensee clients). The licensee clients post that research on their websites in a location that can be accessed by their retail clients with an acknowledgement of the source of the research.</p> <p>Unless the research house has taken reasonable steps to prevent its advice being passed on to retail clients (such as the three reasonable steps listed in RG 175.121), it is likely to be providing financial product advice to the retail clients by implicitly causing or authorising the provision of its advice to the retail clients, and would need to meet all of the retail client requirements.</p> <p>If the research house allows the licensee clients to pass on its advice to the retail clients, the research house would need to meet all the retail client requirements, including arranging for an FSG to be provided by the licensee clients to the retail clients on its behalf. This would be necessary because, by allowing the licensee clients to pass on its advice, the research house is providing a secondary service to the retail clients.</p>
<p>B4 A research house posts research that includes its advice on its website</p>	<p>A research house issues a piece of research that includes general financial product advice and posts this on its website, which is accessible by the public. An AFS licensee takes the information from the website and passes that information on to its retail clients as the research house's advice. The research house has no agreement or relationship with the licensee, and does not know the identity of the clients of the licensee.</p> <p>The research house will be providing the AFS licensee with general financial product advice. Although the research house may also be providing general advice to retail clients of the licensee, the research house will not be required to give those clients a copy of its FSG if s940B applies. This is because s940B provides that no breach occurs where there is 'no reasonable opportunity' to provide retail clients with an FSG. This defence is likely to be available in this example because, in the circumstances described, the research house does not know, and has no reasonable way of finding out, the identities or the addresses of the retail clients receiving the information taken and disseminated by the licensee.</p>

### General advice

**[4.170]** The distinction between personal advice and general advice is discussed in Chapter 3. The above obligations only apply to the provision of personal advice to retail clients. There is no specific requirement that general advice be appropriate for the client's needs, and so this distinction becomes important so as to know whether or not the above duties apply in given circumstances.

In Regulatory Guide 175 at pages 99-100, ASIC sets out the following table, distinguishing between general advice and personal advice:

## Conduct and Disclosure in the Investment Advisory Process

**Table 8: Examples of the difference between personal advice and general advice**

Example	Explanation
A1    Mailout to entire client list	<p>A stockbroker prepares periodic newsletters or research reports containing assessments of various financial products and sends them to their entire client list.</p> <p>We would expect that those newsletters or research reports would ordinarily be general advice and not personal advice. We would expect them to contain a general advice warning under s949A.</p> <p>This is because the stockbroker would not ordinarily take into account any individual's relevant circumstances in preparing and providing a periodic newsletter or research report that is sent to all of their clients, and nor would a reasonable person expect them to have done so.</p>
A2    Investment seminar for all clients	<p>A person invites all their clients to an investment seminar.</p> <p>We would expect that they would ordinarily provide general advice and not personal advice at an investment seminar that is open to all of their clients. We would expect them to provide a general advice warning under s949A at such a seminar.</p> <p>This is because the financial product advice the person provides at a seminar that is open to all their clients would not ordinarily take into account any individual's relevant circumstances, and nor would a reasonable person expect it to have done so.</p> <p>However, if the person wants to confine their seminar to providing general advice, they need to consider how the information in the seminar is communicated to the audience and, in particular, ensure that they clearly communicate that they are providing general advice. For example, it is important that the person:</p> <ul style="list-style-type: none"> <li>• does not use language in the presentation that gives the impression that they have considered the objectives, financial situation or needs of any audience members in providing the financial product advice that it contains;</li> <li>• does not respond to audience comments or questions in a way that gives the impression that the financial product advice that they are providing takes into account any audience member's objectives, financial situation or needs; or</li> <li>• does not give personal advice in their response to audience questions.</li> </ul>
A3    Mailout of brochure in response to a client query	<p>A product issuer, in response to client queries, sends out a marketing brochure about a particular product or product range that they offer.</p> <p>We would expect that these brochures would ordinarily contain general advice and not personal advice. We would expect them to contain a general advice warning under s949A.</p> <p>This is because a product issuer would not ordinarily take into account any individual's relevant circumstances in providing a marketing brochure in response to a client query, and nor would a reasonable person expect them to have done so.</p>



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Example	Explanation
A4 Quoting from a PDS in response to a query	<p>A product issuer responds to telephone queries about product features by either quoting from the PDS, or by using their own words to convey the information in the PDS.</p> <p>By quoting from the PDS in response to a telephone query about product features, the product issuer would not ordinarily take into account any individual's relevant circumstances and nor would a reasonable person expect them to have done so. We would expect the product issuer to provide a general advice warning under s949A.</p>
A5 Mailout to particular client groups	<p>A person sends different newsletters, research reports or marketing brochures to different segments of their client base.</p> <p>In general, we think this person is likely to be providing general advice when, in deciding to send a particular newsletter, research report or marketing brochure to a particular segment of their client list, they look at broad client groupings based on:</p> <ul style="list-style-type: none"><li>• the size of a client's portfolio;</li><li>• whether a client currently invests in, or has expressed interest in receiving information about, any of the broad market sectors discussed in the newsletter (e.g. property trusts, the industrials sector);</li><li>• a client's age;</li><li>• whether a client is employed or retired; or</li><li>• whether a client has used the person's services within a particular timeframe.</li></ul>
A6 Marketing campaigns to a market segment	<p>An insurance broker markets a product that is suitable for people who are subject to a particular broad type of risk, and sends standardised marketing material for that product to clients who fall within that broad market segment.</p> <p>This situation falls within Example A5, and, for the same reasons, we think the broker is likely to be giving general advice.</p>
A7 Investment seminars for particular client groups	<p>A person invites a particular segment of their client base to a seminar based on broad groupings, as described in Example A5, and provides a previously prepared presentation focusing on areas that are likely to be of interest to that broad client group.</p> <p>These facts do not necessarily mean that the person has, or might be expected to have, taken into account any client's objectives, financial situation or needs in giving them the financial product advice provided at the seminar.</p> <p>As in Examples A2 and A5, we are likely to take the view that the person is giving general advice.</p>

When general advice is given to a retail client, the adviser has an obligation to warn the client that the advice does not take account of the client's relevant personal circumstances, ie the client's objectives, financial situation or needs: s 949A. In these circumstances, there is no need for a SoA to be given.

The warning required under s 949A when general advice is provided by a financial services licensee or their authorised representative to a retail client is designed to cause the client to consider the appropriateness of the advice.

Section 949A(2) requires the adviser to warn the client that:

- (a) the advice has been prepared without taking account of the client's

objectives, financial situation or needs; and

- (b) because of that, the client should, before acting on the advice, consider the appropriateness of the advice, having regard to the client's objectives, financial situation and needs; and
- (c) if the advice relates to the acquisition, or possible acquisition, of a particular financial product – the client should obtain a Product Disclosure Statement (see Division 2 of Part 7.9) relating to the product and consider the Statement before making any decision about whether to acquire the product.

The warning must be given to the client at the same time and by the same means as the advice is provided (s 949A(3)) and failure to comply with s 949A(2) is an offence: s 1311(1). An authorised representative of a financial services licensee has a defence under s 949A(4) in any proceedings for an offence against s 949A if:

- (a) the licensee had provided the authorised representative with information or instructions about the requirements to be complied with in relation to the giving of personal advice; and
- (b) the representative's failure to comply with subsection (1) occurred because the representative was acting in reliance on that information or those instructions; and
- (c) the representative's reliance on that information or those instructions was reasonable.

