THE INVESTMENT ADVICE INDUSTRY

By

Dennis Barton, Principal and Licensee, Andep Financial Consultants

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INTRODUCTION

As an introduction, to provide a numerical perspective, between June 1981 and June 1984 the total number of people licensed under the Securities Industry Act and Codes rose from 4,144 to 10,105. This represents a growth rate of 34.5 per cent per annum or, as some people in the industry would claim, 48 per cent per annum simple.

An earlier paper by Kretchmer ("The Problems of Being Investment Counselled") was prepared because of the author's

> concern that members of the work force in Australia who face investment of lump sum benefits on retirement may need independent unbiased advice as they are likely to be misled or confused by schemes and figures presented by institutions in Government and private sectors to entice investment.

Kretchmer's concerns, while still valid, are less so than they were.

Kretchmer's paper talked of the high quality of the investment content of some pre-retirement counselling seminars. Since his paper, in some States, pre-retirement counselling has become a casualty of the growth in the investment advice industry.

BACKGROUND

Legislative

The activities of the investment advice industry are controlled by Life Insurance legislation and the Insurance (Agents and Brokers) Act and by local Corporate Affairs Commissions (CAC) under powers derived from the Securities Industries Code of individual States.

There are two basic types of CAC licence; dealers and advisers. Subordinate to each of these licences are representatives licences, e.g. a dealer's representative or an adviser's representative.

A dealer is defined in the legislation by reference to the definition of dealing which is:

> "acquiring, disposing of, subscribing for or underwriting the securities, or making or offering to make, or inducing or attempting to induce a person to make or to offer to make, an agreement –

(a) for or with respect to acquiring, disposing of, subscribing for or underwriting the securities; or

(b) the purpose or purported purpose of which is to secure a profit or gain to a person who acquires, disposes of, subscribes for or underwrites the securities or to any of the parties to the agreement in relation to the securities;

The Market

A major part of the investment advice industry's market is retirees. Anecdotal evidence is that this market boomed in the early 80s buoyed by numerous retrenchments and early retirements by large companies. Surveys reflect this anecdotal evidence showing 4660 early retirements in the year ended June 1983 compared with 2814 and 2499 one and two years earlier. The growth of the investment advice industry flows from the strong growth in its market. Narrowing of this market will depress the growth of the investment advice industry.

The Goods

The goods available for sale by the investment advice industry at the time of Kretchmer's paper included:

(a) Debentures (finance company and other)
(b) Ordinary shares
(c) Government and semi-government securities
(d) A limited number of property trusts managed by companies which were generally long established
(e) Very few share trusts

(f) Listed property trusts
(g) A limited number of listed share investment companies
(h) Some single premium assurance policies
(i) Some friendly society contracts

Since Kretchmer's paper, the following changes can be identified.

(a) Significant increases in the number of organisations offering property trusts, equity trusts, single premium assurance policies and friendly society contracts.
(b) The introduction of deferred annuities and approved deposit funds.
(c) An increase in the number of listed property trusts.
(d) The proliferation of cash management trusts.
(e) The introduction of public securities trusts.
(f) Significant changes in the semi-government securities market.
(g) Extension of the tap and tender system to longer dated Commonwealth securities.
(h) The popularisation of mortgage trusts.
(i) The introduction of international investment trusts.
(j) The decline in industrial debentures associated with changes in financing of industrial companies borrowings.

The change from a "postage stamp" menu to a smorgasbord of investment products increased the difficulties faced by retirees and the opportunities for the investment advice industry.

THE PLAYERS INVOLVED

Introduction

A specific question that has arisen relates to who the "players" in the industry are. A more refined term like "participants" could be used, but players is an apt description which lends itself to some other meaningful lists.

Even if one restricts the players to those who are registered with the various Corporate Affairs Commissions, the game has become very crowded. Appendix A is an extract from the 1984 annual report of the NCSC. It shows that the major categories of players were dealers and their representatives. These totalled 94.0 per cent of those involved. This proportion was substantially unchanged from 1981.

An interesting feature of the Appendix is the growth in corporate dealers. While natural persons holding dealer's licences grew by 10 per cent during the three year period, the number of corporations holding dealer's licences grew by 191 per cent. The substantial growth in dealer's representatives is likely to have been associated with the growth in corporate dealers.

It is my guess that most of the natural persons licenced as dealers in 1981 were partners in stockbroking firms. Of the others licensed as dealers, it is not necessarily true that they were all involved in the personal investment advice industry. Some would have been involved in corporate finance; others involved in managing the investments "sold' by investment advice industry.

It is a reasonable supposition that a large part of the growth in the numbers of dealer's representatives relates to people in the personal investment advice industry.

Accountants

The Securities Industry Code provides an opportunity for accountants to be involved in the personal investment advice industry in that they are exempt from the licencing requirements. This exemption is subject to the proviso that the investment advice is "incidental" to the accountant's practice.

