

LICENSING OF INVESTMENT ADVISERS/DEALERS

Submission provided by The Securities Institute of Australia in response to an invitation by the National Companies and Securities Commission, February, 1984.

The Institute has responded to an invitation by the National Companies and Securities Commission for interested parties to make submissions on the licencing of investment advisers and dealers. Federal Council appointed a Committee consisting of Messrs Ian Davidson (Vic), Max Powditch (NSW) and Michael Sargent (Qld) to coordinate the task. Working parties in each division submitted their views and a drafting Committee in Victoria consisting of Messrs Ian Davidson, Charles Williams and Roy Douglas worked on this material to produce the document printed below, which was then approved by the Federal Committee.

The main themes are that changes in the investment industry have created conditions which were not envisaged when the present licencing system was designed. Something tougher and more extensive is now essential. Specific educational requirements are needed and the SIA is uniquely qualified to play the leading role in providing an educational program for people seeking licences. Members of the Institute will appreciate the thrust of the Submission by reading paragraphs 1.5, 1.7, 2.5 and 5.9.

1. INTRODUCTION

1.1 The Securities Institute of Australia (SIA) regards the invitation of the National Companies and Securities Commission (NCSC) for submission on this subject as extremely timely.

1.2 There is an unprecedented demand for investment advice and an unprecedented requirement that those giving advice be both expert in the field and conscious of their responsibility to those who use their services.

1.3 Investment advising has now become a service industry in its own right. It is no longer an adjunct to stockbroking or banking or to the professions of law and accounting. Those who seek to make a living from advising the public should possess adequate and acceptable educational qualifications, together with appropriate experience.

1.4 Various groups operating within the investment industry, such as the Association of Superannuation Funds (ASFA), have expressed concern about the quality of investment advice being given and have taken independent action, such as the establishment and publishing of guidelines, for choosing an adviser, approved lists, etc., but clearly such moves are temporary and inadequate. Indeed, an association of investment advisers — the Australian Investment Planners Association — has already been formed due to a concern for professional standards within the industry.

1.5 The longer term solution clearly must lie in reform of the regulatory system within which advisers are required to operate. Such reform should address two central problems. It is too easy to get a licence, and the present licensing structure is not appropriately related to the industry it is intended to regulate.

1.6 The difficulties to be surmounted in the course of a reform of the licensing system are indisputable. However, there are at least four clear essentials:

1.61 Licensing must be function based and not product based.

1.62 Issue of licences should require applicants to demonstrate an appropriate level of knowledge about investment matters and about the ethical standards required of them. Mere absence of detected acts of dishonesty or incompetence is not enough.

1.63 The knowledge referred to above will, in the case of applicants after a cut-off date, need to have been acquired by formal study, as well as by experience.

1.64 The appropriate course of study must be practically based, nationally accessible and grounded on the premise that students are being equipped to advise on investment matters, not to sell particular products.

1.7 The SIA is the leading educational body within the industry. Both its membership and participants in its two courses (Certificate and Diploma) cover the total spectrum of the industry and as well there are many students who are taking the courses in an endeavour to enter the industry. Within the Institute there are NO divisive factions, as tend to exist between various sections of the industry. No other body can claim this unique and accepted position. Therefore, the SIA's role as a responsible member of the industry, and its role as an educational body, both add weight to the SIA's recommendation that the legislative requirements relating to the licensing of dealers and advisers be tightened considerably, particularly in relation to educational qualifications, and that an

appropriate course of study should be introduced by the SIA after detailed discussions with the NCSC and other interested parties.

1.8 The SIA does not propose that licence holders be required to be members of the Institute — but that it devise and administer a prescribed course for all licence holders.

1.9 This approach is now accepted by both Canadian and US regulatory bodies and, to various degrees, it is written into legislation as a prerequisite to the issuance of a licence in those countries.

2. PRESENT POSITION

2.1 A problem of major proportions has arisen due to the rapid changes in the securities industry over the last decade. Structural changes within the industry have left existing legislation and regulation inadequate, out of date and, in many cases, irrelevant.