The above defence does not apply to civil proceedings.

Section 949A(5) provides that licensees must take reasonable steps to ensure that an authorised representative of the licensee complies with s 949A(2).

## Disclosure

**[4.180]** The CLERP 6 policy proposal paper (1997) p 102 explains the importance of conflict of interest disclosure in a SoA:

The disclosure of benefits received by an intermediary and any conflicts of interest assists clients in assessing the merits of a product recommendation and reduces the opportunity for advisers to act in self-interest to the disadvantage of the client.

Disclosure requirements are designed to promote informed decision-making by both advisers and investors. In the context of financial services disclosure documents, the aim is to enable investors to compare and make informed choices relating to financial products.

Chapter 7 of the *Corporations Act 2001* institutes a regime of disclosure through documentation. A Financial Services Guide (FSG) must be given to a retail client provided with a financial service, while a Statement of Advice (SoA) must be given to a retail client provided with personal advice by a financial services licensee or their authorised representative. The requirements for FSGs and SoAs are contained in Pt 7.7 of the Act – “Financial Services Disclosure”. Part 7.9 – “Financial Product Disclosure” requires that a retail client must receive a Product Disclosure Statement (PDS) before acquiring a financial product.

Sections 942B(2)(e) and (f), and 942C(2)(f) and (g) of the *Corporations Act 2001*, which apply to financial services licensees and authorised representatives respectively in relation to the content requirements of the Financial Services Guides, require disclosure of:

- information about the remuneration (including commission) or other benefits that may be received by the financial services provider or related parties that are associated with the provision of the services; and
- information about any associations or relationships that might reasonably be expected to be capable of influencing the providing entity in providing the services.

Sections 947B(2)(d) and (e), 947C(2)(e) and (f) of the *Corporations Act 2001*, which apply to licensees and authorised representatives respectively concerning the contents of a SoA, require the following:

- information about any remuneration (including commission) or other benefits to be received by the provider or related parties that might reasonably be expected to be or have been capable of influencing the provider in providing the advice; and
- information about any interests, whether pecuniary or not and whether direct or indirect, of the provider or related parties and any associations or relationships between providers and their associates and the issuers of any financial products that might reasonably be expected to be or have been capable of influencing the provider in providing the advice.

The requirements of Pts 7.7 and 7.9 cannot be contracted out of: ss 951A and 1020D.

Regulatory Guide 168: *Disclosure: Product Disclosure Statements (and other disclosure obligations)*, describes the PDS as “A document that must be given to a retail client for the offer or issue of a financial product.”

Regulatory Guide 175: *Licensing: Financial Product Advisers – Conduct and Disclosure* sets out ASIC's policy for administering the law on:

- providing product advice;
- preparing and providing a FSG;
- preparing and providing suitable personal advice; and
- preparing and providing a SoA.

Where general advice is given to a retail client, a SoA is not required; however, warnings must accompany all general advice regardless of how the advice is provided: see s 949A.

### **What constitutes good disclosure?**

**[4.190]** Apart from the disclosure requirements set out in Ch 7 of the *Corporations Act 2001*, RGs 168 and 175 contain guidance relating to PDSs and conduct and disclosure under *Corporations Act 2001*. Regulatory Guide 168 introduces “good disclosure principles” which are discussed in detail in section C which, while directed towards issuers preparing a PDS, are equally applicable to all financial services disclosure.<sup>4</sup> These principles provide guidance on ASIC policy for all licensees, authorised representatives and product issuers who are preparing a PDS.

The Good Disclosure Principles are outcome focused. The key outcomes that we seek to achieve are to help consumers make better decisions and to help consumers compare financial products.<sup>5</sup>

Regulatory Guide 175 also refers to these principles in relation to the preparation of Financial Services Guides..

The principles are that disclosure should:

- be timely;
- be relevant and complete;
- promote product understanding;
- promote comparison;
- highlight important information; and
- have regard to consumers' needs.

### **Disclosure requirements elsewhere in the law**

**[4.200]** Chapter 6D – “Fundraising Provisions” of the *Corporations Act 2001* includes a general disclosure test in s 710 in relation to prospectus content. A prospectus for a body's securities must contain all the information that investors and their professional advisers would reasonably require in order to make an informed assessment. However, this is only to the extent to which it is reasonable for investors and their professional advisers to expect to find the information in the

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<sup>4</sup>RG 168 Section C, Key Points.

<sup>5</sup>RG 168.57, available at

[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg168-published-28-October-2011.pdf/\\$file/rg168-published-28-October-2011.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg168-published-28-October-2011.pdf/$file/rg168-published-28-October-2011.pdf)  
(accessed 22 July 2013)

prospectus and only if a person whose knowledge is relevant actually knows the information or, in the circumstances, ought reasonably to have obtained the information by making inquiries.

Introduced into the *Corporations Act 2001* as a result of recommendations of CLERP 9, Ch 6CA recognises that disclosure of relevant information at the time that the financial product or security is first released on the market only protects a limited number of investors who choose to invest in a release of a new financial product or security, and that continuous disclosure of relevant information provides greater protection to a larger number of investors. Continuous disclosure principles have existed in the ASX listing rules for some time. Sections 674 and 675 of the *Corporations Act 2001* provide generally that listed disclosing entities must disclose information that is not generally available to the public and that the information is such that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of the security. Listed entities must disclose the information to the ASX, and unlisted entities must disclose it to ASIC.

While the most useful remedies to investors for non-disclosure are found in legislation, the common law has developed principles relating to disclosure in the areas of misrepresentation and non-disclosure. The connection between misrepresentation and disclosure (silence as misrepresentation) is well-known and will not be explored here. However, the leading authority on unconscionable conduct in Australia, *Commercial Bank of Australia Ltd v Amadio*,<sup>6</sup> which saw the decision in favour of the guarantors on the grounds that it would be unconscionable to enforce the third party security because of the guarantor's special disability, could just as easily have been couched in terms of misrepresentation and non-disclosure. The *Amadio* case provides a principle which describes a duty to disclose in terms of the natural and legitimate expectations of the guarantor.

In the *Amadio case*, it was stated by the High Court of Australia in relation to the taking of guarantees and third party securities that:

A contract of Guarantee is not *uberrimae fidei*. However, the principal creditor is under a duty to disclose anything in the transaction between the creditor and the debtor which has the effect that the position of the debtor is different from that which the intending surety would naturally expect, particularly if it affects the nature or degree of the surety's responsibility.<sup>7</sup>

A contract of insurance is a contract of the utmost good faith (*uberrimae fidei*) whereby all matters relevant to the risk being undertaken by the issuer have to be disclosed. It appears from the principle above that contracts of guarantee approximate to similar disclosure requirements.

In the present context, it is interesting to note that a financial services licensee must not, in or in relation to the provision of a financial service, engage in conduct that is, in all the circumstances, unconscionable: s 991A. These circumstances could include non-disclosure.

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<sup>6</sup>*Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447; 46 ALR 402.

<sup>7</sup>*Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447; 46 ALR 402 at 403.

