13. Intermediaries

Introduction

13.1 Many investments in securities, including interests in collective investment schemes, are made through an intermediary,[1] who is often the only person an investor discusses a prospective investment with. Investors rely on intermediaries to provide accurate information and appropriate advice. The role of intermediaries is becoming increasingly important as more and more people with little financial sophistication seek to invest significant amounts of money, for example, their lump sum superannuation payment.

> [M]any investors rely almost exclusively on the recommendations of their advisers. Without careful regulation and close scrutiny, intermediaries have the capacity to negate all other regulatory controls on the collective investment industry.[2]

In 1991 the Martin Committee recommended that there should be a general review of quality control of financial advisers and agents.[3] In December 1992 the Trade Practices Commission reported on various aspects of the conduct and operation of life insurance agents.[4] This chapter makes recommendations to improve the regulation of intermediaries of securities and thereby improve protection for investors against the consequences of uninformed decision making. Intermediaries of securities are regulated by the Corporations Law. The recommendations in this chapter are made in respect of all securities, not just interests in collective investment schemes, because it is logical to regulate in the same way all those who sell securities. It is also important that intermediaries who sell or advise on similar investments that are not regulated by the Corporations Law[5] are subject to equivalent controls and minimum standards, even though they are regulated under different laws. The principles on which the recommendations in this chapter are based should be reflected in the regulatory framework for these investments.[6]

Licensing of intermediaries

Corporations Law

13.2 ***Dealers and advisers.*** Anyone who carries on a business of dealing in securities[7] or a business of advising other persons about securities[8] must be licensed under the Corporations Law.[9] Because they are securities, a person who

1. Intermediaries include accountants, share brokers, trustee companies and people who are also agents for life insurance companies.
2. Stokes & Company (Securities) Pty Ltd *Submission* 26 November 1992.
3. Martin Report, recommendation 17.
4. TPC *Superannuation and life insurance* December 1992. The Review refers to the recommendations of the Trade Practices Commission where relevant.
5. eg superannuation schemes and some insurance products. See discussion in ch 3 of investments that are similar to collective investment schemes.
6. In some instances the Review makes specific recommendations in respect of intermediaries that do not sell collective investment schemes: see, eg, para 13.23.
7. Corporations Law s 93.
8. Corporations Law s 77.
9. s 780, 781.

sells interests in prescribed interest schemes as a business can only do so if he or she is a licensed securities dealer.[10] A person who has a business of advising on interests in prescribed interest schemes must, however, be either a licensed dealer or a licensed investment adviser.[11] It is ASC policy that, if a person who gives advice on a business basis on securities receives a benefit other than from the investor, he or she must have a dealers licence, not an investment advisers licence.[12]

13.3 ***Authorised representatives.*** The Securities Industry Code required the representatives of securities dealers, as well as the dealer, to be licensed. This system proved to be cumbersome and ineffective. The Corporations Law provides for licensed securities dealers and investment advisers to authorise representatives to act on their behalf.[13] It does not prescribe any standards for representatives.[14] The licensee has an incentive to ensure a high standard in its representatives because it could lose its licence as a result of its representatives' actions.[15] This approach is appropriate. Standards for representatives do not need to be specified in the law.

Recommendations

13.4 It is appropriate that the provisions of the Corporations Law which presently require intermediaries who carry on a business of dealing or advising in securities, including interests in collective investment schemes, to have a dealers or advisers licence should continue. Two qualifications will, however, need to be made.

- *Scheme operator dealing in interests in its own scheme.* The ASC administers the Corporations Law on the basis that 'dealing in securities' includes the issue, and buying back, of interests in a scheme by its operator. That interpretation of the Corporations Law was developed in the context of a dealers licence being the only licence available to be used to control prescribed interest scheme operators. The Review's recommendation for a separate class of licence — a scheme operators licence — alters this position. The Review **recommends** that the prohibition in the Corporations Law on dealing in securities without a dealers licence should not be infringed