Despite this opportunity, accountants were slow to take advantage of this market. They typically did not have a client base amongst retirees, nor until recently were they able to advertise. These two factors, together with the perception that accountants were for big companies or doing tax returns and nothing else, led the retirees to largely bypass that profession.

Prodded by deregulation and assisted by removal of advertising restrictions, the accountancy profession is now making moves into the personal investment advisory industry. It is doing so largely through purchase of established investment advisers.

Actuaries

The involvement of the actuarial profession in investment advice to retirees has been limited. Several factors contributed to this.

(a) The requirement that all partners of a firm need to be licensed in order for the firm to give

investment advice.
(b) The ethical constraints on marketing.
(c) The volume of other traditional and more interesting work available for actuarial practices.

The activity of actuaries in this area has been largely as part of the total package offered to superannuation fund trustees. It involves the addressing of pre-retirement counselling seminars and the provision of non-specific advice (for which licenses are not required) to individual retirees known to the actuaries.

With the exception of assistance in the complex calculations of retirees' tax affected options, the actuarial profession does not seem to be moving strongly into this market.

Bank and Credit Unions

Bank managers are exempt from the requirement to be licensed under the Securities Industries Code. They were a major source of investment advice to retirees around the time of Kretchmer's paper.

At the time of Kretchmer's paper, the Westpac Banking Corporation managed a number of unit trusts which were marketed mainly by its staff.

Since then, the Australia and New Zealand Banking Group Ltd. has taken over Delfin Investment Services Ltd. With this acquisition came the Australian Fixed Trust Group (AFT). This group was the largest unit trust manager and had been operating through it own sales force (discussed below) for many years.

Some banks have appointed retirement advisory officers. These, and other licensed people employed by banks, generally, but not exclusively recommend products managed by or associated with their employer.

One savings bank has established a full advisory service.

Most credit unions have links of varying degrees of formality with independent sales organisations.

Independent Sales Organisations

In this paper, the terms "sales organisations" or "sellers" are used to denote commission remunerated licensed dealers. Its use is not intended in a pejorative sense.

The independent sales organisations are now the dominant force in the industry.

These organisations generally grew from tied sales forces of unit trust managers. Individual representatives of managers took two important steps to achieve this. They formed their own companies and therefore lost the immediate link with their principal. Having done this, they entered into representative arrangements with other unit trust managers and styled themselves "licensed investment consultants".

The appearance of these independents was a precondition to the rapid growth of those unit trust managers without their own sales forces.

While the first of these moves occurred in the 1970s, they were still taking place as late as 1982.

Typically, these organisations were first licensed as representatives to a number of unit trust managers. There was a limit to the number of managers that an individual could represent but a group of individuals could collectively represent sufficient managers to offer a reasonable spread of products. By 1983, most of these arrangements had changed in that the principals of the firms involved had become dealers in their own right.

The transition from the unit trust representative to licensed security dealer was paralleled by transition from life office representative to licensed security dealer in a number of cases.

While these transitions were taking place, people from other backgrounds recognised the segmentation of the investment advisory market. Unit trust sales organisations were promoting unit trusts, stockbrokers wer promoting listed investments and life office people were promoting life office products. This recognition lead to the establishment of investment sales organisations aiming to provide balanced advice and a wider coverage to include products recommended by all of the other groups of players in the market.

Independent Advice Organisations

Independent advice organisations are defined for the present purposes as those owned by individuals and which derive income solely from fees. There are few such organisations. They fall into two basic categories.
(a) Those established solely as investment advisers.
(b) Those which grew out of other professional practices.

Those initially established as investment advice operations were typically founded by people with financial backgrounds who left larger organisations to set up as small businessmen in the investment advice industry.

A small number of professional practices perceived the problems and opportunities posed by the excesses of some of the sellers. Bound by their codes of ethics to account to clients for all commissions, they could not become sellers. These practices obtained licenses as advisers or dealers and set out to offer investment advice as an adjunct to their normal professional practice. In time, some investment advisory practices have split from the host professional practices.

Life Offices

The involvement by life offices in personal investment advice to retirees has generally been limited to the sale of life office products. One major life office has, however, purchased a majority shareholding in an independent sales organisation.

Life office representatives have, as mentioned above, made the transition to licensed dealers. This trend has accelerated as investment sales organisations have attacked the more traditional life office market of younger individuals' savings. Seeing their prospects seduced by a wider range of investments, life office representatives have moved to emulate their competition.

One life office has established a service providing research material and marketing support for investment sales organisations. No doubt part of this effort is directed at increasing sales of its products. A major reason, however, is a perception that the life offices need to be involved in the widening range of investment products to preserve their market share.

Tied Sales Forces

The tied investment seller is a licensed representative of a unit trust manager. This group has existed as long as unit trusts. From this group came the first of the independent sellers.

In the late 1970s, there were several unit trust managers operating with tied sales forces.

The best know example of tied sales forces is that of AFT. While this company does not market exclusively through tied sales forces, its offices are a familiar feature of the suburban and country landscape.