## Disclosure through documentation

[4.210] Regulatory Guide 168.1 sets out, from a consumer's perspective, documentary disclosure that is required under Ch 7 of the *Corporations Act 2001*, with each document representing different stages of the investment process:

**Table 4.1. Disclosure required at each stage of investment process**

<b>What service am I getting?</b>	Disclosure is in a Financial Services Guide (FSG)
<b>What advice am I getting?</b>	Disclosure is in a Statement of Advice (SoA) if the advice is personal
<b>What product am I buying?</b>	Disclosure is in a PDS and can be in a Short-Form PDS

Each must be “worded and presented in a clear, concise and effective manner”.<sup>8</sup>

## Financial services disclosure: Part 7.7

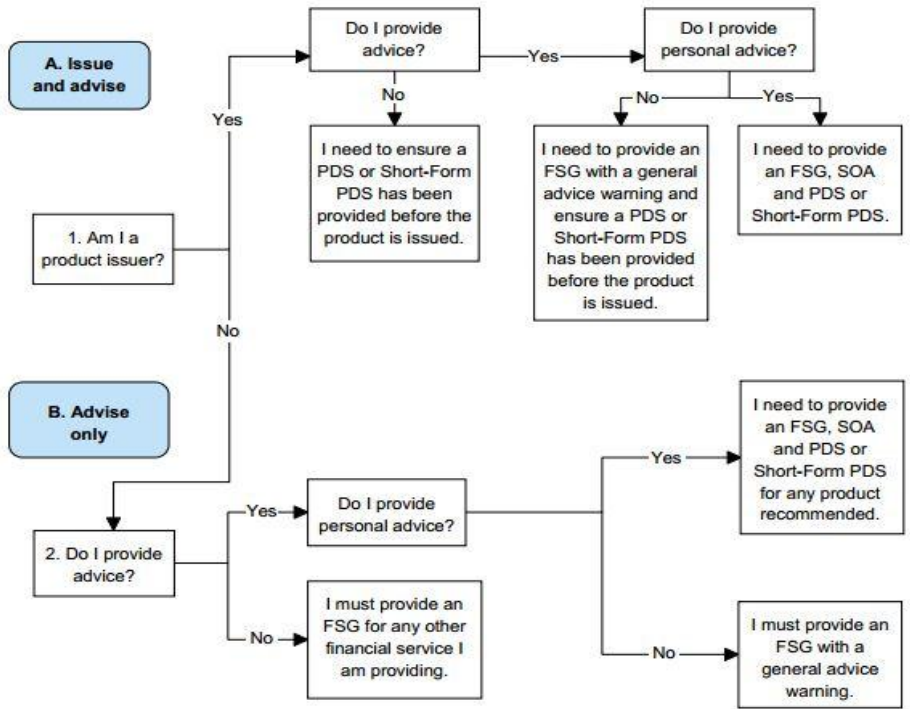
[4.220] Under Pt 7.7 of the *Corporations Act 2001* both licensees and authorised representatives are required to provide disclosure documents to retail clients, as set out in the following flowchart on RG 168, page 9:

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<sup>8</sup>RG 168.17 (last accessed 22 July 2013).

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**Figure 1: Flow chart of investment process and disclosure documents required**



## Financial Services Guide

**[4.230]** Financial services licensees and authorised representatives who provide financial services to retail clients are required to give the retail client a Financial Services Guide (FSG). This obligation applies whether personal or general financial product advice or any other financial service is provided: s 941A (licensee) and s 941B (authorised representative).

The purpose of a FSG is to enable retail clients to make an informed decision as to whether to obtain financial services from a particular provider. The level of detail required in the FSG is that which would reasonably be required by a person for the purpose of making a decision as to whether to acquire financial services as a retail client: ss 942B(3) and 942C(3).

A FSG must be worded and presented in a clear, concise and effective manner: ss 942B(6A) and 942C(6A). The FSG must not contain information or statements that are misleading or deceptive.

## Circumstances where a FSG is required

**[4.240]** Financial service providers, whether licensees or their representatives, have an obligation to give a retail client an FSG whenever it is likely that financial services will be provided: s 941D. The FSG should be supplied before any services are provided so that the client can make

an informed decision whether to receive the available services.

Under s 941C a FSG does not have to be provided where:

- the client is not a retail client;
- no financial service is provided;
- the retail client has already received an FSG containing the required information;
- the providing entity is the product issuer dealing in its own products;
- the providing entity is the responsible entity operating a managed investment scheme;
- general advice is provided in a public forum; and
- if the financial service is a dealing in, or relates to a basic deposit product, a facility for making non-cash payments that is related to a basic deposit product or other exemptions specified by the regulations.

The exemptions for product issuers and responsible entities are due to the required information being contained in the PDS required under Pt 7.9 of the *Corporations Act 2001*. If either the product issuer or responsible entity provides other services, or any dealing is through an intermediary, an FSG must be provided. For example, in the case of dealing in derivatives, the licensee effecting the trade on a financial market would be the product issuer and would need only to provide a PDS in relation to that dealing. However, an FSG would need to be given in relation to the intermediary services necessarily provided, such as advice.

### **When a FSG is provided**

**[4.250]** The FSG must be given to the client as soon as practicable after it becomes apparent to the providing entity that the financial service will be, or is likely to be, provided to the client. The FSG must in any event be given to the client *before* the financial service is provided: s 941D.

Section 941D(2) provides that an FSG can be given after a financial service has been provided in “time critical cases” where:

- the client expressly instructs that the financial service be provided immediately, or by a specified time; and
- it is not reasonably practicable to give the FSG to the client before the service is provided as so instructed.

In these circumstances information relating to remuneration and possible conflicts of interest must be supplied before the FSG is provided (s 941D(3)) and the client must be given the FSG within five days after being given the s 941(3) statement, or sooner if practicable: s 941D(4).



## Contents of a FSG

[4.260] The title “Financial Services Guide” must be used on the cover of, or at or near the front of, a Financial Services Guide. In any other part of a Financial Services Guide, “Financial Services Guide” may be abbreviated to “FSG”: s 942A.

The content requirements of FSGs provided by financial services licensees and authorised representatives are set out in ss 942B and 942C, respectively. The FSG must include certain statements and information and the level of information about a matter that is required is such as a person would reasonably require for the purpose of making a decision whether to acquire financial services from the providing entity as a retail client: ss 942B(3) and 942C(3).

### Main requirements of FSG: s 942B

[4.270] The FSG must include the following statements and information:

- (a) a statement setting out the name and contact details of the providing entity;  
and
- (b) a statement setting out any special instructions about how the client may provide instructions to the providing entity; and
- (c) information about the kinds of financial services (the *authorised services*) that the providing entity is authorised by its licence to provide, and the kinds of financial products to which those services relate; and
- (d) information about who the providing entity acts for when providing the authorised services; and
- (e) information about the remuneration (including commission) or other benefits that any of the following is to receive in respect of, or that is attributable to, the provision of any of the authorised services:
  - (i) the providing entity;
  - (ii) a related body corporate of the providing entity;
  - (iii) a director or employee of the providing entity or a related body corporate;
  - (iv) an associate of any of the above;
  - (v) any other person in relation to whom the regulations require the information to be provided;
- (f) information about any associations or relationships between the providing

entity, or any related body corporate, and the issuers of any financial products, being associations or relationships that might reasonably be expected to be capable of influencing the providing entity in providing any of the authorised services; and

- (g) if the providing entity provides further market-related advice (see subsection 946B(1)) – a statement in relation to which the following requirements are satisfied:
  - (i) the statement must indicate that the client may request a record of further market-related advice that is provided to them, if they have not already been provided with a record of that advice;
  - (ii) the statement must set out particulars of how the client may request such a record;
  - (iii) any limitations in those particulars on the time within which the client may request such a record must be consistent with any applicable requirements in regulations made for the purposes of this subparagraph or, if there are no such applicable requirements, must be such as to allow the client a reasonable opportunity to request a record of the advice; and
- (h) information about the dispute resolution system that covers complaints by persons to whom the providing entity provides financial services, and about how that system may be accessed; and
- (i) if the providing entity acts under a binder in providing any of the authorised services – a statement that:
  - (i) identifies the services provided under the binder; and
  - (ii) states that they are provided under a binder; and
  - (iii) explains the significance of the services being provided under a binder; and
- (j) if the providing entity is a participant in a licensed market or a licensed CS facility – a statement that the providing entity is a participant in that market or facility; and
- (k) any other statements or information required by the regulations.