10. The Corporations Law s 781 provides that a person must not carry on a securities business unless the person holds a dealers licence or is an exempt dealer. A securities business is the business of dealing in securities: s 93. Prescribed interests are securities: s 92(1).
11. A dealers licence entitles the holder to carry on a business of dealing in securities: Corporations Law s 780, 9, 93. 'Deal' in securities includes to acquire, dispose of or subscribe for or underwrite securities: s 9. An investment advisers licence entitles the holder to carry on a business of advising other persons about securities: Corporations Law s 781, 9, 77.
12. See NCSC Release 333 para 14, which has been adopted by the ASC. There are many more licensed securities dealers than there are licensed investment advisers.
13. Corporations Law s 806, 807.
14. The ASC may, however, impose conditions on a licence about what the holder of the licence is to do, by way of supervision and otherwise, to prevent the holder's representative from contravening a securities law or another condition of the licence and to ensure that each representative of the holder has adequate qualifications and experience having regard to what the representative will do on the holder's behalf in connection with a securities business or investment advice business carried on by the holder: Corporations Law s 786(2)(e), (f).
15. Corporations Law Pt 7.3, Div 4.

merely because the licensed operator of a collective investment scheme issues, buys or redeems interests in the scheme. If, apart from this, a collective investment scheme operator carries on the business of dealing in securities,[16] the operator must also hold a dealers licence.

- *Advising.* Similar reasoning applies to the prohibition in the Corporations Law on carrying on an investment advice business without a licence. The Review **recommends** that that prohibition should not be infringed merely because the operator of a scheme gives advice, either directly or through its staff, about interests in any scheme of which it is the operator. Later recommendations in this chapter ensure that other protective controls apply when scheme operators give advice.

If a scheme operator authorises representatives (in the same way as a securities dealer can authorise representatives), the Review **recommends** that the procedures and requirements for such representatives should be the same, as nearly as possible, as for representatives of licensed dealers. In particular, the scheme operator should have the same liability as a licensed dealer has for its representatives' actions.

Corporations Law standards for dealers and investment advisers

Are the standards adequate?

13.5 Under the Corporations Law, persons applying for a dealers or investment advisers licence must be solvent and have educational qualifications and experience adequate for a licence of the kind applied for. In addition, the ASC must have no reason to believe that the person is not of good fame and character or will not perform his or her duties efficiently, honestly and fairly.[17] It must have regard to any conviction in the past 10 years for serious fraud.[18] If the applicant is a body corporate, the applicant must not be externally administered and the ASC must be satisfied that the educational qualifications and experience of each responsible officer of the applicant are adequate having regard to the duties that the officer would perform in connection with the licence.[19]

Minimum standard of education

13.6 The Corporations Law lists no specific educational qualifications and experience needed to gain an advisers or dealers licence. DP 53 proposed that, in the longer term, these matters should be prescribed for intermediaries.[20] The Review suggested that this would promote consistency and public confidence in intermediaries. It anticipated that, beyond a prescribed minimum, the level of

16. eg as the operator of an equity trust would.
17. Corporations Law s 783.
18. Corporations Law s 783(4). 'Serious fraud' is defined in s 9.
19. Corporations Law s 784.
20. Proposal 10.1.

education should vary depending on the type, or range, of collective investments the licensee would be entitled to sell or advise on. The proposal received wide support.[21] Many submissions urged that prescribed qualifications be introduced promptly.[22] The Review **recommends** that specific educational qualifications and experience necessary to gain a dealers licence under which the licensee will be allowed to advise persons about securities or an investment advisers licence should be prescribed.[23] The development of licence categories and appropriate standards for each category should be done by the ASC in consultation with industry participants and consumers of intermediary services.[24] This should be done as soon as possible.

Making securities recommendations

Duty to give appropriate advice in light of the investor's circumstances

13.7 ***'Know your client'.*** A person offering advice or making a recommendation to an investor about securities should know the needs and circumstances of the investor. Referred to as the 'know your client' rule, the Corporations Law provides that a securities adviser is liable to pay damages to a client who loses money after acting on that adviser's recommendation if the adviser did not have a reasonable basis for making the recommendation.[25] An adviser does not have a reasonable basis for making a securities recommendation unless

> (a) in order to ascertain that the recommendation is appropriate having regard to the information the securities adviser has about the person's investment objectives, financial situation and particular needs, the securities adviser has given such consideration to, and conducted such an investigation of, the subject matter of the recommendation as is reasonable in all the circumstances; and
> (b) the recommendation is based on that consideration and investigation.[26]