The move by some of these sales people to establish their independence led to all but AFT and the recently collapsed Balanced and Telford Group disbanding their tied sales forces. These managers then relied on independent sellers and advisers. In doing so, they strengthened the position of the independents.

In the past, tied agents have operated under business names that gave no clue to their tied status. There are now few tied representatives not obviously identifiable as such.

Specialist Superannuation Consultants

Of the organisations usually involved in providing services to large superannuation funds, it is the superannuation consultants that have taken the greatest steps into the investment advice industry.

These steps, by themselves, have not been large but are likely to be significant for the future.

One firm of employee benefit consultants has purchased a controlling interest in an investment sales organisation and another has established an advisory practice.

Stockbrokers

The involvement of stockbrokers in the investment advice industry in early years was minimal. Stockbrokers during the boom period of 1979 and 1980 saw institutions, not retirees as their target market. They were unable to advertise aggressively until late 1982. Nor could they approach non-clients.

While some had assisted in pre-retirement planning seminars, they generally were unable to match the marketing efforts of the independent sellers.

Since stockbrokers have been able to advertise more aggressively, some have actively pursued the market that they had lost.

Stockbrokers' involvement in this industry has taken two different directions. Some have sought to offer personal investment advice selling the same products as the independent sellers as well as acting as agents in purchase of listed securities. Others have established separate divisions for the provision of personal investment advice. Some of these divisions were established from the ground up – others by the acquisition of sales organisations.

Tax Agents

The competition between stockbrokers and independent investment sellers has been paralleled by that between the accountancy profession and the tax agent.

Tax agents, having always had an obvious suburban presence, were able to extend their services to the selling of investment products. This extension was uninhibited by the restriction placed on accountants' receipt of commission by their code of ethics. These two factors contributed to the early ascendency of this group over the accountancy profession in this market.

THE GAMES

Introduction

If one accepts that participants in the investment advice industry are players, it is appropriate to describe the games they play.

Some of the game are a cause for serious concern. They are played to the detriment of the investing public. As Max Weston of Godfrey Weston Ltd told a CEDA audience in Sydney in February 1985 "soundly based investment advice for the investment public ... in many cases has been sadly lacking".

These games have quietened in recent times but most of them are still played to some degree. Retirees and people counselling them need to know of these games.

The Growth Rate Game

In 1983 and early 1984 it was impossible to pick up a paper without seeing an advertisement promising an inordinately high percentage return.

There were two major reasons why these promised returns were high.

(a) Some players in the market persisted in using simple rather than compound growth rates.

(b) They were based on results achieved in times of high inflation.

As illustrated in the introduction to this paper, one can announce a substantially higher growth rate by quoting a simple rather than compound figure.

Unit trust managers used simple growth rates in their marketing material to enhance the attraction of their products. In some cases the use of simple growth rate was in ignorance of its limitations. Sadly, this was not always so.

Criticism of the use of simple growth rates by otherwise reputable unit trust managers was often met with words to the effect that "this is the industry standard – we know it is not right but it is the standard".

The Nominal Returns Game

Unit trust managers, and indeed life offices, in the past have been reluctant to express investment returns in real terms. They have preferred to use nominal returns and not to mention the underlying inflation rate.

The problem with this method of measuring returns is that the nominal returns could only expected to continue while inflation continued at the same rate. As inflation fell, returns on capital growth based investment also fell.

The Ignored Front End Load Game

Most products offered by unit trust managers include front end loads of about 8 per cent. Many of the returns quoted in marketing material ignored the impact of these front end loads. This is not a problem any more in published material but is still prevalent in verbal pitches.

The Scoreboard

Before describing some other games, a look at the way the scoreboard responded to the first three games is instructive.

The marketing material of unit trust managers, which was often uncritically passed on to investors by sellers, exaggerated potential returns in three ways:

(a) It dealt with past simple growth.
(b) It dealt with nominal, not real, growth achieved during times of rapid inflation.
(c) It ignored transaction costs.

This resulted in unrealistically high expectations for the investment performance of their products. A particular example is the AFT Real Property Growth Trust No. 2. When first revalued in November 1984, this trust produced a return to the initial investor of 6.23 per cent per annum. This return attracted criticism from the press. The criticism had, as its basis,

the comparison between this return and the marketing material put out previously by the manager.

The performance of this trust was influenced by:

(a) The fact that in a rapidly growing trust it is impossible for it to be fully invested. (Funds must be held awaiting investment.)
(b) The manager intended, over a longer term, to gear the trust to achieve higher capital growth but had not done so in its formative years.

Against the background of these constraints, the performance of the assets underlying this trust in matching inflation was not bad. But it did not match the expectations that had been built up. It was the disappointment with this failure to live up to expectations that signalled the beginning of the disenchantment of many investors with property trusts.

The Risk and Reward Game

Within the areas of property trusts, share trusts and single premium assurance policies, there are managers who pursue a high risk/high reward policy. There is nothing inherently wrong with this. It is, however, wrong when returns from such investments are compared with those of moderate risk/moderate return investments.

