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Investment industry needs more educational requirements

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My corporations professor in law school once said, “Financial advisors are nothing more than used car salesmen with more expensive suits.” Although her words may have been somewhat harsh, her comment was prescient in one particular regard — the subject of education.

Whether one sells used cars or investments, the educational prerequisites for those who sell used cars and investments are identical — there are none. Perhaps there is good reason in the case of the car salesperson, but is the same true with respect to one’s advisor? Do investors really care whether the person with whom they are entrusting their life savings ever graduated from high school or college? Of course they care.

While there certainly are many financial advisors who are qualified to responsibly serve their investor clients, many lack sufficient educational credentials to practice in today’s complex world of financial investment.

Unfortunately, neither the SEC nor the Financial Industry Regulatory Authority (FINRA) mandates educational prerequisites for taking the primary stockbroker licensing examination. Some candidates simply take a 4-8 week cram course to pass this mandatory “Series 7” licensing exam. This leaves it up to the client to ascertain the qualifications of a recommended advisor before establishing an investment relationship.

Some critics might speculate that most stockbrokers already have college degrees, thereby making such regulation unnecessary. Unfortunately, there is insufficient evidence to support such criticism. FINRA’s BrokerCheck® website provides access to financial advisors’ Central Registration Depository (CRD) reports. The reports do not reference prior education.

Some of the largest U.S. brokerage firms do not require college degrees before sponsoring candidates to take the Series 7 examination. For example, Edward Jones, a St. Louis-based firm, only requires a high school degree or G.E.D. Raymond James, a Tampa-based firm, states on its website that a four-year college degree is "preferred," but "an equivalent combination of experience, education, and/or training as approved by Human Resources" is acceptable.

As of March 2012, there were 4,428 FINRA member firms, 162,153 branch offices within those firms, and 629,526 registered representatives. As of September 2010, more than 11,000 investment advisers were registered with the SEC. Those individuals managed more than $38 trillion for more than 14 million clients. According to the Securities Industry Financial and Regulatory Authority (SIFMA), U.S. retirement assets stood at $17 trillion as of the third quarter of 2011. At the same time, there were approximately 110 million public customer accounts at U.S. broker-dealers. Given these vast amounts of money and the responsibility both accepted and sought by the industry, one would hope that entry qualifications would be more significant.

Both the securities industry and regulators allow individuals without any formal higher education to not only advise people how they should invest their life savings, but also to recommend and sell products that have "rocket science" complexity. In the past 10 years the types and varieties of complex, structured products and hedge funds have exploded. Many of these products' strategies are so intricate that the sales people selling them readily acknowledge that they do not understand them, and are forced to rely upon marketing literature presented by their firms.

Does either the securities industry or the SEC mandate any training program to ensure that advisors are competent to explain complex products and strategies? The answer is no. This is a clear sign of the failure of self-regulation within the securities industry. Minimally educated stockbrokers are selling these products with no SEC- or FINRA-mandated product training. In most states, one cannot get a driver's license without demonstrating an ability to parallel park. Yet, somehow, advisors are permitted to sell complex, structured investment products without demonstrating comprehension of them.

In its January 2011 Study on Investment Advisers and Broker-Dealers, the SEC addressed the duties owed by investment advisors and broker-dealers. When it came to the subject of education, the SEC failed to suggest even a single change to the current system related to either educational prerequisites or continuing education. Instead, the SEC focused on investor education.

Recognizing that many retail investors "may not have the time, information, market sophistication or access needed to represent themselves effectively in today's complex capital markets when pursuing their financial goals," the SEC expressed its support of programs to support the "financial literacy of retail investors."

The SEC missed the mark. While the financial literacy of retail investors is important, the greater focus should be on educating the advisors. Systems based upon the blind leading the blind are inevitably unsuccessful.

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