Similar provisions are found in s 942C when authorised representatives issue financial services guides.

A Supplementary FSG (SFSG) can correct misleading or deceptive statements or omissions in a FSG or update the information contained in the FSG. The licensee must authorise the distribution

of a SFSG by their authorised representative: s 943A.

## Statement of Advice

**[4.280]** According to ss 947B(3) and 947C(3), the Statement of Advice (SoA) should contain a level of detail as to what a person would reasonably require for the purpose of deciding whether to act on the advice as a retail client and it must be worded and presented in a clear, concise and effective manner: ss 947B(6) and 947C(6).

### Appropriate advice rule

**[4.290]** All personal advice must comply with the “appropriate advice” and “best interests of the client” obligations discussed above. Accordingly, the SoA must clearly and unambiguously set out the provider's advice as well as the reasoning that led to that advice. It must also identify all conflicts of interest that may affect the advice, eg commission and other benefits. This requirement is consistent with the fiduciary obligations that arise out of the adviser-investor relationship.

### Obligation to give client a SoA

**[4.300]** The provision of personal advice to a retail client must be accompanied by a SoA: s 946A. The SoA may be a record of the advice given or the means by which the advice is given, as in the case of a financial plan. The title “Statement of Advice” must be used on the cover of, or at or near the front of a SoA; elsewhere the abbreviation “SoA” may be used: s 947A. The obligation to prepare and provide a SoA applies to personal financial product advice but not to general advice. The amount of information that should be in a SoA is determined by reference to what a retail client would reasonably require in order to make a decision whether to act on the advice of a provider: ss 947B(3) and 947C(3).

### Circumstances where a SoA is not given

**[4.310]** Regulatory Guide 175.153 lists circumstances where a SoA is not required:<sup>9</sup>

- “(a) where the advice is provided to a client who is not a retail client;
- (b) where the advice relates to a cash management trust, basic deposit products, non-cash payment products related to a basic deposit product or traveller’s cheques (but only if the information mentioned in s946B(6) is provided) (reg 7.7.10);
- (c) where the advice relates to a general insurance product (except for advice about sickness and accident or consumer credit insurance) (reg 7.7.10);
- (d) in the case of further advice (reg 7.7.10AE)...;
- (e) where the advice does not recommend or state an opinion about the acquisition or disposal of a financial

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<sup>9</sup>Also *Corporations Regulations 2001* (Cth) regs 7.7.02 and 7.7.02A.

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product and where the providing entity and certain associates do not receive any remuneration or benefit in relation to the advice (but only if the information mentioned in s947B(2)(d) and 947B(2)(e), or s947C(2)(e) and 947C(2)(f), is provided) (s946B(7))”.

(f) where the advice relates to financial investments whose value does not exceed \$15,000 (s946AA and reg 7.7.09A). (Note: This exemption does not generally apply for advice about derivatives, general insurance products or life insurance products. When relying on this exemption, the providing entity must keep a record of the advice provided: s946AA(4) and reg 7.7.08C. This record of advice (including the information mentioned in s947B(2)(d) and 947B(2)(e), or s947C(2)(e) and 947C(2)(f)) must be given to the client: s946AA(5)).

### Small investments

[4.320] A SoA is *not* required pursuant to s 946AA where the advice:

- is small investment advice, ie the total amount to be invested is below the “threshold amount” (\$15,000);<sup>10</sup> and
- does not relate to derivatives, general insurance, life insurance, superannuation or RSA products.

However, if advice is given in relation to “small investments”, the entity providing the advice must keep a record of that advice and provide the client with a copy.<sup>11</sup>

### Further market-related advice

[4.330] A SOA is not required pursuant to s 946B where:

- the entity providing the advice is a participant in a licensed market and has previously given the client a SoA (within the last 12 months) and the current advice relates to financial products or securities that can be traded on the licensed market; furthermore, the entity providing the advice must be certain that the client's circumstances are unchanged, that the advice is required promptly and that it is provided by telephone, fax, email or other electronic means;
- the advice relates to basic deposit products; or
- the advice does not recommend or state an opinion in respect of the acquisition or disposal of a financial product, or the modification of an investment strategy, and no benefit flows to the entity providing the advice, their employees, directors or associates.

In all these circumstances, a “record of advice” must be kept by the advising entity.

### When a SoA is provided

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<sup>10</sup>*Corporations Regulations 2001* (Cth) reg 7.7.09A(1) sets out the threshold amount and also gives examples of how this regulation works in practice.

<sup>11</sup>*Corporations Regulations 2001* (Cth) 7.7.09A(10) and 7.7.08C and *Corporations Act 2001* (Cth) s946AA(4) & (5) s946AA(4)

**[4.340]** If the SoA is not the means by which the advice is provided, a SoA must be given to the client at the same time as, or as soon as practicable after, the advice is provided. In any event, the SoA must be given to the client before the providing entity provides another financial service to the client that arises out of or is connected with the advice, such as arranging for a financial product to be issued to the client: s 946C(1).

If the SoA is not given to the client when the advice is provided, the provider must, when the advice is provided, give the client a statement that contains the information that would be required by ss 947B(2)(d) and (e), 947C(2)(e) and (f), as the case requires, and by s 947D, if applicable.

There may occur “time critical” cases where the client expressly instructs that they require a further financial service that arises out of, or is connected with, the advice to be provided immediately, or by a specified time, and it is not reasonably practicable to give the SoA to the client before that further service is provided as so instructed. The providing entity must then give the client the SoA within five days after providing that further service, or sooner if practicable: s 946C(3).

### **Content of SoA**

**[4.350]** The content requirements for SoAs provided by licensees or authorised representatives are set out in ss 947B and 947C respectively of the *Corporations Act 2001*. The differences arise out of the need of the representative to disclose the nature of the licensee-representative relationship.