Dynamic growth and change within the securities industry is inevitable because of the industry's central position within the economic system. However, corresponding change is not reflected in regulatory provisions. Dealers' Licences were originally introduced to cater for organisations dealing in securities such as merchant banks and stockbrokers, and Dealers' Representative Licences for their employees. Advisers' Licences were introduced to cover the few who were involved only in the provision of advice. Today the industry is very different. A new breed of investment adviser has been issued with a Dealers' Licence, as indeed have many trust managers. The role and function of these new participants in the industry is clearly quite different from what was contemplated when the existing licensing provisions were drafted and introduced.

2.2 The reasons for recent changes in the numbers and roles of investment advisers are fairly clear. Household savers, especially those receiving lump sums at retirement, have a clear need for investment advice.

Their need has provided opportunities for organisations prepared to sell direct through specialty salesmen or to offer commissions to advisers able to reach this new mass market. A trend is now emerging for distinctions between groups offering investment services to become blurred. "Financial supermarkets" are developing. These may be nominally bankers, stockbrokers, life insurance companies, or something else. Their products may or may not be securities as defined by legislation.

2.3 It is suggested that existing licensing arrangements do not prevent persons and corporations with inadequate qualifications and/or experience from entering the industry. Some of those being attracted by ease of entry are less than professional and view their involvement with the investment industry as short-term.

2.4 At present, relatively strict conditions of operation are imposed upon stockbrokers, both by the Stock Exchanges themselves and through legislative controls and monitoring. Similar controls and monitoring are not being imposed upon other advisers and dealers who operate under the same licensing systems and who, in many cases, perform very similar functions.

2.5 A number of categories of persons are specifically excluded from the present licensing provisions. These exclusions are no longer appropriate. Currently, bank officers, solicitors, accountants, and insurance personnel are exempt. Such exemptions would appear to result from a product-based concept of licensing rather than one which is function-based. They also ignore the current blurring of whatever functional distinctions may have previously existed.

2.5.1 In many instances, bank officers are clearly providing a wide range of advice to customers, as to many members of the public they are the only "financial consultant" they know or feel they can trust.

This position may well become more obvious as the ANZ Bank takeover of Development Finance Corporation becomes effective. It is entirely possible that bank officers will be in the position of actively marketing financial products of that organisation. Why should the same product be sold through unlicensed bank managers as well as through salesmen of Australian Fixed Trusts — who are required to be licensed?

2.5.2 Accountants are in a similar position in that, with more scope for advertising after April 1st, 1984 they will be able to hold out to the public their ability to provide advice on a wider range of areas than has previously been the case. Many members of the public already view their accountants as a source of investment advice and seek it from them, yet accountants are not necessarily qualified to give investment advice. This situation contains two anomalies. Accountants giving investment advice are not required to be licensed, and the accounting bodies do not require their members to have

received specific training to fit them for this specialised role.

2.5.3 Solicitors fall into the same category. Whilst their professional standing within their industry is accepted, it is no longer realistic to assume that they are adequately qualified to advise on the broad range of financial alternatives available today.

2.5.4 The insurance industry is another area where the absence of licensing is hard to justify. Insurance personnel are able to give advice to the public in relation to investment products which have been developed by insurance organisations, but there is very little to distinguish some of these products from those which can only be sold or advised on by licensed persons. In fact the industry is actively encouraging its members to avail themselves of the investment market.

2.6 The SIA is aware that the NCSC, through its delegates, is taking an increasingly active interest in the granting of licences and maintenance of standards. Furthermore, many of the potential problems associated with a gradual introduction of more stringent educational requirements as a pre-requisite for licensing could be reduced if such close monitoring were to continue and credit given for experience to date rather than demanding that current participants undertake courses of study to meet new educational standards.

3. PUBLIC CONSIDERATIONS

3.1 Information suggests that the potential for the unscrupulous operator in the field of investment advice has reached an unacceptable level.

3.2 The unprofessional or unscrupulous operator within the industry undermines public confidence in it, makes it more prone to fraud and harms the economic efficiency of capital markets.

3.3 The political and social implications of inadequate licensing standards and controls are self-evident, particularly with respect to the handling of money on behalf of clients.