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21. Credit Union Services Corporation (Australia) Ltd *Submission* 27 November 1992; JP McAuley *Submission* 23 November 1992; Macquarie Investment Management Limited *Submission* 24 November 1992; JK Denyer *Submission* 3 November 1992; National Mutual *Submission* 3 December 1992; AMP Society *Submission* 30 November 1992; National Information Centre on Retirement Investments *Submission* 24 November 1992; IFA *Submission* 1 December 1992; FPAA *Submission* 7 December 1992; MLC Investments Ltd *Submission* 17 December 1992; County NatWest Australia Investment Management Limited *Submission* 18 December 1992; TCA *Submission* 17 December 1992; MLC Life Ltd *Submission* 18 December 1992. One submission criticised the standards in the industry generally. It also said that the ASC lacked a clear policy on what minimum standards should be required and failed to use its enforcement powers when complaints about individual intermediaries are made: Australian Investors Association *Submission* 16 December 1992.
22. eg T Valentine *Submission* 5 November 1992; IFA *Submission* 1 December 1992; County NatWest Australia Investment Management Limited *Submission* 18 December 1992.
23. The Review does not consider that educational qualifications and expertise to gain a scheme operators licence need to be prescribed (see para 10.50). A scheme operators licence will, however, only allow the holder to advise on its own securities, about which, it is fair to assume, it will be sufficiently well informed.
24. The FPAA is already consulting with the ASC about prescribed standards for licensees: FPAA *Submission* 7 December 1992.
25. s 851, 852. A securities adviser is a dealer, an investment adviser or a representative of either: Corporations Law s 9, 94.
26. s 851(2).

13.8 ***Securities advisers should have to enquire.*** The Review agrees with the basic thrust of this provision but considers it has several deficiencies. First, it does not impose a positive obligation to ask clients about their investment objectives, financial situation and personal needs. Without this, an adviser could claim to have a reasonable basis for making a securities recommendation to a person about whose situation the adviser knew little or nothing. In 1990 the NCSC expressed its view that the *Securities Industry Act 1980* (Cth) s 68E, the equivalent of the Corporations Law s 851, imposed a positive duty on advisers to ask clients for such information if it was clear that the client needed to rely totally on advice sought from an adviser concerning a particular matter.[27] The Review supports the policy set out by the NCSC. However, its interpretation of s 851 may be questionable. What s 851 requires is that the adviser, in order to check whether a recommendation is appropriate *having regard to the knowledge of the client's circumstances that the adviser presently has*, must investigate the subject matter of the recommendation, that is, the securities. The adviser need not inquire further of the client. DP 53 proposed that the Corporations Law be amended to impose on advisers a positive obligation to make appropriate inquiries about the client's investment objectives, financial situation and needs.[28] Submissions overwhelmingly agreed.[29] Also, the recent TPC report on life agents recommended that all life insurance intermediaries should have to conduct 'needs based' and 'know your client' analyses to establish relevant facts about and needs of their clients and to recommend products which match their needs and financial capacities.[30]

13.9 ***When does service involve a recommendation?*** DP 53 suggested that an intermediary who does not advise or make a recommendation to an investor but merely sells an investment should not be subject to a 'know your client' requirement, just as the person is not presently subject to s 851. One submission warned against interpreting 'recommendation' too narrowly. It considered that counter staff or client service officers who make favourable statements to individuals are in fact making recommendations and should, therefore, be required to carry out a 'know your client' exercise before advising people whether to make a purchase.[31]

13.10 ***Recommendation.*** The Review **recommends** that the Corporations Law should be amended to prohibit a securities adviser or the holder of a scheme operators licence from making a securities recommendation to a client that the client may reasonably be expected to rely on unless

27. NCSC Release 352 para 12.
28. Proposal 10.2.
29. eg Minter Ellison Morris Fletcher *Submission* 19 November 1992; LIFA *Submission* 18 December 1992; TCA *Submission* 17 December 1992; St George Funds Manager Limited *Submission* 18 December 1992; MLC Investments Ltd *Submission* 17 December 1992; MLC Life Ltd *Submission* 18 December 1992; ISC *Submission* 12 November 1992; IFA *Submission* 1 December 1992; Macquarie Investment Management Ltd *Submission* 24 November 1992; Stokes & Company (Securities) Pty Ltd *Submission* 26 November 1992.
30. TPC Report, recommendation 2(a).
31. FPAA *Submission* 7 December 1992. It suggested that the only exception to this obligation should be where a client desires an 'execution only' service and is warned that no advice or recommendation is being given.

- the adviser or operator has made reasonable inquiries about, and other reasonable investigations of, the client's investment objectives, financial situation and needs and
- the recommendation is based on the results of those inquiries and investigations.