In RG 175.157, ASIC indicates that in administering the law it will expect a SoA to contain:

- (a) the title “Statement of Advice” on the cover, or at or near the front, of the document (s 947A);
- (b) the name and contact details of the providing entity (s 947B(2)(c) and 947C(2)(c)) and, if the providing entity is a licensee, its AFS licence number (s 912F and reg 7.6.01C(1)(e));
- (c) where the providing entity is providing the advice as an authorised representative – the name, contact details and AFS licence number of the authorising licensee(s), and a statement that the providing entity is the authorised representative of that licensee or those licensees (s 947C(2)(d) and reg 7.7.11A);
- (d) a statement setting out the advice (s 947B(2)(a) and 947C(2)(a));
- (e) information about the basis on which the advice is or was given (s 947B(2)(b) and 947C(2)(b)): see RG 175.168–RG 175.171;
- (f) information about the remuneration, commission and other benefits that the providing entity (and other persons specified in s 947B(2)(d) or 947C(2)(e))

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will, or reasonably expects to, receive that might reasonably be expected to be, or have been capable of, influencing the providing entity in providing the advice (s 947B(2)(d) and 947C(2)(e), regs 7.7.11 and 7.7.12);

- (g) information about the remuneration, commissions and other benefits that a person has received or is to receive for referring another person to the licensee or providing entity (regs 7.7.11 and 7.7.12);
- (h) details of any interests, associations or relationships that might reasonably be expected to be, or to have been capable of, influencing the providing entity in providing the advice (s 947B(2)(e) and 947C(2)(f)); and
- (i) if s 961H requires a warning to be given to the client – a statement setting out or recording the required warning (s 947B(2)(f) and 947C(2)(g)). Furthermore, the SOA should be dated and specify the period of time the advice remains current

The SoA reproduces some contents of the FSG but concentrates on the advice given by the provider and its basis and the disclosure of any possible conflicts of interest.

The level of detail about a matter that is required is such as a person would reasonably require for the purpose of deciding whether to act on the advice as a retail client: ss 947B(3) and 947C(3).

The statements and information included in the SoA must be worded and presented in a clear, concise and effective manner: ss 947B(6) and 947C(6).

There are additional SoA content requirements when the personal advice recommends replacement (in full or part) of one financial product with another (also known as switching): ss 947B(5) and 947C(5). These requirements are contained in s 947D(2), which specifies the information which must be included in the SoA to the extent that the information is known to, or could reasonably be found out by, the providing entity. These obligations were summarised by ASIC in 175.160 as requiring additional statements about the following:

- “(a) that the client’s existing product has been considered;
- (b) the cost of the recommended action (i.e. the disposal of the existing product and acquisition of the replacement product);
- (c) the potential benefits (pecuniary or otherwise) that may be lost; and
- (d) any other significant consequences of the switch for the client.”

The SoA must also include information about any other significant consequences for the client of taking the recommended action that the providing entity knows, or ought reasonably to know, are likely; as well as any other information required by regulations made for the purposes of s 947D.

It is noted in RG 175.160 that the SoA should include information about the exit fees applying to the withdrawal, the loss of access to rights (such as insurance cover) or other opportunities, including incidental opportunities (such as access to product discounts) associated with the existing product (including rights or opportunities not presently available to the client but which may become available in future) and the entry and ongoing fees applying to the replacement

product. The s 947D additional disclosure requirements are clearly designed to discourage “churning” by advisers in order to maximise commissions earned.

## Financial product disclosure: Part 7.9

### Product Disclosure Statements (PDS)

**[4.360]** Part 7.9 of the *Corporations Act 2001* covers financial product disclosure and other provisions relating to the issue and sale of financial products. Part 7.9, however, generally does not apply to disclosure in relation to securities, which is covered by Ch 6D (and Ch 6CA continuous disclosure): s 1010A. Under Ch 7 of the *Corporations Act 2001*, interests in managed investment schemes are classed as financial products and are required to comply with the PDS requirements of Part 7.9.

While Part 7.9 does not apply to financial products not issued in the course of a business of issuing financial products, the issue of any managed investment product or superannuation product is taken to occur in the course of such a business: s 1010B.

Regulatory Guide 168: *Disclosure: Product Disclosure Statements (and other disclosure obligations)*, provides the detail on PDSs. This guide states that:

RG 168.36: A PDS is to be prepared by or on behalf of the issuer or seller of the financial product: see s1013A. A PDS must contain sufficient information so that a retail client may make an informed decision about whether to purchase a financial product: s 1013D.

RG 168.37: The broad objectives of PDS disclosure are to help consumers compare and make informed choices about financial products. To achieve these objectives, the legislation requires that all information contained in a PDS must be worded and presented in a clear, concise and effective manner: s1013D.

A PDS has to be provided to a consumer before the investor applies for a financial product and ss 1016A and 1013C(3) provide that information included in a PDS must be worded in a clear, concise and effective manner. The PDS requirements are designed to promote financial product understanding for retail clients, allow comparison of financial products and help investors to make informed decisions to acquire particular financial products.

Regulatory Guide 168, Part C encourages those persons issuing PDSs to consider the “good disclosure principles” when drawing up PDSs, namely:

1. Disclosure should be timely.
2. Disclosure should be relevant and complete.
3. Disclosure should promote product understanding.

4. Disclosure should promote product comparison.
5. Disclosure should highlight important information.
6. Disclosure should have regard to consumers' needs.

Despite the above, the *Parliamentary Joint Committee on Corporations and Financial Services* (PJC) commented that in the case of Storm Financial these objectives were not being pursued by the relevant financial advisers.

The limited understanding that some Storm clients had of their financial arrangements is of concern to the committee. The committee acknowledges that some of these clients admit they did not have a strong understanding of the leverage and margin loan arrangements that they signed up to. Indeed, some explained that it was out of awareness of their limited knowledge that they sought the guidance of, and acted on the recommendations of, professional financial advisers.<sup>12</sup>

### **Obligation to provide PDS**

**[4.370]** A PDS must be provided to a retail client by a regulated person (eg the issuer of the financial product, seller of the financial product, any financial services licensee or their authorised representative) when personal advice includes a recommendation that the client acquire a particular financial product: ss 1012A – 1012C.

### **Situations requiring PDS to be provided**

**[4.380]** The circumstances in which a PDS must be provided to a retail client are:

- a recommendation situation where there is personal advice recommending the acquisition of a particular financial product: s 1012A;
- an issue situation where a person initially offers to issue or arrange for the issue, or does issue a financial product to a retail client: s 1012B; or
- a sale situation where a person offers to sell a financial product (other than securities) to a retail client: s 1012C.

### **Tailored PDS**

**[4.390]** **Since** 1 January 2011, a tailored PDS regime has applied to PDSs for standard margin lending facilities. The tailored regime for standard margin lending facilities:

- (a) removes the usual PDS content requirements for financial products in s 1013D of the *Corporations Act 2001* (Cth);

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<sup>12</sup>PJC at 3.43.



- (b) substitutes new PDS content requirements which are more prescriptive and specifically address the key information a person acquiring a superannuation product would wish to know (Sch 10C); and
- (c) requires a maximum page limit of four A4 pages (or equivalent) for the PDS, with an expectation that the person responsible for the PDS will make substantial use of incorporation by reference to provide additional information for clients.<sup>13</sup>

This tailored regime also now applies to First Home Saver Accounts: RG 168.129.

## Shorter, simpler PDS

**[4.400]** For all financial products except those that are subject to a tailored regime, a Short-Form PDS may be provided if certain conditions are met:

RG 168.107: The Short-Form PDS is intended to help product issuers avoid the problem of lengthy and complex product disclosure documents by allowing them to present a summary document rather than a full-length PDS. In general, a Short-Form PDS summarises the key information in a PDS (eg information about the issuer, benefits, risks, costs, return, dispute resolution and cooling off) and complies with Div 3A of Pt 7.9.