3.4 Self-regulation by and within the industry is far preferable to outside intervention. However, unless licensing standards are regarded as adequate — and at present they are clearly inadequate — outside intervention by such bodies as the Trade Practices Commission should be anticipated. The SIA firmly believes that such intervention is totally

avoidable if action is taken immediately to protect the public interest.

4. THE ROLE OF EDUCATION

4.1 The purpose of an educational pre-requisite for licensing should be to assure persons dealing with the licensee that he or she has successfully undertaken prescribed training in the knowledge, skills and ethical principles appropriate to the field. It will not, of course, guarantee the successful application of such learning.

4.2 Education must be complemented by relevant practical experience of an appropriate duration before individuals are granted a licence.

4.3 The need for appropriate education and experience is recognised both by securities legislation and by Stock Exchange membership pre-requisites. That standards should be raised is implicitly acknowledged by the current draft revised membership rules of the AASE. These would require an applicant to have successfully completed either the Diploma Course or the Certificate Course conducted by The Securities Institute of Australia or a course considered to be substantially equivalent.

4.4 Education within the investment industry must be practically-oriented and directly relevant to the giving of investment advice.

4.5 No academic institution is presently offering studies which are, of themselves, sufficiently broad and practically-oriented to satisfy these requirements. It is suggested that an appropriate course of studies should require the close and continuing involvement of people in the investment industry, and be aimed directly at those providing investment advice.

4.6 The SIA believes that pre-requisite education for licences should be rigorous but general. Specialist studies should not be mandatory, although they are available within the present structure of SIA courses. *The first step is to augment the present limited supply of people with an appropriate educational background.*

4.7 The securities industry is national and thus education for licences should be organised on a national basis.

4.8 The SIA believes that over time, public demands for professionalism will increase. This may give rise to a need for refresher or professional development courses for licence holders.

4.9 The SIA recognises the problem of participants already in the investment industry who may not meet new educational standards. It is important that those

who are established within the industry be given credit for experience to date, as an alternative to undertaking a complete course of study.

5. THE ROLE OF THE SIA

5.1 The SIA appreciates the degree of difficulty posed by the licensing problem but it is firmly of the view that it is in the long-term interest of both investors, and those who service their needs, that very clear regulations and guidelines be established and enforced in relation to educational standards as a pre-requisite for licensing within the industry.

5.2 The SIA is recognised as the leading educator within the investment industry and represents all facets of the industry, including stockbrokers, merchant banks, insurance, banks and investment advisory organisations. Its members include both those in private enterprise and employees of the regulatory bodies themselves. This operative integration within the investment industry is unique.

5.3 The SIA's national membership is currently 1,926. It is estimated that during the 1984 academic year, 2000 students will undertake the Diploma and Certificate Courses. All facets of the industry are represented within the membership and student body, as show below.

INDUSTRY GROUPINGS

	Students (N.S.W.)	% Members (National)
<i>Stockbroking: Research, advising/dealing, administration etc.</i>	21.3	31.4
<i>Merchant Banking: corporate finance, money market, investment research, etc</i>	19.4	15.2
<i>Institutional: investment, management/research, etc.</i>	11.0	13.1
<i>Futures and Money Market, Industry/Commerce</i>	9.1	12.1
<i>Banking (Other than Merchant)</i>	8.0	5.9
<i>Other</i>	31.2	22.3
	<u>100.0</u>	<u>100.0</u>

Existing courses are typically completed on a part-time basis, prior to or after business hours and accordingly, whilst being undertaken, complement practical business experience.

5.4 The SIA is the only existing organisation with a national network of branches which could cope with the issues resulting from a tightening of educational requirements as a pre-requisite for licensing. Existing SIA courses provide facilities for students in mainland capital cities and extension of these facilities is under discussion.

5.5 The SIA recognises that some degree of change will be required of it. It is currently strengthening its educational organisation and is prepared to go further

to meet new demands which would result from more stringent licensing requirements in relation to educational standards.

5.6 The SIA also recognises the importance of other educational bodies, such as Universities and Institutes. These organisations already provide valuable academic input to the industry and the SIA would look forward to working with them in establishing studies appropriate to meeting the licensing requirements.

5.7 In order to meet the anticipated demand for educational qualifications, it is submitted that close co-ordination and co-operation between the SIA and these bodies would be required — particularly for participants who are not close to an SIA Branch. However, it is also submitted that the course content *MUST* be standardised through a central body — which we believe should be the SIA.