Whether what has been done in a particular case amounts to making such a recommendation will depend on the circumstances. The holder of a scheme operators licence will have to ensure that its employees know when they are making securities recommendations and that they take the necessary care when making them. One submission suggested that the law should expressly provide that, if nothing in an adviser's range of product competence is suitable for a client, the adviser should have to refer the client to another adviser with a different area of competence or make no recommendation.[32] The Review considers the obligation imposed on intermediaries by the recommendation just made will in practice preclude an adviser making a recommendation if he or she does not have a suitable product, because he or she will not have a reasonable basis for recommending one of his or her products.

13.11 ***Recommendation to be in writing.*** One submission argued that the quality of advice is enhanced if the advisory process is adequately documented and a copy of the analysis and recommendation is provided to the client on request.[33] The Review agrees. The TPC recently made the following recommendation in respect of life insurance intermediaries.

> To create an appropriate 'paper trail' of the point-of-sale advice and information disclosure provided to consumers . . . all intermediaries should be required to document (and to provide copies for consumer, life office and intermediary) the relevant facts and bases for recommendations and to ensure that the facts and recommendation bases are explained to the clients.[34]

The Review **recommends** that the Corporations Law should require that, if a securities adviser or the holder of a scheme operators licence makes a securities recommendation to a client who can reasonably be expected to rely on it, it should have to give the client a written statement of the recommendation. The statement should include the particulars of the enquiries made by the adviser and the information required under recommendation made in paragraph 13.19.

Best advice

13.12 DP 53 proposed that the law should prohibit an intermediary from recommending a product to a client unless it is, in the intermediary's professional judgment, the product within the range of products on which the intermediary is

32. FPAA *Submission* 7 December 1992.
33. ibid.
34. TPC Report, recommendation 2(c).

competent to advise that will best suit the client's needs.[35] Submissions on this proposal were mixed. Some said that this requirement would narrow the range of advice offered, limit the market opportunities of some institutions and tend to encourage agents into recommending large players in the industry.[36] Several submissions considered that it would be problematic to enforce because of the difficulty of showing that a product was not the most appropriate 'in the professional judgment of the adviser'.[37] The Review accepts these concerns. It does not recommend that a 'best advice' obligation be imposed on intermediaries.

Independence of financial intermediaries

Independent intermediaries

13.13 The word 'independent', when used in the context of investment advice, connotes separation of the person giving the advice from the promoter of the investment opportunity. It suggests that the advice is objective and made only in the light of the client's interests. At the moment, advisers who may not fulfill these expectations are able to call themselves independent.

Distinction between giving advice and selling a product

13.14 Giving advice and selling a product are very different activities. The difference affects the degree of independence expected of the intermediary. This is particularly so if the sale involves a commission for the intermediary.

> Strictly speaking, advisers who operate on [a commission] basis are not remunerated for the *advice* they give their clients, but for *placing* their clients' investment or insurance business.[38]

Unless advice is given free of any consideration by the intermediary of the benefit that may flow to him or her as a result, that advice will not be truly independent. Any possible benefit, no matter how minor or seemingly insignificant, has the potential to influence an intermediary in making a recommendation and could, in the extreme, drive a recommendation.

Use of term 'independent'

13.15 A potential conflict of interest exists when an intermediary may be influenced in recommending an investment by a consideration other than the value of the investment for the client in the client's circumstances. The potential for

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35. Proposal 10.4. In the UK intermediaries selling 'packaged products', which include life policies, authorised unit trusts and recognised overseas collective investment schemes, are subject to a 'best advice' rule, under which a recommendation must not be made unless there has been a conscientious search across packaged products that are within the adviser's competence to recommend and the packaged product recommended is believed to be at least as good as any other available: Securities Investment Board Core Rule 17.
36. Treasury *Submission* 24 December 1992; National Mutual *Submission* 3 December 1992.
37. eg T Valentine *Submission* 5 November 1992; St George Funds Manager Limited *Submission* 18 December 1992.
38. Stokes & Company (Securities) Pty Ltd *Submission* 31 October 1991.

such a conflict is particularly significant when an intermediary enters an arrangement under which he or she will receive a commission from the promoter on the sale or recommendation of a particular investment.[39] Many intermediaries who currently describe themselves as 'independent' mean merely that they operate their business away from the office of the promoter of a particular product or that they are able to offer products from a range of promoters or institutions, that is, that they are not sole agents. The general community understanding, however, is that 'independent' connotes a lack of possible conflict of interest and is, therefore, inconsistent with receiving commission.