It is a valid criticism of many investment sales organisations that they did not, and to an extent still do not, adequately explain to their clients the relationship between risk and reward.

The Commission Disclosure Game

The Securities Industries Code requires the disclosure of commission through the disclosure of interest provisions contained in Section 65.

This requirement was, and largely still is, generally more honoured in the breach than the observance. It was rare that investment advisers disclosed the commissions they received.

It is now an obligation that such disclosure be made with property trust prospectuses but it tends to be skated over by the seller in both verbal and written reports.

Some sales organisations include their disclosure of commission in a pre-printed statement on the covers of their reports to the effect that normal commission will be paid. There is no mention of the amount of commission, nor is there any mention of any non-commission support given to the seller by unit trust managers.

It is fair to say that the same criticism can often be levied at insurance salespeople.

THE CLUBS

Introduction

The players in the investment advisory game have retained some old club memberships and established some new clubs.

Like all clubs, they seek to enhance the interest of the members. Like many sporting clubs, they also seek to influence the decisions of the umpire. Some even go as far as wanting to provide the umpires themselves.

The associations formed in the industry have largely been directed to the aims of lifting the standards and the public perception of the industry. There does not seem to have been a tendency to use the groups to limit entry to the industry in any unreasonable way.

The Australian Investment Planners Association (AIPA)

This association was formed about three years ago. Its membership originally comprised corporations that were licensed as security dealers. Its membership now includes natural people.

This organisation has achieved a high penetration amongst the investment sellers. It has had little, if any, effect on the fee for service advisers. Nor has it proved attractive to life office people or stockbrokers.

The senior members of this organisation are, in some cases, also members of the Securities Institute of Australia.

The International Association for Financial Planning (Australia)

The above association grew out of the attendance of some Australians at a meeting of the International Association for Financial Planning in the United States of America. Its main appeal seems to be to those for whom the AIPA had no attraction. These are generally the stockbrokers and the life insurance industry.

The group published a set of eight cannons which

comprised its code of ethics. One could not argue with the sentiment behind these cannons. However, their practical implications may be a different matter.

The IAFP appears to have lost the publicity war with the AIPA and it is likely that it will become a progressively smaller force in the Australian market.

The Australian Associated Stock Exchanges (AASE)

The member firms of the AASE's member exchanges have, for a long time, had their own club.

While some members have become involved in the investment advice industry, the attentions of the broking fraternity have generally been on higher things. The main thrust of the stock exchanges in public affairs in recent times has been related to take-over regulation and the encouragement of entrepreneurial floats.

Occasionally, stock exchange chairmen have been moved to criticise investment sellers.

Securities Institute of Australia

The Securities Institute of Australia is recognised as the pre-eminent professional body in the securities industry. Its members are involved in all aspects of the industry including people in senior positions in investment sales organisations. Many employees of these organisations are also undertaking courses of study with the Institute.

The Institute has been concerned about the activities of some of the sellers and about the ease with which one can be licensed. It has, however, been forced by the rapid growth of its educational activities to devote a considerable amount of its resources to this area. It has, I think, lost the chance to be seen as the speaker for the personal investment advisory industry.

Fee for Service Advisers

The fee for service investment advisers have generally not joined the AIPA or the IAFP. Those who were members of the SIA or other traditional professional bodies have retained that membership.

In June 1985, an attempt was made to form an association of fee for service advisers. The association could have met in the proverbial telephone box. Its formation needed unanimous support of the fee for service advisers. Such support was not forthcoming and these advisers as a group remain unrepresented.

THE UMPIRES

Introduction

The industry is presently regulated under the Securities Industries Code and the Life Insurance Act and the Insurance (Agents and Brokers) Act.

The Securities Industries Code is co-operative legislation sponsored by the Commonwealth subject to consent of the States. Individual State Corporate Affairs Commissions regulate the industry within their State.

There are significant differences in the standard of this regulation.

The fact that individuals marketing some investment products (those under the Life Insurance Act) are subject to different control from others as raised the ire of those controlled by the Corporate Affairs Commissions. It is an open secret that NCSC officers would like all purveyors of investments to individuals to be subject to their control.

Major areas in which the NCSC has influenced the investment advisory industry have been in the licensing of dealers and advisers, and in the control of prospectuses issued for unit trust debentures and company floats.

Licensing

The conditions that one must meet for a dealer's license have been described as "motherhood and apple-pie" conditions. Expressed in legalese, they are, as they apply to a natural person;

(a) The applicant is not an insolvent under administration;
(b) The applicant has not been convicted, . . . with the period of 10 years immediately preceding the date on which the application was made, of an offence involving fraud of dishonesty punishable on conviction with imprisonment for three months or more;
(c) The Commission is satisfied as to the educational qualifications or experience of the applicant having regard to the nature of the duties of a holder of a dealer's licence or and investment adviser's licence, as the case may be;
(d) The Commission does not have any reason to

believe that the applicant is not of good fame and character; and

(e) The Commission does not have any reason to believe that the applicant will not perform the duties of a holder of a dealers licence or of an investment advisers licence, as the case may be, efficiently, honestly and fairly; or . . ."

