

Investing in the stock market: Points to ponder

Before an investor buys or sells shares, he needs to contact a stockbroker, licensed with the Securities and Exchange Commission of Sri Lanka (SEC) to carry out the transactions on the Colombo Stock Exchange (CSE).

Given below are some of the important things novice investors should be aware of when investing in the stock market.

Client agreement in writing

Rights and duties of a broker and his client are stipulated in the Client Agreement. Therefore, stockbroker firms shall enter into a written agreement (Client Agreement) with each investor (client) before services are provided to the client. Stockbroker firms shall provide a copy of the Client Agreement to the client and draw the client's specific attention to the risks that are described in the appropriate risk disclosure statements. The type of Client Agreement may vary depending on the services provided. The Client Agreement shall include a written 'risk acknowledgement statement' to the effect that the client is aware of the risk associated with trading of securities.

Minimum contents of a Client Agreement

A Client Agreement shall contain at least provisions to the following effect:

- A description of commission, brokerage and any other fees and charges that are to be paid by the client to the stockbroker
- Undertakings by the stockbroker and the client to notify the other in the event of any material change to the information
- The full name and address of the client as verified by a retained copy of the identity card, relevant sections of the passport, business registration certificate, corporate documents, or any other official document which uniquely identifies the client
- The full name and address of the stockbroker's business including the stockbroker's licensing status with the Securities and Exchange Commission
- A description of the nature of services to be provided to or available to the client, including whether investment decisions are to be on a discretionary or non-discretionary basis
- The risk acknowledgement statement
- Any incentive scheme applicable for employees of the stockbroker which is based on the turnover generated from the transactions carried out by the employees for the clients
- Fees for any other services

Risk disclosure statements

A Client Agreement shall include applicable risk disclosures, declaration by staff and acknowledgement by client in substantially the following form and should be in print at least as large as other text in the Client Agreement. The following substance contained in the risk disclosure statements is considered to be the minimum required. A stockbroker may elect to provide additional risk disclosure information as appropriate. Where any of the following risk disclosure statements are applicable, a declaration by staff and acknowledgement by client should be executed.

The substance contained in the following declaration by staff and acknowledgement by client is considered to be the minimum required.

Declaration by the staff

A member of the staff, who is authorized by the Board of Directors to make declarations on behalf of a stockbroker should sign and date a declaration confirming that the stockbroker has:

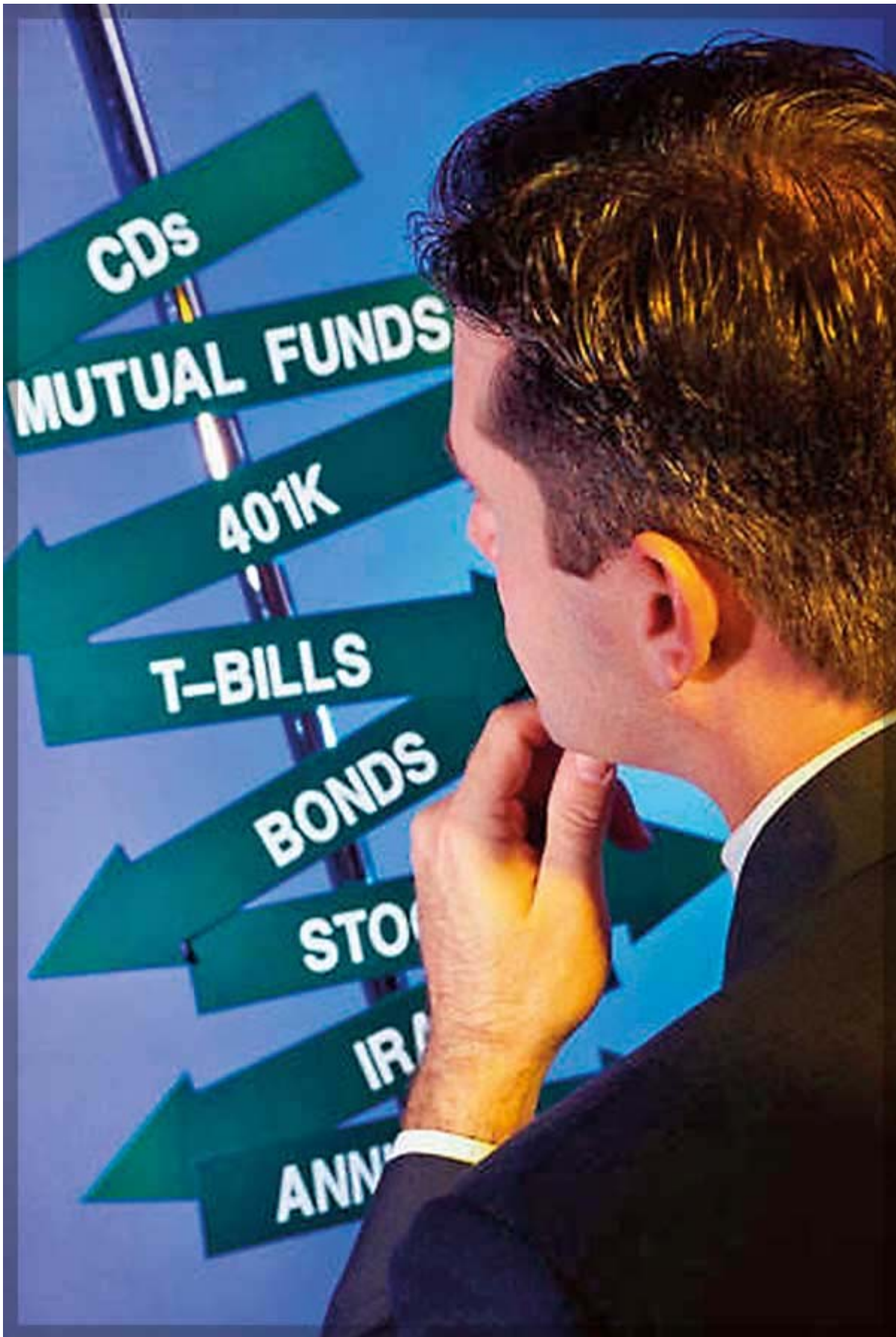
Clearly explained the risk disclosure statement to the client

- Invited the client to read the risk disclosure statement, ask questions and take independent advice if the client wishes
- The name of that staff member should be stated in block letters in the risk disclosure statement.

