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FIDUCIARY DUTY DEBATE: TOWARD A NEW STANDARD

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The CSA's new paper explores the possibility of introducing a fiduciary duty for advisors

Should financial advisors have an explicit duty to place the interests of their clients above their own? Investor advocates scream, "Yes." The investment industry squeals, "No." The regulators? They're not sure.

In October, the ***Canadian Securities Administrators*** (CSA) published their long-awaited consultation paper on the question of fiduciary duty – that is, whether financial advisors should be required to act in their clients' best interests and not merely to ensure the suitability of their clients' investments.

The CSA paper sets out the case for a fiduciary duty, explains some of the potential drawbacks and examines related developments in various other countries.

However, the paper doesn't take a position on whether the regulators believe formalizing such a duty is necessary.

In what promises to be a highly polarized debate, with investor advocates on one side and the industry on the other, the regulators are casting themselves as the undecided voter.

The CSA's paper stresses the regulators' agnosticism on the issue: "No decision has been made whether a statutory best interest standard should be adopted (and on what terms), whether another policy solution would be more effective or whether the current Canadian standard of conduct framework is adequate."

The CSA presents its paper as an initial step in soliciting public input. And the paper indicates that if regulators decide that imposing a fiduciary duty is warranted, there would first be "broad public consultation and discussion."

In other words, the CSA isn't rushing into anything. The paper is out for an unusually long, 120-day comment period, which runs until late February 2013.

And given the CSA's professed agnosticism on the issue, its promise for further consultation and the reality of the policy-making process in Canada in general, the imposition of a fiduciary duty is likely to be years away – if it comes at all.

This noncommittal approach worries retired securities lawyer Glorianne Stromberg: "There is so much fuzzy thinking and so little understanding of what 'fiduciary' is and what constitutes fiduciary obligations. The bottom line is that a salesman is a salesman, and [the regulators] shouldn't allow nomenclature that suggests he or she is anything else."

Yet, as the CSA deliberates, most investors will continue to be under the illusion that financial advisors already have a fiduciary duty to their clients. According to research published earlier this year by the Toronto-based ***Investor Education Fund*** (IEF), an online survey of investors carried out in December 2011 and January 2012 found that 70% believe an advisor already has a legal duty to put their clients' interest ahead of their own; 21% weren't sure; and just 9% believe that's not the case.

This common misconception among investors that advisors already have a fiduciary duty to their clients, the CSA's paper states, is one of the basic arguments in favour of regulators introducing such a duty.

The CSA paper spells out five basic investor-protection concerns that possibly could be addressed by adopting a fiduciary duty, including matching the regulatory reality with investors' existing beliefs.

The other weaknesses that the CSA paper suggests a fiduciary duty could help solve are that: the suitability standard may not be strong enough, given low levels of financial literacy; the "buyer beware" principle is not adequate; the impact on investors of the

fact that suitability doesn't equal investors' best interests; and the current conflict-of-interest rules may be less effective than intended in practice.

The CSA paper notes the potential drawbacks of imposing a fiduciary duty, such as the possibility that this duty could ultimately raise the cost of advice and limit its availability.

Other potential negative effects on different sectors of the industry are noted in the CSA paper, such as for mutual fund dealers, which are licensed to sell only one type of product, or the exempt market.

Such concerns are among the industry's main criticisms of any proposed fiduciary standard. In anticipation of the CSA's paper, the ***Investment Industry Association of Canada*** (IIAC) submitted a report to the CSA outlining IIAC members' overall opposition to the imposition of a fiduciary standard, arguing that such a move could lead to numerous, potentially negative consequences for investors and the industry, including: possibly reducing choice among business models; reducing access to financial products; and decreasing the affordability of financial advice.

The IIAC also worries that a fiduciary duty could create uncertainty within the client/advisor relationship while imposing onerous compliance requirements and increased exposure to liability for advisors.

The IIAC would rather see any perceived problems with the provision of advice remedied by beefing up aspects of the current regulatory regime, such as the disclosure and suitability rules.

The introduction of a fiduciary standard could have major implications for the self-regulatory organizations as well. Mark Gordon, president and CEO of the ***Mutual Fund Dealers Association of Canada***, says that the discussion about a fiduciary standard "is an important one for regulators all over the world" – and he lauds the CSA for its paper. However, he adds, it's important to explore all the issues, including how such a standard would work in the real world, before deciding whether to impose such a duty.

Just as important, Gordon suggests, regulators should be examining whether they have been effective in regulating the existing requirements – particularly, the current suitability standard. IE

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