Expressed in the vernacular, they are:

(a) Not broke
(b) Not caught yet
(c) Having some knowledge, albeit minimal, of the Securities Industry
(d) A nice bloke.

Criticism of the quality of licensees and the advice that they give has lead the NCSC to propose an amendment to the code. This amendment requires a dealer, adviser or representative to ensure that recommendations are based on fact, reasonable and appropriate for the circumstances of their clients.

Some in the investment advisory industry have hailed this change as an advance. I consider its necessity and indictment of the industry.

Dissatisfaction with the quality of licensees and the administrative burden placed on the various Corporate Affairs Commission lead the NCSC to announce a review of the licensing provisions of the Act in August 1983. Nothing has yet come of that review.

At the time the review was announced, substantial strengthening of licensing requirements was, I believe, justified. I suspect that changes in the industry since the review was announced make the review less necessary.

I fear that draconian measures will be introduced. Such measures will not protect greedy or gullible investors against their own greed and gullibility. They will only serve to increase costs to careful investors.

Prospectus Control

There is no doubt that some prospectuses and marketing material issued by unit trust managers in the past have been misleading.

Unit trust managers have been carried away in their enthusiasm for their own products. This was particularly so of property trusts.

The standard of property trust prospectus disclosure has, however, been improving over the last two or three years, partly due to efforts of the Unit Trust Association of Australia.

In April 1985, NCSC property trust guidelines came into force which, in words that had been applied to the Erisa Act in the U.S.A., "set the practices of the best manager in concrete and festooned them with red tape".

These changes were too much and unnecessary because they were too late. One can expect similar tightening of the prospectuses for other products.

Not only has the standard of prospectus disclosure improved, but the sophistication of investment advisers and the investing public has improved. As Weston pointed out in his paper, a number of major sales organisations have established research departments to examine the offerings of unit trusts and other investment managers. While one could argue that research is an essential part of giving investment advice and therefore be surprised that big organisations have not always had research departments, it is nevertheless pleasing to see these departments established.

This greater sophistication by major players in the industry, in my view, provides far better protection for the public than increased legislative control.

The Umpire's Helpers

It was a concern to non members of the AIPA that that organisation sought in the first half of 1985 to become the arbiter of standards and a proxy for the NCSC. However, the NCSC has indicated that the AIPA will not have a monopoly on regulation.

As Weston pointed out in his paper, the NCSC has already delegated the disciplining and controlling of members of stock exchanges to their committees. The AIPA would, I think, like to have membership of it deemed a sufficient condition for one to practise as a licensed investment adviser. I don't think that there can be any argument against this.

However, there are very stong arguments against AIPA membership being a necessary condition to practise in this area.

EDUCATION AND TRAINING

Introduction

The NCSC licensing requirements oblige licensees to have education qualifications and experience satisfactory to the Commission.

There has not, in the past, been any formal education available to investment advisers per se. There have, however, been a number of professional bodies which provide a broad education background which can be used in the investment advice industry. These include the actuarial and accounting professions and the Securities Institute. Tertiary qualifications in accounting or related disciplines also provide a background to investment advice.

Since March 1984, an Associateship or Affiliateship of the Securities Institute of Australia has been required for one to become a member of (for example) the Stock Exchange of Perth Ltd, and more recently, membership has been granted to those only completing the certificate level course.

The AIPA Course

The AIPA has recently announced a home study course directed specifically at investment advisers. This innovation will do much to enhance the status of that body and should consolidate its position as representative of most participants in the industry.

As AIPA's leaders grow in experience in the industry and progressively lift the standards of its membership, its justification for being regarded as a leader in the industry will increase.

A praiseworthy aspect of the AIPA course is the fact that the AIPA is not going to open it personal membership to people who have not passed its course. This absence of a "grandfather" clause is most unusual and will have a significant effect on the quality of investment advice provided by that association's members.

The SIA Course

One should, however, not get carried away with the AIPA course. The fifty hours home study program is minimal compared with the eight units of up to thirty hours of lectures alone and tertiary qualification needed for an Associateship of the Securities Institute of Australia.

One would like to see directors and partners of investment advisory organisations looking to the Securities Institute as the appropriate qualification. Indeed, this seems to be a view shared by Weston who is the convenor of the AIPA's education subcommittee. He expressed the hope that licensees be encouraged to take higher education courses such as those provided by the Securities Institute.

Other Educational Courses

The educational courses provided by the Insurance Institute of Western Australia and the Life Underwriters Association of Western Australia (Inc.), and similar bodies in other states, together with some foreign based courses may also emerge as qualifications for securing licences. They are, however, unlikely to be either broad or Australian enough to provide the background to meet the need of investors in this country.

The Appropriate Course

The AIPA course is more practically orientated than the SIA course and is designed for a different purpose than it. One could call the AIPA course technical and the SIA study professional.

