

**The Canadian Securities Administrators (CSA)
Consultation Paper 33-403:
The Need for a Statutory Best Interest for Financial Advisers**



Executive Summary

Saving for retirement a major priority

Many Canadians rely on professional investment advice for financial planning. Saving for retirement is often the chief goal of the average retail investor, but doing so is increasingly a challenge for most Canadians. Statistics Canada reported in 2011 that only 4.5% of the total RRSP contribution room was used, and this number has decreased from 2010.ⁱ Canadians now leave over \$630 billion dollars of RRSP contribution room untouched, representing a lost opportunity for both individuals and the financial industry. Approximately 70% of pre-retirees, according to the Canadian Institute of Actuaries, are concerned about “maintaining a reasonable standard of living for the rest of their life” and almost half admit to being unprepared for retirement.ⁱⁱ

It is no surprise that average retail investors are overwhelmed and reluctant to invest. In addition to the recent economic turmoil and investment losses suffered in 2008, Canadians are losing trust in financial professionals. One third of CARP members have suffered a loss from an investment that was personally unsuitable. The vast majority of CARP members who suffered such a loss claim that their advisor encouraged the poor investment, even though most invest conservatively and pride themselves on their financial knowledge and investing acumen.ⁱⁱⁱ A substantial minority of CARP members think most financial fraud originates with financial advisers.^{iv} Almost 40% of CARP members polled think that it is common for a financial professional to mislead or defraud investors.

Retail investors are at a disadvantage

The current investment system often puts common retail investors at a disadvantage. Due to the complexity of financial products and information, investors trust and rely on financial advisers for advice to plan for retirement. Investors assume that the industry is as well regulated as other professions, that their interests are protected, and that they have recourse if there is misconduct. This expectation is at odds with the reality. For example, CARP members polled said that they thought that financial advisers already lose their jobs if found to have acted against their clients' interests despite there being no regulatory regime that guarantees that result. In particular, financial advisers are not legally required to put their clients' interests ahead of their own. Rather, a client who suffers a loss must go to court to first prove that the adviser owed the client a duty of trust. No other recourse is available to get the client's money back.

To level this playing field, CARP supports a legislated fiduciary duty both to balance the ongoing relationship between financial professional and investors and to improve access to restitution. Many CARP members have had to confront the gaps in the system and want to see those gaps filled with greater investor protection.

CARP calls for legislated fiduciary duty

CARP is calling for legislated standards that will bridge the gap between the average retail investor and the financial advice industry, starting with a legislated fiduciary duty. A legislated fiduciary duty will help give investors an opportunity to save for their retirement both adequately and fairly by giving investors more protection from conflicts of interests, misconduct and fraud. A legislated fiduciary duty sets a standard that, when enforced, can influence the behaviour of financial advisors so that they are more likely to act in the investor's best interest. Currently, as we have seen in the recent case of the Octagon Capital, the investor still has no right to get his/her money back without going to court even when the existing regulatory and self-regulatory bodies have ruled against the adviser. Therefore, a legislated fiduciary duty will also give investors access to restitution by providing them the legal framework and resources to sue an adviser and pursue their case.



Who We Are

CARP is a national non-profit non-partisan association with 300,000 members across Canada, most of whom are retired members, with above average education, income and net worth – comfortable in retirement but concerned about out-living their money and about their children and grandchildren whom they see as not saving enough for retirement – like a lot of Canadians We are in constant communication with our members - through the pages of ZOOMER magazine – which reaches every household 9 times a year – and through our twice monthly e-newsletter which reaches 90,000 email addresses and allows us to poll the membership on our advocacy issues. Our members are highly engaged and vocal and are willing to act upon their convictions. On average, we get 2,000-3,000 responses to the CARP Poll in our newsletter.

Canadians Need a Legislated Fiduciary Duty

A legislated fiduciary duty will help level the playing field

A legislated fiduciary duty can help level the playing field for financial advisors and investors. There is now an asymmetry of information, with advisers having much more financial knowledge and expertise than their clients. The fiduciary duty recognizes that imbalance and requires the adviser to exercise knowledge in the best interests of the clients, even ahead of the advisor's own interest.

Studies have shown that investors score poorly when tested on their financial and investment knowledge, including topics such as investment risks and returns, financial planning and goal setting, rules for RRSPs, and applying their knowledge to real life decisions, which makes them vulnerable to inappropriate advice and even investment fraud.^{v vi} Along with inadequate financial and investment knowledge, investors are generally unable to distinguish between professional designations and are unaware of whether there is adequate protection and regulation in place. CARP's Poll revealed that 64% do not know which professional designations provide the most protection to investors and almost half do not know which agency has responsibility for regulating financial advisors.^{vii}

Financial education efforts are helpful but they cannot be reasonably expected to be sufficient to absolve the advisers of their responsibility. Indeed, the focus of court decisions has been on this gap in knowledge and the degree of reliance that the client had on the adviser, thereby giving rise to a fiduciary duty and ultimately damages for giving advice that the adviser knew to be inappropriate for the client. A legislated fiduciary duty will impose that responsibility on financial advisers to provide the best advice based on their expertise and act in the best interest of their clients.