## Incorporation by reference

**[4.410]** A person responsible for producing a PDS need not include certain statements or information that would otherwise be required to be included. These statements or information can be “incorporated by reference” if it is in writing and is publicly available in a document other than the PDS, including electronic sources such as the internet. The information cannot be incorporated from a Short-Form PDS.

Incorporation by reference reduces the length of disclosure documents by allowing some of the required information to be incorporated, by providing a reference in the PDS to another document, instead of including the information in full in the PDS.<sup>14</sup> However, if the client requests the information that is included by reference, then it must be provided as soon as possible.

## PDS content requirements

**[4.420]** Generally, the PDS must be prepared by the issuer of the financial product and is called

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<sup>13</sup>RG 168.125.

<sup>14</sup>*Corporations Regulations 2001* (Cth) reg 7.9.15DA, RG 168.106, 168.107 and 168.108.

an issue statement: *Corporations Act 2001* (Cth) s 1013A. In RG 168.97, it is noted that product issuers should focus not only on the technical content requirements that apply to PDSs, but also the quality of the information being provided to consumers, and in particular, the “clear, concise and effective requirement”. ASIC notes at RG 168.98 that this may require:

- “(a) monitoring carefully the class of consumers to whom the PDS is directed;
- (b) producing a PDS that is based on a format that has been consumer tested;
- (c) producing a PDS that has taken into account feedback (including complaints) from consumers about past or current point-of-sale offer documents used by the product issuer;
- (d) personalising the information contained in the PDS for the consumer; or
- (e) improving the quality of the disclosure in the PDS to promote product understanding by consumers (e.g. drafting a PDS to improve the comparability of competing financial products”.

The title “Product Disclosure Statement” must be used on the cover of, or at or near the front of, a PDS. In any other part of a PDS, “Product Disclosure Statement” may be abbreviated to “PDS”: s 1013B.

While prospectuses have a limited life time, PDSs have no expiry date but must be kept up-to-date: s 1012J.

The content requirements for PDSs are contained in ss 1013C – 1013F. Essentially, PDSs are required to contain:

- the statements and information required by s 1013D: s 1013C(1)(a)(i);
- any other information that might reasonably be expected to have a material influence on the decision of a reasonable retail client whether to acquire the product: s 1013E; and
- other Pt 7.9 requirements such as date (s 1013G) and title (s 1013B).

### **PDS content requirements: s 1013D**

**[4.430]** Section 1013D(1) sets out the main content requirements for PDSs (emphasis added):

- (a) a statement setting out the *name and contact* details of:
  - (i) the issuer of the financial product; and
  - (ii) if the Statement is a sale Statement – the seller; and
- (b) information about any *significant benefits to which a holder of the product will or may become entitled*, the circumstances in which and times at which those benefits will or may be provided, and the way in which those benefits will or may be provided; and
- (c) information about any *significant risks* associated with holding the product; and

- (d) information about:
  - (i) the *cost* of the product; and
  - (ii) any *amounts that will or may be payable by a holder* of the product in respect of the product after its acquisition, and the times at which those amounts will or may be payable; and
  - (iii) if the amounts paid in respect of the financial product and the amounts paid in respect of other financial products are paid into a common fund – any amounts that will or may be deducted from the fund by way of fees, expenses or charges; and
- (e) if the product will or may generate a return to a holder of the product – *information about any commission, or other similar payments*, that will or may impact on the amount of such a return; and
- (f) information about any *other significant characteristics* or features of the product or of the rights, terms, conditions and obligations attaching to the product; and
- (g) information about the *dispute resolution system* that covers complaints by holders of the product and about how that system may be accessed; and
- (h) general information about any significant *taxation implications* of financial products of that kind; and
- (i) information about any *cooling-off regime* that applies in respect of acquisitions of the product (whether the regime is provided for by a law or otherwise); and
- (j) if the product issuer (in the case of an issue Statement) or the seller (in the case of a sale Statement) makes *other information* relating to the product available to holders or prospective holders of the product, or to people more generally – a statement of how that information may be accessed; and
- (k) any other *statements or information* required by the regulations; and
- (l) if the product has an investment component – the extent to which *labour standards or environmental, social or ethical considerations* are taken into account in the selection, retention or realisation of the investment; and
- (m) ...

Despite anything in s 1013D or s 1013E, information is not required to be included in a PDS if it would not be reasonable for a person considering, as a retail client, whether to acquire the product to expect to find the information in the statement. In determining this, the matters that may be taken into account include:

- the nature of the product (including its risk profile);
- the extent to which the product is well understood by the kinds of person who commonly acquire products of that kind as retail clients;
- the kinds of things such persons may reasonably be expected to know;
- if the product is an enhanced disclosure security, the effect of Ch 2M as it applies to disclosing entities and ss 674 and 675;
- the way in which the product is promoted, sold or distributed; and
- any other matters specified in the regulations: s 1013F(2).

### **Advertising and PDSs**

**[4.440]** Advertising or promotional material that is reasonably likely to induce people to acquire a product that is available, or likely to become available, for acquisition by retail clients must (s 1018A):

- identify the issuer;
- indicate that a PDS for the product is available and where it can be obtained; and
- indicate that a person should consider the PDS in deciding to acquire, or continue to hold the product.

### **Cooling off**

**[4.450]** A cooling off period of 14 days applies to the following financial products issued or sold pursuant to an offer (s 1019A):

- risk insurance products;
- investment life insurance products;
- managed investment products;
- superannuation products; and
- retirement savings account products.

An investor exercising cooling off rights has the right to return the financial product to the responsible person and to have the money already paid for the product repaid. This is so even if the responsible person is being wound up: s 1019B. The right can only be exercised during the period of 14 days beginning on the earlier of the time when any confirmation requirements are complied with or the end of the fifth day after the day on which the product was issued or sold:

s 1019B(3).

### **Circumstances where a PDS is not required**

[4.460] A PDS is not required where:

- the client is not a retail client;
- the product is not a financial product;
- the financial product is not issued in the course of a business issuing financial products: s 1010B;
- the client has already received an up-to-date PDS: s 1012D(1);
- the client has or has access to up-to-date information: s 1012D(2);
- the client already holds a financial product of the same kind and the advice relates or the offer is made under a distribution reinvestment plan or switching facility: s 1012D(3);
- no consideration is to be provided to acquire an interest in a managed investment scheme or the financial product is an option and no consideration is to be provided on the exercise of the option: s 1012D(5) and (6);
- the offer is made as consideration for an offer made under a takeover bid and the offer is accompanied by a bidder's statement: s 1012D(7);
- the responsible entity of an unregistered managed investment scheme is an exempt body: s 1012D(8);
- the financial product is an interim contract of insurance, eg cover notes: s 1012D(9);
- the client is associated with the responsible entity of a registered managed investment scheme: s 1012D(9A); and
- the financial product constitutes a small scale offering (20 issues or sales in 12 months) of managed investment and other prescribed financial products and all of the financial products are issued by the same person and the amounts raised by the issuer do not exceed \$2 million in a 12-month period: s 1012E.

Section 761GA allows the adviser to treat a client as a “sophisticated investor” and not as a retail client and therefore not provide a PDS if the licensee is satisfied on reasonable grounds that the client has previous experience in using financial services and investing in financial products that allows the client to assess:

(d)

- (i) the merits of the product or service; and
- (ii) the value of the product or service; and
- (iii) the risks associated with holding the product; and
- (iv) the client's own information needs; and
- (v) the adequacy of the information given by the licensee and the product issuer; and
- (e) the licensee gives the client before, or at the time when, the product or advice is provided a written statement of the licensee's reasons for being satisfied as to those matters; and
- (f) the client signs a written acknowledgment before, or at the time when, the product or service is provided that:
  - (i) the licensee has not given the client a Product Disclosure Statement;

...