Acknowledgement by client

The client shall sign and date an acknowledgement confirming that:

- The risk disclosure statement was explained to the client
- The client was invited to read the risk disclosure statement, to ask questions and take independent advice if the client wishes



Discretionary accounts

Discretionary accounts are investment accounts that are structured to allow the broker or another authorized individual to manage the assets of the investor without the need to clear the transactions with the investor beforehand. This approach is usually employed when the investor has a great deal of confidence in a given stockbroker firm or an individual and feels comfortable enough to turn over all trading decisions to the broker or other person. While the authority to make trading decisions on behalf of an investor is present with any discretionary account, the investor remains the owner of the account and has the ability to revoke privileges at any point in time.

The advantage of a discretionary account is that it allows the investor to be involved in the investing process as he or she wishes. Individuals who are extremely busy with career or family concerns often find the creation of a discretionary account the ideal way to grow an investment portfolio. Because someone trustworthy is managing the investments, there is no need for the investor to spend time researching potential purchases, projecting future performances, or wondering if a given security should be put up for sale in the near future.

The investor who chooses to have his or her portfolio managed by a third party always has the ability to look at the current status of the holdings, their current performance levels and how much of a return was generated in a recent period. The manager of the discretionary account provides the investor with periodic reports, or arrange for the investor to peruse recent activity via a secure channel over the Internet.

Furthermore, the investor has the ability to revoke the privileges of the individual or entity managing the discretionary account and become more actively involved in the investment process.

The disadvantage of a discretionary account is that the investor is not fully involved in the decision-making process and if he doesn't pay attention or keep in touch regularly, he might lose the track of his investment. If the broker who handles the account is not competent enough, it will create issues in the long run.

To operate a discretionary account, the following criteria must be followed:

- A stockbroker firm shall implement internal control procedures to ensure proper supervision of the operation of discretionary accounts.
- Such written authorization given by the client shall clearly state the investment objectives of the client.
- A stockbroker firm shall not effect transactions in a discretionary account unless the client has given prior written authorization to the stockbroker firm to effect transactions for the client without the client's specific instructions.
- The chief executive officer of the stockbroker firm shall approve any arrangement to operate a discretionary account.
- Each authorization or acceptance may be terminated by notice in writing by the stockbroker firm or the client, as the case may be.

Prohibited trading activities

Unauthorized activity occurs when your broker buys or sells a security in your account without the prior approval of the client. Unless the broker has discretion to manage a client's account without seeking prior approval for each transaction, your broker must follow rules designed to assure that you, in fact, approved each transaction. Unauthorized trading can occur for any number of reasons.

Unauthorized trading

A stockbroker firm and employees of such firms, who deal with clients shall not

- Execute trades contrary to the instructions received from the client; execute its/their personal trades in the account of the client
- Execute a buy/sell transaction in a client account without the authority of the client
- Use the client's account for third party trading
- Some investors tend to sign documents provided by the stockbroker without going through them carefully and in turn give authority to stock brokers to maintain discretionary accounts. They do this mistake due to their busy schedule or due to pure negligence. This is a common mistake made by investors and subsequently complains that the stockbroker has executed transactions without getting the permission of the investor.

Client-stockbroker dispute resolution

When a dispute arises in connection with dealing with a stockbroker firm, the client is able to settle the dispute in the following manner:

The decision of the Dispute Resolution Committee shall be referred to the Board of Directors for ratification. The decision of the Board of Directors shall be conveyed to the relevant parties in dispute.

The Dispute Resolution Committee shall consist of four Directors of the CSE, one of whom shall be an elected Director and the other three shall be appointed Directors.

If the client is not satisfied with the decision taken by the stockbroker firm or the manner in which the complaint was dealt with by the stockbroker firm, the client may refer the complaint to the Colombo Stock Exchange (CSE).

If a client has a complaint against a stockbroker firm in respect of dealings in securities such client shall, in the first instance, refer same in writing to the Compliance Officer of the stockbroker firm within a period of three months from the date of the disputed transaction/s. The Compliance Officer shall deal with the complaint and shall ensure that it is resolved expeditiously and satisfactorily.

The complaint shall be dealt with by the officer/s appointed by the Chief Executive Officer of the CSE to deal with such complaints and the decision of the officer/s shall be conveyed to the client and/or stockbroker firm in dispute, as appropriate. If a party is not satisfied with the decision, such party may appeal, within a period of 21 days from the date of the decision, to the Dispute Resolution Committee for an adjudication of the decision.

The Dispute Resolution Committee shall adjudicate upon such complaint and if required, the Committee may give a hearing to the stockbroker firm and/or the complainant, as the case may be.

In the event, the stockbroker firm does not abide by the decision taken by the officer/s of the CSE and where the stockbroker firm has not appealed to the Dispute Resolution Committee for a review of the decision the Chief Executive Officer of the CSE shall refer the matter to the Arbitration and Disciplinary Committee.

Effective stock investing is not about doubling your money in one month. Success in investing comes by being patient, continuously learning and being rational.

(Source: Colombo Stock Exchange, Stockbroker Rules)