Proposal and recommendation

13.16 DP 53 proposed that only intermediaries who do not receive any benefit, monetary or otherwise, other than from their clients should be able to hold themselves out as independent.[40] Submissions generally supported the proposal.[41] Some considered that full and effective disclosure would provide enough information for clients to judge the extent of bias or impartiality of the advice provided.[42] It was also suggested that the proposal would reduce competition.[43] The Review is not persuaded by these arguments. To describe oneself as independent when, according to the ordinary community understanding of the word, one is not independent is a form of misleading market activity. The Review recommends two restrictions on intermediaries holding themselves out as independent. First, it **recommends** that the Corporations Law should prohibit a dealer or investment adviser from holding himself or herself out as independent, whether by describing himself or herself as independent or otherwise, if he or she will receive, or has entered into any arrangement to receive, as a result of a recommendation to a client, a benefit other than from the client on account of buying or selling any securities.[44] 'Benefit' should include all benefits, not just commissions. Intermediaries who only receive commissions and arrange for commissions to be rebated and instead receive payment for services from their client should not, however, be prevented from describing themselves as independent. The second prohibition arises from a suggestion in one submission that the expression 'independent' should not be available to intermediaries who are owned (partly or wholly) by the operator of a collective investment scheme.[45] The Review

39. In the UK intermediaries are divided into independent financial advisers (who give advice across a range of products) and tied agents (who sell the products of only one company): *Financial Services Act 1986* (UK). Under this division, independent financial advisers may receive commissions.
40. Proposal 10.5.
41. eg T Valentine *Submission* 5 November 1992; National Mutual *Submission* 3 December 1992; Minter Ellison Morris Fletcher *Submission* 19 November 1992; AMP Society *Submission* 30 November 1992; St George Funds Manager Limited *Submission* 18 December 1992; TCA *Submission* 17 December 1992; ASCPA & ICAA *Submission* 15 February 1993; Treasury *Submission* 24 December 1992; ISC *Submission* 12 November 1992.
42. eg FPAA *Submission* 7 December 1992; MLC Investments Ltd *Submission* 17 December 1992; Mercantile Mutual Holdings Ltd *Submission* 16 December 1992.
43. FPAA *Submission* 7 December 1992.
44. The Review notes that the TPC recommended that any intermediaries who are remunerated by commission or are otherwise obligated or responsible to, or employed by, a life office should be prohibited from describing their position or service as 'independent': TPC Report, recommendation 1(b).
45. Stokes & Company (Securities) Pty Ltd *Submission* 26 November 1992.

agrees. The potential for an intermediary that is controlled by the offeror of securities to give advice that is influenced by that relationship is significant enough to warrant prohibiting that intermediary from calling itself independent, even if it is remunerated only by its clients. The Review **recommends** that a dealer or investment adviser that is a body corporate must not hold itself out as independent if a body in whose securities it may lawfully deal or about whose securities it may lawfully advise other persons or publish reports is in a position to control it.

Restricting method of remuneration

13.17 An intermediary may be paid by a client, by the offeror of the securities or by both. Payments by commission inevitably involve the possibility of bias. One submission particularly criticised the commission system of remunerating agents.

> [A]dvisers must be objective. They must not be in a position where there is a conflict of interest (ie to be in a situation where the income earned from recommendations varies according to the investment recommended). Advice on physical health from a person who derives income from commissions paid by drug manufacturers with a tendency to recommend the drug which pays the highest commission would be completely unacceptable.[46]

DP 53 asked whether there is a need to control the way in which intermediaries determine their fees. Most submissions expressed the view that, so long as intermediaries disclosed fully and fairly the remuneration and other benefits they get, legislative controls on fee or benefit levels were unnecessary.[47] The Review agrees. Disclosure of fees, in particular commissions, is more important than what kind of payments are made.[48]

Disclosure by intermediaries

Disclosure of benefits

13.18 Commissions and other benefits paid to intermediaries have the potential to place intermediaries in a position of conflict of interest. They may take into account, in making a recommendation, factors other than the client's needs. Clients should be made aware of this, to let them judge for themselves. Under the Corporations Law a securities adviser must, when making a securities recommendation, give the client details of

- commissions, fees or other benefits or advantages, whether pecuniary or not, that the adviser, or an associate, has received or will receive on account of making the recommendation[49]

46. Australian Investors Association *Submission* 16 December 1992.
47. Minter Ellison Morris Fletcher *Submission* 19 November 1992; Credit Union Services Corporation (Australia) Ltd *Submission* 27 November 1992; T Valentine *Submission* 5 November 1992; NE Renton *Submission* 3 December 1992; St George Funds Manager Limited *Submission* 18 December 1992; Mercantile Mutual Holdings Limited *Submission* 16 December 1992; FPAA *Submission* 7 December 1992; MLC Investments Ltd *Submission* 17 December 1992.
48. See para 13.18.
49. s 849(2)(c).