However, this section will not protect the adviser against negligent advice claims – its purpose is to recognise sophisticated investors who do not require the level of disclosure that is necessary for retail clients.

## Liability for contravention of conduct and disclosure rules

**[4.470]** Where there is non-compliance with the conduct and disclosure requirements of Pts 7.7 and 7.9 of the *Corporations Act 2001*, or a defective disclosure document is provided, the enforcement provisions provide for offences against the service provider or product issuer and the civil remedy of compensation for investors who suffer loss or damage caused by the contraventions or defects.

### Criminal liability

#### Failure to provide disclosure documents

**[4.480]** It is an offence not to provide a disclosure document when one is required for a FSG and a SoA (s 952C) and for a PDS: s 1021C.

#### 952C Offence of failing to give a disclosure document or statement

- (1) A person (the *providing entity*) commits an offence if:

- (a) the providing entity is required by a provision of this Part to give another person a disclosure document or statement (the *required disclosure document or statement*); and
- (b) the providing entity does not give (within the meaning of section 940C) the other person anything purporting to be the required disclosure document or statement by the time they are required to do so.

...

- (2) An offence based on subsection (1) is an offence of strict liability.

The offence provisions generally make licensees or authorised representatives liable for contravention of the provisions relating to FSGs and SoAs: ss 952D – 952M. There is a defence for authorised representatives who have reasonably relied on information provided by their authorising licensee; it is also a defence where a licensee or authorised representative took reasonable steps to ensure that the disclosure document is not defective.

In relation to PDSs, similar offences exist for contraventions of the Pt 7.9 requirements; the majority of the offences are strict liability offences and hence afford no defences. The person liable for contravention is generally the preparer of the PDS, ie the issuer, although certain provisions, eg failure to provide a PDS, are directed at the relevant provider and defences in this instance (similar to those in Pt 7.7) are available.

## Defective disclosure documents

**[4.490]** It is also an offence to provide a defective disclosure document: ss 952D and 952E (FSG and SoA) and ss 1021D and 1021E (PDS).

A disclosure document or statement is defective under ss 952B or 1021B if:

- there is a *misleading or deceptive statement* in the disclosure document or statement; or
- there is an *omission* from the FSG, SoA or PDS of material required by ss 942B or 942C, ss 947B, 947C or 947D, or s 1013C (other than title and date) respectively; or
- there is an *omission of any other information or statement of material required* by the respective disclosure requirements,

being a statement, or an omission, that is or would be materially adverse from the point of view of a reasonable person considering whether to proceed to be provided with the financial service, to act in reliance on the advice, or whether to proceed to acquire the financial product, concerned.

The term “materially adverse” means whether the investor's appreciation of the risk is altered.

Table 4.2 below summarises the legislative provision for Pts 7.7 and 7.9 disclosure documents together with the equivalent Ch 6D provisions:

**Table 4.3. Defective disclosure documents**

<b>Disclosure document</b>	<b>Definitional provision</b>	<b>Civil action for loss or damage</b>
<i>Corporations Act 2001</i> (Cth) Pt 7.7 <b>FSG</b> <b>SoA</b>	<b>s 952B</b>	<b>s 953B</b>
<i>Corporations Act 2001</i> (Cth) Pt 7.9 <b>PDS</b>	<b>s 1021B</b>	<b>s 1022B</b>
<i>Corporations Act 2001</i> (Cth) Ch 6D Prospectus	<b>s 728</b>	<b>s 729</b>

### Civil liability

**[4.500]** An investor may suffer loss or damage because:

- they were not given the disclosure document or statement that they should have been given; or
- the disclosure document or statement they were given was defective; or
- there was a contravention of s 961B (duty to act in the best interests of the client), s 961G (duty to provide appropriate advice), s961H (duty to warn the client if advice is based on incomplete or inaccurate information), or s961J (duty to prioritise the interests of the client).

The investor may recover the amount of the loss or damage by action against a liable person being, in general, the financial services licensee under Pt 7.7, or the product issuer under Pt 7.9: ss 961M and 1022B.

A person is not liable under s 953B or s 1022B in the case of a defective disclosure document or statement if the person took reasonable steps to ensure that the disclosure document or statement would not be defective: ss 953B(6) and 1022B(7).

Investors have available as a remedy for a defective PDS or where the financial product disclosure requirements are not met, the right to return the product and have the money paid to acquire the product repaid: s 1016F. This right can only be exercised during the period of one month from the issue or sale of the product to the client.

### Misleading or deceptive conduct

**[4.510]** There is a general prohibition against misleading or deceptive conduct and civil liability will arise if this conduct occurs (s 1041H of the *Corporations Act 2001*):



**1041H Misleading or deceptive conduct (civil liability only)**

- (1) A person must not, in this jurisdiction, engage in conduct, in relation to a financial product or a financial service, that is misleading or deceptive or is likely to mislead or deceive.

Conduct that contravenes s 670A (misleading or deceptive takeover document) or s 728 (misleading or deceptive fundraising document) or conduct in relation to FSGs, SoAs or PDSs are excluded from the ambit of s 1041H (s 1041H(3)) as they are covered by a separate, self-contained disclosure regime.

RG 168.154 provides that ambiguous statements may constitute misleading or deceptive conduct if one or more of the reasonably possible meanings is misleading or deceptive.

ASIC notes, in RG 168-143-155, that:

- “When assessing whether a PDS appears to be misleading or deceptive, we will pay particular attention to:
- (a) statements about future matters such as forecasts (they should have reasonable grounds). A statement about any future matter is misleading or deceptive if the maker does not have reasonable grounds for making it. For example, a statement about prospective financial information based on a number of hypothetical assumptions is unlikely to be based on reasonable grounds;
  - (b) statements about past performance;
  - (c) statements of opinion (they should be formed honestly and reasonably);
  - (d) the likely overall impression of the PDS;
  - (e) the use of illustrations or examples to highlight an aspect of the disclosure being provided;
  - (f) the use of disclaimers;
  - (g) ambiguous statements;
  - (h) whether statements draw inaccurate, unfair or inappropriate comparisons;
  - (i) the currency of information; and
  - (j) how information is set out and the prominence given to particular pieces of information.

Care should be taken when showing past performance information including, in particular, giving consideration to any misleading or deceptive representation that may arise from:

- (a) the currency of past performance information (e.g. does the information need to be updated, including by means of a supplementary PDS?);
- (b) the length of time a product or investment strategy has been in existence or the investment period selected;
- (c) the periods for which past performance information is shown (e.g. different sub-periods in the life of any past performance information may produce entirely different past performance figures);
- (d) whether the past performance information is shown in accordance with any industry standards;
- (e) any explicit or implicit suggestion of a link between past performance and future prospects;
- (f) the use of hypothetical or reconstructed past performance figures;
- (g) changes in the state of the market such that returns in the short to medium term are likely to be significantly less than the past performance being quoted; and
- (h) changes in the method or mechanism by which the investment strategy is implemented (e.g. appointment of a new investment manager).

A statement about past performance should be accompanied by a prominent warning that past performance is not necessarily a guide to future performance.

