

INVESTING & WEALTH

CFA SINGAPORE INSIGHTS

By CFA Singapore Advocacy Team

Is your investment adviser guilty of mis-selling?

An investment professional must consider the best interests of the client when making a recommendation

ON May 17, 2018, the Monetary Authority of Singapore (MAS) issued prohibition orders against six individuals for mis-selling investment products. A prohibition order bars an individual from the financial industry, and is usually issued only for serious misconduct. The order may be permanent or last for a specified period of time.

Among the six individuals sanctioned, some were found to have provided financial advice without due consideration of the clients' financial situation – and this is the issue that we will focus on in today's column.

Any investment professional worth his salt must be able to answer the question: "Is the investment suitable for my client?" In other words, an investment professional must consider the best interests of the client when making a recommendation.

To achieve this, an investment professional is required to carry out a fact-find of the customer's investment profile, which includes his investment objectives, investment experience, investment time horizon, liquidity needs and risk tolerance.

No investment product is inherently suitable or unsuitable for a client. An elderly client living on monthly CPF payouts would find speculative investments like swaps and leverage extremely unsuitable. She would have a low risk tolerance for investments which are not principal-protected.

A businessman with significant investment experience and capital, on the other hand, might be comfortable taking on those speculative investments as part of his portfolio.

The MAS has issued the Fair Dealing Guidelines that focus on board and senior management responsibilities for delivering fair dealing outcomes to customers. One of these outcomes is for financial institutions to offer products and services that are suitable for their target customer segments by undertaking formal due diligence on any investment product that they intend to distribute, tailoring their marketing approach to the profiles, financial objectives and general financial literacy of their target customer segments.

Related to suitability is the term "fiduciary". Both seek to protect the investor from foreseeable harm or excessive risk. However, the standards of investor care are different. An investment fiduciary is any person who has the legal responsibility for managing someone else's money.

Broker-dealers and financial advisers in Singapore are customarily compensated by commission, and generally have to fulfil only a suitability obligation. Fund and asset managers, who are usually management fee-based, are bound to fiduciary standards.

Any investor who believes that his investment adviser has sold him an investment product that does not meet his investment profile and financial objectives can choose to seek redress by raising a complaint to the financial institution concerned. If the financial institution does not address the complaint to the investor's satisfaction, he may go to

FIDReC, or the Financial Institution Dispute Resolution Centre Ltd, to resolve the matter through mediation or adjudication.

Practise, practise, practise

Today's case is based on a Financial Industry Regulatory Authority (FINRA) enforcement action from 2013.

Awesome Investment Brokers (Awesome) is a broker that has historically sold unit trusts and insurance products to individual investors. In 2018, the firm began selling private placements to clients as well. Annabelle Chua, vice-president of Awesome, was responsible for conducting due diligence on the private placements and placing them on an approved list that Awesome investment advisers can view on the firm's internal website. Annabelle relied on third-party due diligence reports to assess

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the viability and appropriateness of the private placements for Awesome's clients.

Simon Tan was one of Awesome's investment advisers who reviewed the internal list of approved private placements and sold several of these investments to his clients. Simon did not create any sales materials for these private placements but instead relied on sponsor-created sales materials to give to his clients.

Did Annabelle or Simon engage in any misconduct? These are the possible answers.

A: Annabelle is guilty of misconduct in selecting the private placements for Awesome to sell.

B: Annabelle is not guilty of misconduct in selecting the private placements for Awesome to sell.

C: Simon is guilty of misconduct in providing sponsor-created sales material to clients.

D: Simon is not guilty of misconduct in providing sponsor-created sales material to clients.

Analysis

Investment professionals are encouraged to use the CFA Ethical Decision-Making Framework – which includes questions such as: What is the ethical issue involved? To whom is a duty owed? What are the important facts?

The ethical issue involved in this case for both Annabelle and Simon relates to diligence and reasonable basis. Annabelle based her evaluation of private placements on third-party due diligence reports without conducting the analysis herself. Simon gave sponsor-created sales material to clients without producing his own information on the private placements for his clients.

Both Annabelle and Simon owed a duty to the clients of Awesome Investment Brokers to act with diligence and reasonable basis in investigating the private placement investments and recommending them to clients.

Determining whether Annabelle and Simon met their responsibilities requires examining the relevant facts. In this case, not much background is provided, making it difficult to tell whether either engaged in misconduct.

It is acceptable for Annabelle to rely on third-party due diligence reports to evaluate investments as long as she took steps to ensure that those reports are from a reputable source and have a reasonable and sound basis. It is not clear what steps Annabelle took to evaluate the quality of the third-party due diligence provider. Without a critical evaluation of the third-party due diligence provider, she may have violated the standard.

Similarly, it is acceptable for Simon to rely on Annabelle to fulfil her responsibilities to conduct thorough due diligence of potential client investments.

Simon can assume that investments listed on Awesome's approved private placement list have been thoroughly vetted by the firm through Annabelle without having to go back and conduct the due diligence himself, unless he has reason to question the validity of the process.

It is also not necessarily improper for Simon to rely on sponsor-created marketing material to provide information to clients, as long as Simon, Compliance, or other senior personnel at Awesome have thoroughly reviewed the material to ensure that it meets all applicable disclosure requirements and contains no misrepresentations. If Simon simply forwarded the material to clients without such a review, then he could be violating his duty of diligence to clients by potentially disseminating inaccurate or misleading materials to clients.

Because of the lack of information provided, an argument could be made that under certain circumstances, any of the responses could be chosen.

☞ **The writers are CFA charterholders who volunteer with the Singapore society on advocacy issues with a view towards promoting financial literacy among retail investors and improving overall standards and integrity in the industry.**

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