- any other pecuniary or other interest of the adviser, or an associate, that may reasonably be expected to be capable of influencing the recommendation.[50]

The Review supports this obligation.

Disclosure of how much of the client's money is actually invested

13.19 The Review recommends elsewhere that scheme operators should have to disclose in the prospectus how their fees and charges are worked out.[51] Disclosure of such benefits does not, by itself, give the whole picture. It is most important that investors also know how much of their money is actually invested. Some intermediaries in the collective investments industry already provide investors with these details.[52] DP 53 proposed that the Corporations Law s 849 should be amended to make this further disclosure mandatory.[53] This proposal received widespread support.[54] It should not be left to an investor to seek from the intermediary information about how much of his or her funds are actually invested. The information should be volunteered. The Review **recommends** that the Corporations Law should be amended to require securities advisers and scheme operators, when they make a securities recommendation, to disclose to their clients how much of the client's investment will be deducted for fees, commissions and other charges. The amount of each fee and charge, and its purpose, should be disclosed in writing before the transaction recommended, or one substantially like it, is carried out. Failure to disclose should be an offence. Given the way remuneration is structured for such policies, it may not be a straightforward matter in all cases to provide information on the amount of contributions that are actually invested. This kind of difficulty is not enough to outweigh the benefits of full disclosure.[55] In fact, it underlines the importance of the recommendation.

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50. s 849(2)(d).
51. See para 5.14. Prospectuses for unit trusts usually disclose the entry fee and specify that up to a stated percentage of that entry fee can be paid to the intermediary. The actual percentage to be paid is determined at the discretion of the operator. Alternatively, an adviser may come to an agreement with a client that the client will pay the adviser a fee for service instead of the adviser receiving the commission. In this case, the adviser notifies the manager that the commission is to be rebated and the manager issues additional units to the investor to the value of the rebated commission.
52. Most advisers now provide a summary table showing the investment product, amount invested in dollar terms, the establishment fee in percentages or dollars, the brokerage receivable, both initial (amount or percentage) and on-going (% a year): K Breakspear 'The right to know an adviser' 1992 (June) *Financial Planning*.
53. Proposal 10.7
54. eg Treasury *Submission* 24 December 1992; TCA *Submission* 17 December 1992; County NatWest Australia Investment Management Limited *Submission* 18 December 1992; Mercantile Mutual Holdings Ltd *Submission* 16 December 1992; MLC Investments Ltd *Submission* 17 December 1992; FPAA *Submission* 7 December 1992; IFA *Submission* 1 December 1992; Macquarie Investment Management Ltd *Submission* 24 November 1992.
55. The TPC Report commented on this matter: 'Should the ISC and the life offices, in seeking to implement [the recommendations about disclosure of commissions], be unable to overcome the practical difficulties that may be involved in defining and measuring intermediary remuneration and benefits on a consistent basis, consideration should be given to restricting intermediary remuneration and benefits to specified forms which are capable of clear definition and measurement': 1-16.

Ultimately, it should be for the investor to judge whether the remuneration arrangements of the intermediary are fair and reasonable, the extent to which they affect the returns on the investment and the extent to which they may have influenced the intermediary's recommendation.

Information about themselves

13.20 DP 53 proposed that intermediaries should provide information about themselves, for example, about the services they can offer and the type of licence they have.[56] In light of the above recommendations, the Review no longer considers this necessary.

Issues relating to life insurance products

Equivalent controls on the marketing of similar products

13.21 Even though investment linked life policies are not regulated under the Corporations Law, they compete with investments that are regulated by that law. They should be marketed in a similar way, with similar restrictions. Investors will then be better able to compare products and make an informed choice.