It would be unreasonable to insist that licensees have completed the diploma course of the SIA. To do that is to ignore the value of experience and the carry credentailism to ridiculous extremes.

The AIPA course appears a reasonable compromise between the requirement of some standards of people entrusted with advice advising people on the investment of their life savings and the need to avoid an elitist closed shop. It is not too much, however to expect those who aspire to leadership in this industry to undertake the SIA course.

THE FUTURE

Introduction

The predominant influence on the future of the investment advisory industry is likely to be deregulation.

Deregulation will affect the industry by increasing the number of participants and the variety of their backgrounds. It will also allow for more aggressive advertising.

While deregulation will allow participants in the industry to roam wider and to come from further

afield, they will be hobbled by prudential or licensing regulations. Thus, paradoxically, regulation will be a major future influence in an industry influenced by deregulation.

The increasing complexity of available investment products will have an effect on the industry's future.

Changes in the industry's markets will also influence this future. At this stage, however, the direction of the changes are difficult to predict.

Mergers and Acquisitions

The increasing complexity of the products available will require the industry to devote greater effort to research. This is an expensive activity. One can expect mergers or acquisitions as firms in the industry seek to grow to achieve economies of scale to cover research costs.

Institutional Involvement

Life offices, banks, building societies and credit unions are, to varying degrees, seeking to offer a total service to their client base.

While fixed interest deposit taking institutions have largely been protected from the activities of the investment advisory industry by high real interest rates, this cannot be expected to continue. When these institutions suffer severe outflows of funds, they will react by joining the investment advisory industry in increasing numbers. They will do this by either acquisition or establishment of their own operations.

To be credible, however, these institutions will have to ensure that the investment advisory activities are at arms length from the host institution. If they do not do this, they will be perceivd as simply marketing arms for the institution, not independent investment advisory operations.

Trustee company involvement in this area is also possible.

Professional Involvement

The actuarial and the accountancy professions are seeking to widen the services offered to their clients. They will come to recognise personal investment advice as a market to which they are suited.

As the public's perception of the competence and integrity of the better players in the market becomes more widespread, the reluctance that these professions have shown to join the industry will fade.

Because of the establishment costs of research activities, one could expect the trend to start with the more innovative medium sized firms.

Superannuation Consultanties

Superannuation consultanties have already moved into this area. The trend can be expected to accelerate. These organisations will see investment advice to retirees as a natural extension of the advice now being provided to superannuation funds. In time, they will extend this advice to other clients.

Stockbrokers

The incentive for stockbrokers to move into the personal investment advice industry will come when the current boom ends. At that time, brokers will feel the effects of negotiated brokerage. They will need to look to other activities.

Some brokers will actively pursue this market and further acquisitions or establishment of investment advisory divisions are likely.

Less likely, but not impossible, is the acquisition by an investment adviser of a stockbroker.

The Market

The major markets of the investment advisory industry will continue to be the retirees. This market is at risk, however, if superannuation funds start offering pension benefits.

A new market which will become available in the next decade is the post World War II demographic bulge making investments after it has shed its family responsibilities and expenses.

Available Products

It is hard to predict exactly what new products will come on the market. Who could have predicted ADF's and deferred annuities? Suffice to say that the ingenuity of investment institutions will lead to hitherto unexpected responses to changing conditions.

One prediction can be made with certainty; the level of front end loads on products offered is likely to decline slowly. Already, "no load" products have been offered.

Such products can only be marketed through fee for service advisers. There may not be enough of these advisers yet to ensure the success fo the "no load" offerings. However, gradual reduction in commission levels and hence front end loads is not so reliant on fee for service advisers and can be expected in the near term.

Services Offered

The investment advice industry can develop in two ways:

(a) Moving towards a department store approach offering sub-professional services in a range of disciplines. This would include preparation of taxation returns and (in States where the legal profession has no monopoly) conveyancing, wills and estate administration. Other services which may be offered by the department store approach are real estate, mortgage broking and insurances, both life and general. The extension of these activities to stockbroking is possible.

(b) Contracting to a boutique approach specialising in investment advice.

There will still be room for the boutique but the department stores will predominate. This will be caused by the need for economies of scale to finance adequate research. Those advisers opting for department store status are likely to become subsidiaries of institutions.

Education and Training

It is likely that the AIPA will gain acceptance as the predominant educational body in the industry.

There will, however, still be people joining the industry from other disciplines, notably the accoutancy profession.

Ethics and Regulation

The AIPA will gradually lift the standard of ethics of its members and is likely to become involved in co-regulation of the industry.

This co-regulation could take the form that a licence will be automatically issued to a member of the AIPA while that membership is retained.

A similar arrangement may apply with professions. The residual licensees, not members of any other body may be subject to NCSC regulations.

There is a grave risk that the NCSC regulations will represent an overkill. No matter what is done legislatively, it will not stop the fringe elements of the industry deceiving the greedy and the gullible.

