Starting to invest: Opening an account

So, you have analyzed your financial and personal situation and found an investment advisor (IA) who has the experience and knowledge to help you make suitable decisions. But, how can you be sure that this important person will choose the right products for you?

The main tool for IAs is the New Account Application Form (NAAF) – the form you fill out when you first open an account with an investment firm. It's on that form that you must crystallize your financial objectives. The NAAF provides the key information that will help your advisor choose suitable investments for you and it's in your best interests to make sure every fact on this application is as accurate and complete as you can make it.

The NAAF will ask you a lot of questions, such as:

- your full name
- your permanent address, home and business telephone numbers
- citizenship
- occupation, employer, type of business
- if you are an officer, director or in a control position of a public company
- age
- investment objectives and risk tolerance
- investment knowledge
- net worth and earnings
- bank and credit references

This is all part of the all-important rule of the securities industry, that is, the *Know Your Client (KYC)* rule. Interestingly enough, the rule was originally introduced to protect investment firms from clients defaulting in their accounts. But later on, it evolved into a powerful tool to protect clients against dishonest IAs.

When you engage the services of an IA, you can expect a certain standard of service. There are numerous rules and regulations that advisors must follow, but it is the KYC rule that takes the centre stage, requiring from IAs to make a concerted effort to understand the client's financial and personal status and goals, and to make recommendations that reflect these criteria.

The rule states that:

- advisors must learn the essential facts relative to every client and to every order or account accepted;
- the acceptance of any order for any account is within the bounds of good business practice; and
- to ensure that recommendations made for any account are appropriate for the client and in keeping with his or her investment objectives.

This is the bottom-line behavior for an IA and the minimum you should expect from your investment advisor. But, as an investor, you too should make suitability your main focus and before you start investing, consider your financial situation and your goals and think about the kind of investment products that would suit you.

Some of the questions you find on the NAAF may seem nosy, like your occupation or whether you are married or not. But, this can be important in unexpected ways. For example, your occupation may indicate your level of understanding of the securities business. In addition, the identity of your employer could help guard against insider trading.

So, don't be shy about telling your advisor the answers to these questions. At the same time, don't exaggerate the facts, such as your income or level of investment knowledge or willingness to tolerate risk. If you do so, your IA might start recommending inappropriate investments that could get you into trouble.

Cash versus margin accounts

Your advisor will also ask you what type of account you want to open. The two main types of accounts are cash and margin.

If you open a regular cash account, you must make full payment for purchases or full delivery

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for sales on or before the settlement date. The settlement date for most securities is three business days after the trade.

On the other hand, if you open a margin account, you'll be able to buy securities on credit. You'll pay only part of the full price at the time you make a trade. The part you pay, by the way, is called the margin. The brokerage firm will lend you the remainder, charging you interest on the loan.

Buying securities on margin can be a good deal and, if you are an experienced investor, you might want to explore this option. But, there are pitfalls. When a brokerage firm lends you the money to buy securities, it uses the securities in your account as collateral. If those securities drop in price, the company may ask you to advance more money. This is known as a margin call and answering the call isn't optional. If you don't advance the money in time, the securities may be sold, possible at a loss to you, to settle the account. So, don't use margin unless you'll be able to come up with the cash to answer any margin call quickly and easily.

The Client Agreement

Whichever type of account you open, it's a good idea to talk with your broker about your responsibilities. Some of these are spelled out in a document known as a Client's Agreement, which will be sent to you when you open an account. For example, many agreements for both cash and margin accounts specify that the firm has the right to close out the account if proper settlement isn't made. Let's say you fail to pay in time for securities that you asked your advisor to buy. Under most agreements, the firm would legally be able to sell securities in your account to pay the outstanding balance. It's your responsibility to live up to the terms of the agreement.

One more thing, when you open an account with an investment firm, open a file of your own at home. Keep copies of every document that's important to you as an investor, including your New Account Application Form, the Client's Agreement, and any account statements sent by your advisor. It's a good way to keep on top of your investments. And, if you ever have any problems, having the documents handy will help you find a solution much faster.

Starting to invest

Opening an account is just the first step. Now you start the real business of being an investor – and that's investing, of course! First, you have to decide what you want to buy. If you have done your financial planning homework, you should already know the types of investments suited to your needs. Now, you have to narrow in on a specific investment. To do so, consult the many sources of information available to investors. These range from mass media, like newspapers, to detailed documents like annual reports and prospectuses. Most of these are available on the Internet or in print form. Prospectuses and annual reports of Canadian public companies and mutual funds can be downloaded from a Web site at www.sedar.com.

If you are a self-directed investor, analyze the securities that interest you with aid of many books on the topic or by attending courses that teach methods of evaluating securities. If you are dealing with a full-service investment house, you should ask your IA for research and recommendations. But, don't feel obliged to act on all recommendations. Your broker has a responsibility to recommend investments that are suited to your needs. The financial decision, however, is always up to you. Don't make an investment that you don't understand or that you don't agree with. Do your own thinking.

If your broker is making recommendations that don't suit you, tell him or her how you feel. It's possible that your advisor hasn't understood your needs properly or that he or she has a different view on what's right for you. But, if you have discussed the issue and you continue to disagree with recommendations, consider looking for another advisor.

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