Insurance (Agents and Brokers) Act

13.22 Life insurance company agents are subject to the supervision of the life insurance company with whom they have entered an agency arrangement. Under the *Insurance (Agents and Brokers) Act 1984* (Cth), life companies are responsible for the actions and behaviour of their agents. The Act does not prescribe minimum standards for selection or supervision of agents.[57] Some life companies operate unit trusts, usually through a subsidiary, as well as offer life insurance policies. Those unit trusts are often marketed through a life company's life agents, but in the agents' capacity as representatives of the life company's subsidiary, which, under the current law, must have a dealers licence to operate the trust. In respect of the sale of interests in the unit trust, the agent will be regulated by the Corporations Law. An intermediary acting for a life company can, therefore, be regulated by two laws, depending on which product he or she is selling at a particular time. Investors are entitled to assume that all intermediaries selling products that serve the same function are regulated similarly, even if the organisations offering the products are regulated by different regulators. This is particularly so in respect of disclosure of commissions and other benefits.

56. Proposal 10.6.
57. In ALRC 59 the Review recommended that the *Insurance (Agents and Brokers) Act 1984* (Cth) s 10 should be amended to provide that an insurer must not enter into an agreement under which the insurance intermediary is authorised to offer superannuation unless satisfied that the intermediary is of good fame and character, will be able to act honestly, has adequate educational qualifications and expertise and is not bankrupt: recommendation 8.14. This recommendation was designed to encourage life companies to impose on their agents similar standards to those imposed on licensed dealers and investment advisers.

Requirements for life agents

13.23 Life agents who sell interests in collective investment schemes run by their principals will be required under the Corporations Law to disclose to the client details of

- commissions, fees and other benefits or advantages the agent will receive on account of making the recommendation[58]
- any other pecuniary or other interest that the agent has that may reasonably be expected to be capable of influencing the recommendation.[59]

Under earlier recommendations in this chapter, agents in these circumstances will also have to disclose how much of the client's money will actually be invested and how much will be taken as fees and other charges. A detailed breakdown of these fees and charges will have to be given.[60] Those agents will also be subject to the Review's recommendations requiring recommendations to be in writing,[61] obliging intermediaries to inquire about, and investigate, a client's investment objectives, financial situation and needs[62] and restricting intermediaries from holding themselves out as independent if he or she is in a position to receive a commission.[63] These restrictions do not apply to life agents selling investment linked products.[64] The Review noted earlier in this report that its recommendation not to include investment linked life insurance policies within the collective investment schemes governed by the Corporations Law depended on a similar regulatory framework being imposed on those products.[65] That framework includes the regulation of the sellers of these products. The Review **recommends**, accordingly, that the *Life Insurance Act 1945* (Cth) should be amended to impose on persons selling investment linked life policies requirements that reflect the recommendations made in this chapter about written recommendations,[66] making inquiries of clients, disclosure of commissions, fees and charges and the amount of money actually invested on behalf of the investor and intermediaries holding themselves out as independent. For example, there should be a separate legal obligation imposed on life insurance agents to give the same disclosures as to commissions, fees, benefits and interests as the Corporations Law imposes on persons who sell securities. This is consistent with the TPC recommendation in its recent report that all life insurance intermediaries should have to disclose to

58. s 849(2)(c).
59. s 849(2)(d).
60. See para 13.19.
61. See para 13.11.
62. See para 13.10.
63. See para 13.16.
64. There is at present no legal obligation on life agents to make similar disclosures in connection with the sale of life insurance policies, in particular, investment linked life insurance policies, although ISC Circulars encourage such disclosure. It is arguable that the insurer's obligation to act towards the client with the utmost good faith in all matters concerning the contract, which extends to pre contractual negotiations, would require the insurer (rather than the agent) to inform the client fully of these matters. Nevertheless, the Review considers that this should be made explicit in the law as an obligation imposed directly on the agent, who deals with the client.
65. See para 3.15.
66. The TPC Report recommended similarly: see para 13.11.

consumers, before the proposal form is signed, the amounts of commission and other benefits payable by the supplier of the recommended products as a result of the sale of the product.[67]