Fees or Commissions

There has yet to develop a stong trend towards advisers operating solely on a fee basis. However, fees are slowly becoming an increasing element of the industry's remuneration. This is likely to continue. This is a conclusion shared by Weston (op cit).

The elements directing this trend are likely to be:

(a) The influence of the professions on the industry with their ethical pronouncements against commissions.
(b) Increasing public awareness of commissions.
(c) The obtaining by the public of second opinions making sales more difficult for sellers to achieve.
(d) The likely gradual reduction in levels of commission offered.
(e) the possibility of stockbrokers charging fees for advice to private clients.

Winners and Losers

The winners from future change are likely to be the retirees, the investing public and the aggressive competent investment advisers.

The clear losers will be the less reputable investment sellers. It is also likely that the influence of tax agents and advisers associated closely with investment managers will wane.

CHOOSING AN INVESTMENT ADVISER

Introduction

That the editor of Personal Investment Magazine headlined an article in September 1984 "Finding an Honest Investment Adviser" is an indictment of the industry at that time.

The same issue of the magazine contained a sub-article headed "Salesmen by any other name" and dealt in detail with a trainer of financial services salesmen and the methods that he was teaching to so-called "advisory staff".

Happily, the situation has improved somewhat since then.

Some would argue that journalistic concern about the quality of investment advice is an exaggeration designed to sell publications.

My experience is that written reports that I have seen are not of a high standard. I have seen venality but not criminality in other advisers' reports. I have not seen any other investment adviser's report that I would have been proud to sign. Nor indeed have I seen many that I would have been prepared to sign. I have seen some sloppy work, some negligence and some opinions which differ from mine in matters of legitimate professional opinion.

It is likely, however, that the worst excesses of the investment advisory industry are not contained in written reports. Journalists have told me that they frequently receive information about unethical practices by some selling organisations. Doubtless, Corporate Affairs Commission officers share this experience.

Appendix B is a checklist that has been supplied by my firm to accountancy practices to enable them to evaluate investment advice. It is equally relevant to superannuation trustees helping retirees to evaluate advice.

The comments made in this section relate to the more important aspects of that Appendix.

The Necessity to Ask Questions

Politeness often prevents people from asking adequate questions of investment advisers.

Let me allay those fears. I appreciate the seriousness of investing one's suparannuation lump sum. I am not offended by clients asking any of the questions or taking any of the actions that I set out below. Nor do I think that any reputable investment adviser would be offended. Indeed, reputable advisers are pleased to answer questions such as set out below because doing so establishes their bona fides.

Venue and Ground Rules

There are several basic rules to start with before even examining an investment adviser. These are:

(a) Conduct your business in the adviser's office, not your home. You can leave somebody else's office but it can be hard to have someone to leave your home.
(b) Establish the fee (if any) that will be charged and the time that is chargeable. Most advisers charging on a fee for service basis will charge for time not only in face to face interviews but in preparation for reports. Get an indication of the likely time involvement. If you wish, get a commitment to a maximum fee which would be payable without further authority.
(c) Insist on a written report.
(d) Insist on not making immediate decision. No investment opportunity is so good as to justify hasty action.

Preliminaries

Some aspects that can be checked before visiting an investment adviser. These include:

(a) License details. Particularly look for any restrictions on the investments that can be sold or recommended.

(b) The adviser's reputation. Checking this is often earier said than done. A friend, colleague or acquaintance who has had experience with the adviser is the best source. Beware of testimonials from satisfied clients. No adviser would ask a dissatisfied client for a testimonial.

(c) Ownership – Most advisers conduct their business through companies. The company can range from public companies to small companies acting as trustees for unit trusts. A few advisers conduct their business as partnerships or sole traders. Remember that an investment adviser operating through a limited liability company has the protection of limited liability. The appearance of a "war memorial" list on a letterhead is of little value for legal redress if one is dealing with a company.

In the remainder of this section I will deal with corporate investment advisers. References to companies and directors can be read as references to firms and partners or sole traders where necessary.

The Company

Either before or at the time of visiting the adviser, questions should be asked to extract the following information.

(a) Qualifications and experience of directors.
(b) Details of research staff and practices.
(c) History of the directors' involvement in the investment industry.

(d) The nature of the company's remuneration and whether it retains commissions.
(e) The extent of professional indemnity insurance carried by the company.
(f) To whom is the client's money paid? Most "managed investments" require the client to pay money to either an insurance company or a well known trustee company. Any departure from this should ring a warning bell.

The Adviser

Often the adviser one is dealing with is not a director of the company. The following information about the adviser is needed.

(a) Qualifications and experience.
(b) Nature of his license.
(c) The training process that he has undergone.
(d) Remuneration – Is the adviser paid a salary, a salary plus commission or straight commission?
(e) the extent to which he is supervised. Some companies permit advisers to sign reports while others insist that all portfolios over a nominated value are seen by head office. Still others insist that a director signs all reports even those emanating from other States.
(f) The extent of the adviser's autonomy. Does the adviser have authority to depart from a model portfolio that the advisory company has prepared? Such authority is not necessarily a bad thing but departures need to be justified.
(g) What is the adviser's attitude to a second opinion? No competent adviser is afraid of a client seeking a second opinion.