5.8 The SIA sees no conflict between its present role and that envisaged above. Successful completion of the licensing pre-requisite course would not entitle the candidate to Institute Membership, but neither would one or both of the Institute's present courses. Later, as licensing requirements are tightened, it may be that the Institute's Diploma Course, which is open only to students with a tertiary qualification, may become the licensing standard.

5.9 The SIA would reiterate that it is a national organisation, with wide experience in running practically-oriented courses for the securities industry. The SIA is able and willing to expand and continue its already well established and accepted function within the industry if called upon to provide a course or courses relevant to licensing requirements.

5.10 The SIA, whilst emphasising the urgency of tighter educational standards as part of the licensing requirements, also recognises the need to consider all aspects of the proposal before any changes are made — in particular, the difficulty of bringing some groups which are presently unlicensed within the licensing system is acknowledged.

6. MECHANICS OF INTRODUCTION

6.1 The SIA would envisage a gradual introduction of change — over a period of, say three years.

6.2 It is recommended that a working party be established comprising representatives of industry groups in order to consider both the ambit of licensing as well as appropriate educational standards.

6.3 It is further recommended that the overseas experience available from Canada, the USA and the UK be drawn upon.

7. OTHER IMPORTANT ISSUES

7.1 Audited accounts of corporations and detailed statements of personal financial position must be provided as an integral part of a licence application.

7.2 The NCSC must be equipped to undertake checks on the mode of operation of licenced persons.

7.3 Adequate indemnity insurance must be a prerequisite to the granting of a licence.

7.4 There is an area of real difficulty in relation to the licensing of persons purporting to be salesmen of single products, rather than those who provide general

investment advice. This problem is particularly clear when the product is a specialised kind of prescribed interest. There may be some cases where one product licences, perhaps with a short but renewable currency, are best. However, advocates of one-product licences must demonstrate that the deficiencies of the present system in this respect can be overcome. For example, a corporation not able to obtain a dealer's licence can have its principals and employees licenced to a separate licenced financial organisation as dealer's representatives of the latter organisation and as such can advise on a multiplicity of financial products since they hold a dealer's licence in their own right.

7.5 Where misconduct by a licensee is suspected, more use should be made of the power to suspend while enquiries are made. The present position seems to be to wait until a clear cut case of abuse has been established, and then seek removal of the licence and the livelihood of the transgressor — a notoriously difficult and protracted operation. Suspension is a step which becomes more effective and more accepted if it is used routinely, as is the case in North America.

7.6 Standards should be established in relation to the age of applicants for various types of licences.

BOOK REVIEW

Yorston, Fortescue & Brown

Australian Secretarial Practice (7th Edition)

by

S.R. Brown

This is one of many recent releases by the publisher The Law Book Company Limited, relating to company law and company secretarial matters. This, the 7th Edition, is the latest revision since 1978 and therefore incorporates all the 1981 major changes to the Companies Act and all amendments since.

The National Companies Code is made up of three basic Acts (Codes), which deal with the securities industry, take-overs, and general company matters. The author has concentrated on the last of the above three Acts but where necessary, has made reference and given short explanations on the other two Acts and, in addition, has included references and discussion on the Stock Exchange Listing Requirements.

The book takes one through the setting up of a company and the importance of the Memorandum and Articles of Association and then details and outlines the procedures in relation to raising share and

debenture capital and any calls or forfeitures associated with these. Next, it goes on to cover the roles of company directors and secretaries and any dealings between them and the company. The areas of meetings i.e. notices, quorums, minutes etc. are then covered in good detail. Finally, the area of fund raising which covers direct borrowing, loan and security records and then on into new issues and prospectus requirements are discussed. Throughout, references are made to case law and a table of cases is set out.

Earlier editions of this book are remembered by most, firstly as a text and then as a ready reference handbook which, in the belief of this reviewer, is still its most important function, particularly due to its unambiguous writing and set out which, with a purchase price under \$40 is still considered to be of great value, not only to the company secretary, but to all those who are in contact and therefore need to be in touch with matters and practices relating to corporate affairs.

Peter Prentice

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