A statement of opinion that amounts to a representation may be misleading or deceptive in the following circumstances:

- (a) an opinion may be a statement about a future matter, in which case it must be based on reasonable grounds. If this is not the case, the expression of opinion may be regarded as misleading or deceptive;
- (b) an opinion may convey that there is a basis for the opinion, that it is honestly held, and when expressed

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as the opinion of an expert that it is honestly held on rational grounds involving the application of the relevant expertise. If this is not the case, the expression of opinion may be regarded as misleading or deceptive (see *Bateman v Slayter* (1987) ATPR 40–762); and

(c) a statement of opinion involving a state of mind may convey the meaning (expressly or by implication) that the maker had the particular state of mind when the statement was made and, commonly, that there was a basis for having that state of mind. If this is not so, such a statement may constitute misleading or deceptive conduct (see *Stanton v ANZ Banking Group* (1987) ATPR 40–755).

A statement of opinion may become misleading or deceptive if it continues to be published when the maker no longer holds the opinion or the grounds on which it was made have substantially changed.”

### Administrative action

**[4.520]** ASIC has the power to take action against licensees and their authorised representatives who breach the suitability and disclosure obligations. Administrative actions include:

1. suspending or cancelling an AFS licence; (ss 915B and 915C);<sup>15</sup>
2. banning a person from providing financial services (s 920A);
3. varying AFS licence conditions (s 914A);
4. directing an AFS licensee to provide us with a statement, which we may require to be audited, containing specified information about the business, activities or services provided by the licensee or its representatives (s 912C);
5. in the case of a contravention of the market integrity rules by an AFS licensee that is a market participant, asking the Markets Disciplinary Panel to issue an infringement notice (RG 216); and
6. accepting an enforceable undertaking as an alternative to other remedies, where we consider it appropriate to do so (RG 100).

Section 920A(1) provides that ASIC can make a banning order against a licensee if:

...

- (b) the person has not complied with their obligations under section 912A; or
- (ba) ASIC has reason to believe that the person will not comply with their obligations under section 912A; or

...

- (e) the person has not complied with a financial services law; or

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<sup>15</sup>The *Parliamentary Joint Committee on Corporations and Financial Services* (PJC) recommends that ss 915B and 915C of the *Corporations Act 2001* (Cth) be amended to allow ASIC to deny an application, or suspend or cancel a licence, where there is a reasonable belief that the licensee “may not comply” with their obligations under the licence.

- (f) ASIC has reason to believe that the person will not comply with a financial services law.

A banning order is a written order that “prohibits a person from providing any financial services or specified financial services in specified circumstances or capacities”: s 920B.<sup>16</sup>

Regulatory Guide 98 provides information on the administrative powers, including banning orders used by ASIC to enforce the financial services laws.

## Disclosure and the no conflict of interest rule

**[4.530]** The disclosure of any conflict of interest is considered to be a key issue in the provision of investment advice, both in relation to the suitability and disclosure rules.

Section 912A sets out the general obligations of financial service licensees. The primary obligation as set out in s 912A(1)(a) states that the licensee must “do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly”.

Section 912A(aa), which was inserted into s 912A of the *Corporations Act 2001* (Cth) as a result of recommendations in CLERP 9, specifically addresses conflict of interest and is an example of the common law fiduciary principles that have gradually found their way into legislation.

Section 912A(aa) provides:

- (aa) have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative.

Regulatory Guide 181: *Licensing: Managing Conflicts of Interest*, explains ASIC's approach to conflict of interest. This guide defines a “conflict of interest” as:

[RG 181.15] ... circumstances where some or all of the interests of people (clients) to whom a licensee (or its representative) provides financial services are inconsistent with, or diverge from, some or all of the interests of the licensee or its representatives. This includes actual, apparent and potential conflicts of interest.

The focus on conflicts of interest in the financial services sector is explained in the underlying principles to the regulatory guide:

[RG 181.13] Adequate conflicts management arrangements help minimise the potential adverse impact of conflicts of interest on clients. Conflicts management arrangements thereby help promote consumer protection and maintain market

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<sup>16</sup>The *Parliamentary Joint Committee on Corporations and Financial Services* (PJC) has recommended that ASIC be given greater powers to ban individuals from the financial services industry.

integrity. Without adequate conflicts management arrangements, licensees whose interests conflict with those of the client are more likely to take advantage of that client in a way that may harm that client and may diminish confidence in the licensee or the market.

Three mechanisms to deal with conflict of interest are identified by RG 181. These are: controlling, disclosing and avoiding conflict. The key to these three mechanisms is to identify the problem so that it may be controlled, disclosed or avoided. The suitability rule is breached if the financial product advice is given on the basis of the licensee or authorised representative having a connection with, or benefit from, the financial product, and the disclosure rules are also breached if there is not a disclosure of the conflict of interest in the SoA document. It should be remembered that this document is supposed to disclose commissions or other benefits that would flow as a result of the client acting on the information in the SoA and any other information that might reasonably be expected to have influenced the entity providing the advice: ss 947B and 974C.

ASIC's submission to the *Parliamentary Joint Committee on Corporations and Financial Services* (PJC) indicates their concern in relation to commissions and conflict of interest:

Today financial advisers usually play a dual role of providing advice services to clients and acting as the sales force for financial product manufacturers. Approximately 85% of financial advisers are associated with a product manufacturer, so that many advisers effectively act as a product pipeline. Of the remainder, the vast majority receive commissions from product manufacturers and so have incentives to sell products: see Section E. This structure creates potential conflicts of interest that may be inconsistent with providing quality advice and these conflicts may not be evident to consumers.<sup>17</sup>

There is some evidence that the quality of advice is affected by conflicts of interest created by links to product issuers.<sup>18</sup>

ASIC has illustrated the consequences of these conflicts of interests:

Storm may be an example of the potential impact on clients of failure to manage conflicts of interest created by commissions and remuneration based on funds under advice. While our investigations are continuing, we understand that Storm advisers may have counted loans as funds under advice and took a percentage of funds under advice as remuneration, creating a possible incentive to recommend clients take out loans or increase the size of existing loans.<sup>19</sup>

The *Parliamentary Joint Committee on Corporations and Financial Services* (PJC) recommended that the *Corporations Act 2001* be amended to require advisers to disclose more prominently in marketing material restrictions on the advice they are able to provide consumers and any potential conflicts of interest and that appropriate mechanism be examined by which to

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<sup>17</sup>*Parliamentary Joint Committee on Corporations and Financial Services* (PJC) at 111.

<sup>18</sup>PJC at 114.

<sup>19</sup>PJC at 172.

cease payments from product manufacturers to financial advisers.<sup>20</sup>

In response to the *Parliamentary Joint Committee on Corporations and Financial Services* recommendations, the Federal Government released *The Future of Financial Advice* (FOFA) reforms on 28 April 2011. These reforms include:

- A prospective ban on up-front and trailing commissions and like payments for both individual and group risk within superannuation from 1 July 2013.
- A prospective ban on any form of payment relating to volume or sales targets from any financial services business to dealer groups, authorised representatives or advisers, including volume rebates from platform providers to dealer groups.
- A prospective ban on soft dollar benefits, where a benefit is \$300 or more (per benefit) from 1 July 2012.

These reforms were enacted and are discussed in Chapter 5.

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<sup>20</sup>PJC recommendations 3 and 4.