The Interview

Once a client has satisfied himself of the competence of the advising company and particular adviser, he can assess the quality of the advice by the adviser's conduct during an interview and by the subsequent report.

Points to look for in the interview are:

(a) Questions asked by the adviser. If the client has pre-prepared answers to likely questions from the adviser, he should expect a competent adviser to ask questions covering most, if not all, of those aspects. Failure to do so may indicate a cavalier attitude on the adviser's part.
(b) Explanation of risks. A competent adviser will explain the relationship between risk and reward and establish the client's attitude to risk.
(c) Liquidity needs. While this is likely to be covered in any pre-prepared questions by the client, it is an area of great importance that the adviser must address.
(d) The adviser's response to questions asked by the client. It is not necessarily a criticism that an adviser has to say "I don't know" to a question. The criticism is if he does not have ready access to an answer. It is very easy to see the adviser who is stumbling with areas that he does not know.
(e) Disclosure. The adviser should disclose the nature and extent of his interest in any recommended investments. A disclosure along the lines of "I get normal commission" is not sufficient.
(f) Beware of pressures to make quick decisions. They may indicate a fear of a second opinion.

The Report

If a client has insisted on a written report from an adviser as he should, it provides an opportunity for detailed and leisurely study of the advice. Important aspects of the report are:

(a) The best of advisers can misunderstand a client's circumstances. Recital by the adviser of his view of the client's circumstances gives the chance to pick up these misunderstandings.
(b) The report should outline the broad investment strategy to be adopted. There is no point in detailing specific investments without putting them in a strategic context.
(c) The specific investments and the sectorial composition of the recommended portfolio should be set out and their relationship to the strategy explained.
(d) Projections of income can be made with some degree of certainty. This is less true of projections of capital growth. These projections can only be understood against the background of an assumed inflation rate. Failure to disclose this renders the projection useless.
(e) The reasons for choosing particular investments should be given.
One needs to be careful of "reports by photocopier". These are reports which reproduce, often uncritically, marketing material of investment managers.

(f) A written disclosure of the adviser's interest in the securities recommended is mandatory.

Further Opinions

No retiree should be afraid to seek a second opinion on investment advice. Acting on the investment advice is a decision which will affect the retiree's wellbeing for the remainder of his life. It is a very important decision.

It is less likely that a second opinion will be needed on fee for service advice where the investment adviser is rebating all commissions. However, if the retiree is not satisfied with, or does not understand any aspect of the advice, he should not hesitate to seek a second opinion.

The second opinion can either be from another adviser or from a person skilled in matters financial but not necessarily investment. (For example, a tax accountant.) Such a person can evaluate the advice given even if he cannot give alternative advice.

If the retiree has not been charged for investment advice from an investment sales organisation, there is absolutely no reason why he should not seek further free advice from another organisation. No-one should feel any obligation to accept the advice of any salesperson. Salespeople should appreciate that their products are not necessarily unique and that prospects have the right to go elsewhere.

Because free advice carries the possibility (albeit small in the case of more reputable firms) of being influenced by questions of commission, paying for a second opinion from a disinterested party is a sound practice.

Such an opinion need not come from an investment adviser. It could, as mentioned above, come from an accountant.

The fees for a second opinion are trivial compared with the damage that can be done with a bad investment decision.

ACKNOWLEDGEMENT

While responsibility for the content expressed herein is mine alone, I would like to thank the people who have helped in preparing this paper.

This paper covers an area that is little documented except in the Press. I have drawn heavily on the experience and anecdotes of many people involved in the industry. I thank them for their help.

In particular, I thank Mr Bruce Bird, former Chairman of the Unit Trust Association of Australia and Mr Max Weston, the Education Convenor of the Association of Investment Planners of Australia for the help and historical perspective they have given me.

APPENDIX A

Securities Industry Act and Codes
Licences Issued at 30 June 1984 (with 1983, 1982 and 1981 totals for Comparison)

	ACT	NSW	QLD	SA	TAS	VIC	WA	1984	1983	1982	1981
Dealers											
Natural Persons	0	289	61	54	12	276	40	732	702	658	663
Others	13	234	38	17	5	121	40	468	292	217	161
Total	13	523	99	71	17	397	80	1200	994	875	824
Dealer's Representatives	512	4266	613	190	60	2304	356	8301	6443	4052	3037
Investment Advisers											
Natural Persons	0	56	15	3	1	31	11	117	106	86	74
Others	2	43	5	0	1	6	0	57	56	50	38
Total	2	99	20	3	2	37	11	174	162	136	112
Investment Representatives	22	326	18	0	1	63	0	430	397	225	171
Total	549	5214	750	264	80	2801	447	10105	7996	5288	4144