Hawking investments

13.24 Securities, including interests in collective investment schemes, cannot be sold door to door.[68] This restriction applies to securities sold by life agents as authorised representatives of licensed securities dealers. The sale of life policies, on the other hand, is not subject to such a prohibition. It has been suggested that the ability to hawk life products is detrimental to investors and that it provides insurance companies with a competitive advantage (in respect of some of their policies) over collective investment schemes. This raises the issue whether investment linked life policies should be subject to a prohibition on hawking. The life insurance industry's view is that the 14 day free look period that applies to life policies[69] provides as much protection as, if not more than, the prohibition against hawking. DP 53, which proposed that investment linked life products be regulated under the Corporations Law, asked whether life agents should be exempted from the prohibition against hawking securities on the basis that only some of the products they sell would be subject to this prohibition and that it may be difficult, as a practical matter, to operate under two sets of rules.[70] Submissions were divided on this issue. Some considered that the ban on hawking should apply to the sale of any investment linked policies.[71] Some considered that possible high pressure selling techniques, even with the 14 day cooling off period, might not give consumers enough time to consider their investment.[72] Others considered that hawking of life products should continue to be allowed. They said that the legislation already provides adequate protection.[73] The latter approach assumes that the level of disclosure required to be made by life offices to potential policyholders will be increased to a standard comparable to that required under the Corporations Law. As this report does not recommend that investment linked insurance products should be regulated under the Corporations Law, the issue is whether a prohibition on hawking should be introduced into the life insurance legislation applying to investment linked products. The Review has concluded that the improved disclosure requirements for life insurance products which the Review recommends be introduced into the LIA,[74] combined with the fact that life offices are responsible for the actions of their agents, will provide adequate protection for investors in life policies and ample opportunity for the ISC to take action against

67. TPC Report, recommendation 1(c).
68. The Corporations Law prohibits a person from going from place to place offering securities of a corporation for subscription or purchase: s 1078. 'Securities of a corporation' includes prescribed interests made available by a body corporate: s 92(2)(c).
69. See *Insurance Contracts Act 1984* (Cth) s 64.
70. Issue 10A.
71. eg National Information Centre on Retirement Investments *Submission* 24 November 1992; St George Funds Manager Limited *Submission* 18 December 1992.
72. FPAA *Submission* 7 December 1992.
73. National Mutual *Submission* 3 December 1992; AMP Society *Submission* 30 November 1992. They noted that this is also the case in the UK and the US.
74. See para 13.23.

life companies in respect of agents who abuse their position. Subject to these changes being implemented, the Review does not recommend any change to the present law in respect of hawking.

Licensing life agents

13.25 ***Industry proposal.*** Life agents are not licensed under the present law. The life company for whom they act is fully responsible for what they do.[75] Life agents who are authorised to sell interests in a collective investment scheme operated by a life company, or its subsidiary, must be authorised as representatives of the company under the Corporations Law.[76] However they are not separately licensed. The Review understands that the insurance industry favours the introduction of a system of licensing agents. The proposal, which has not been finalised, involves agents being licensed by a separate licensing board in accordance with stipulated minimum standards of education and training, a code of conduct and a procedure to ensure compliance with the code of conduct. Penalties would be provided for breaches of rules or prohibited conduct by agents, including fines, suspension and cancellation.[77] The TPC recommended in its report that any proposal for licensing of agents be submitted to it for assessment under the authorisation procedure of the *Trade Practices Act 1974* (Cth) (for restrictive trade practices).[78]

13.26 ***ALRC 16.*** In its report *Insurance Agents and Brokers* (ALRC 16, 1980) the ALRC considered whether life agents should be licensed. It had been suggested that licensing would be a way to deal with the problems of replacement of life policies (twisting) and misleading comparisons of policies and investments. The ALRC concluded that licensing was not a necessary or appropriate means to that end.[79]

13.27 ***Review's view.*** The Review is not convinced that the benefits, if any, of licensing life agents would outweigh the costs. Rather, life companies should be fully aware of their responsibilities in respect of their agents. Licensing agents could, in fact, have the reverse effect. Focusing on agents could detract from the life company's responsibility. Life companies are in the best position to monitor the behaviour and competence of their agents and responsibility for the acts of their agents should provide incentive to supervise their agents closely. The Review **recommends** that no system for licensing life agents be introduced.

75. *Insurance (Agents and Brokers) Act 1984* (Cth) s 11.
76. Corporations Law s 806, 807.
77. See TPC Report 8-13 for details of the industry's proposal.
78. Recommendation 6.
79. Para 143. The ALRC also considered the issue of licensing in its report on customs and excise. It concluded that licensing customs agents was not justified — any controls could just as effectively be imposed by the criminal law: see ALRC 60 *Customs and excise* Sydney 1992 vol 2, ch 8.