A legislated fiduciary duty will help will set a standard, clarifying the client-advisor relationship

The playing field is further imbalanced by the amount of influence advisers have over investor's financial decisions due to the level of trust, discretion, and access that investors give to their advisers. According to Canadian Securities Administrators (CSA) 2012 Index survey results, increasingly more Canadians have financial advisors and the most of them feel comfortable raising concerns and questions to their financial advisors. Furthermore, 60% of those with financial advisors have not done a background check of their financial advisors, all of which shows the level of trust investors have in financial advisors.^{viii}



A study by the Investor Education Fund, found that investors' trust in their advisors' opinions dominates all other factors in their investment decisions.^{ix} Some even give a certain amount of discretion to their financial advisors over the decisions and management of their investments in good faith, believing that their financial advisor will act in their best interest. However, the advisors are not legally required to act in the best interests of their clients. Current industry rules and codes of conduct demand a suitability requirement, in which advisors are required to only know their client for the purpose of providing suitable investment options. However, the suitability requirement leaves opportunities for conflicts of interests and does not necessarily serve the best interest of the clients.

A legislated fiduciary duty will set a standard of accountability for the position of influence and the trust and discretion that advisors receive from their clients. It will ensure that investors will actually receive the professional service that they are expecting from their financial advisors. The Ontario Court determined that if vulnerability, trust, reliance, discretion, and professional rules or codes of conducts are present, the client-advisor relationship is considered to be a fiduciary relationship.^x

Given the amount of influence advisors have over the financial decisions of their clients, the financial advice industry should be governed by a fiduciary standard, as is the case for regulated professions, such as doctors, engineers, and lawyers. According to CARP's Poll, 97% of members believe that financial advisers should be regulated like lawyers and accountants so that those who breach their professional standards would no longer be allowed to practice.^{xi}

It is clear there are major gaps in investor's behaviour and understanding, and a legislated fiduciary standard would help fill these gaps and by upholding financial advisers as trustworthy neutral allies and clarify the client-advisor relationship as a fiduciary one, in which the advisors are responsible for prioritizing the interest of their clients.

A legislated fiduciary duty will help establish effective means of restitution

A legislated fiduciary duty will help establish better means of restitution. Currently, if people want to get their money back, they must go through various complaint mechanisms and eventually the courts. However, not only is it an onerous process, investors often no longer have the resources to pursue legal action and there is usually a limit on the compensation amount recommended by existing complaints bodies despite the size of the financial loss.

For example, the Ombudsman of Banking Services and Investments (OBSI) will take complaints and make resolution recommendations to financial institutions, but OBSI has no power to make them comply with its recommendations. Even if a compensation recommendation is made, the amount is limited to \$350,000. Investors can pursue their complaints further by taking it to court, but there are limitations and costs deterring many from pursuing this route. For example, small claims courts are less costly and time consuming but one can only claim up to \$25,000, whereas the Superior Court of Justice has no limit on the amount claimed but the litigation costs are prohibitive.^{xii}

A legislated fiduciary duty removes one major uncertainty from the litigation and improves the chances of the client in securing some restitution. The greater impact, however, may be that existence of the legislated duty and greater chance of success in court will influence the behaviour and standards of advisors and their firms, both reducing the losses and encouraging out of court settlements.

Ultimately, legislated fiduciary duty will help people to save adequately and fairly for retirement

Everyone wants financial security in retirement and have a fair opportunity to do so. However, the current environment, including the aftermath of the financial crisis and the proliferation of financial professional designations and increasingly complex investment products, has made retirement planning and saving increasingly challenging. The asymmetry of information and the lack of standards regulating financial advisors have made many investors vulnerable and reluctant to invest. This is not only a lost opportunity for investors but also the financial industry.

CARP calls for a legislated fiduciary duty as part of our advocacy for greater investor protection, in which there is a full continuum of specialized information, investigation, prosecution and restitution. A legislated fiduciary duty has the potential to change the norms and behaviour of financial advisors and lead to a more level playing field, as advisors recognize their position of influence and act in the best interests of their clients. A legislated fiduciary duty can be one of the effective means of increasing the standard for all financial advisors, reduce investor vulnerability, and encourage more savings and investments, benefitting both investors and the financial industry.

ⁱ Statistics Canada. Registered retirement savings plan contributions, 2011. <http://www.statcan.gc.ca/daily-quotidien/130211/dq130211a-eng.htm>

ⁱⁱ Canadian Institute of Actuaries, Retirement Risk: Defining Retirement Horizons

ⁱⁱⁱ <http://www.carp.ca/wp-content/uploads/2012/11/Financial-Report.pdf>

^{iv} <http://www.carp.ca/wp-content/uploads/2012/11/Financial-Report.pdf>

^v Investor Education Fund. <http://www.getsmarteraboutmoney.ca/en/research/Our-research/Pages/financial-literacy-research.aspx#.UQgcDmeafcs>

^{vi} Canadian Securities Administrators. <http://www.securities-administrators.ca/aboutcsa.aspx?id=1104>

^{vii} CARP Investor Protection Poll Report. May 2012. <http://www.carp.ca/2012/05/24/carp-investor-protection-poll-report/>

^{viii} Canadian Securities Administrators. 2012 CSA Investor Index. <http://www.securities-administrators.ca/investortools.aspx?id=1011>

^{ix} Investor Education Fund. 2012. Investor behaviour and beliefs: Advisor relationships and investor decision-making study.

^x Canadian Foundation for Advancement of Investor Rights. http://faircanada.ca/wp-content/uploads/2012/06/Why-A-Fiduciary-Standard_-Kivenko.pdf

^{xi} CARP Investor Protection Poll Report. May 2012. <http://www.carp.ca/2012/05/24/carp-investor-protection-poll-report/>

^{xii} Ontario Securities Commission. <http://www.osc.gov.on.ca/en/22411.htm>