

## **Financial Advisors – Statutory Fiduciary Duty or Best Interest Standard**

Submitted by Diane A. Urquhart, Independent Financial Analyst

[CV Diane Urquhart](#)

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I wish to make this submission in response to the call for comments on:

**CANADIAN SECURITIES ADMINISTRATORS, CONSULTATION PAPER 33-403:**

***THE STANDARD OF CONDUCT FOR ADVISORS AND DEALERS: EXPLORING THE APPROPRIATENESS OF INTRODUCING A STATUTORY BEST INTEREST DUTY WHEN ADVICE IS PROVIDED TO RETAIL CLIENTS***

On March 7, 2013, I was interviewed on BNN, Business Day by Andrew Bell and Sijal Patel in a debate format with Greg Pollock, President of Advocis, the Financial Advisors Association of Canada. The subject of the debate was the proposed Statutory Best Interest Duty for Financial Advisors. I would like this debate found at the following BNN link to be accepted as a submission in respect to the CSA Consultation Paper 33-403.

<http://watch.bnn.ca/#clip880051>

I agree with the new statutory fiduciary duty standard, or best interest duty standard, for financial advisors, who give advice to retail clients. This is proposed by both the Canadian Securities Administrators and the North American Securities Administrators Association:

The Canadian Securities Administrators define this new standard to mean:

**Every adviser and dealer (and each of their representatives) that provides advice to a retail client with respect to investing in, buying or selling securities or derivatives shall, when providing such advice,**

**(a) act in the best interests of the retail client, [ahead of their own or their employer's interests]**

**(b) exercise the degree of care, diligence and skill that a reasonably prudent person or company would exercise in the circumstances.**

Financial advisors impact when you retire and what your retirement income will be. They impact the quality of your life, if you were to become disabled. Your partner and children are affected by flawed savings and insurance products and strategies, if you were to die. The financial adviser's role in your life events is comparable to other professionals who must meet the fiduciary duty standard: doctors, lawyers and trustees protecting the beneficiaries of trust accounts.

The new fiduciary duty standard must not be restricted to just financial advisors. It must apply to the employers who supervise the financial advisors. It must apply to the investment bankers and research professionals at investment dealers, who design and provide expert opinions on complex investment products sold to retail investors. Otherwise, the financial advisors are left holding the bag, when flawed investment products fail.

I agree with Advocis's recommendations for raising the bar on professional standards for financial advisors. (Mandatory membership in an accredited professional association, higher initial qualifications for licensing, continuing education, a complaints and discipline process, and publications of the names of person who breached the professional standards and code of conduct set by the professional association).

Both the new statutory fiduciary duty standard and increased professional standards are required for retail customers to regain trust in the financial industry. Canada has had multiple financial scandals to warrant the implementation of this new financial duty standard on financial advisors and other experts involved in investment and insurance products sold to retail clients.

Self-regulated professional standards are not enough. The new statutory fiduciary duty will be helpful to both government securities and insurance regulators and the courts. A new statutory civil liability regime is also needed. This would allow investors to benefit from private class actions, when securities and insurance regulators and the police ignore their claims of financial industry wrongdoings.

The statutory fiduciary duty standard eliminates the time consuming and costly aspects of regulatory and civil court proceedings that deal with whether or not a fiduciary duty relationship exists. The adjudicators can focus on the evidence of whether fiduciary duty was carried out and whether the financial adviser acted as a reasonably prudent person.

The new statutory duty standard would have clear safe harbour conditions and carve-outs for certain client decision-making situations: no fiduciary duty imposed on discount brokers; no claim can be successful from clients who did not follow the financial adviser's advice.

### **Reasons to Raise Conduct to Fiduciary Duty Standard**

I add points below to each of the reasons provided in the CSA Consultation Paper 33-403 for raising conduct of financial advisors to the fiduciary duty standard .

**• many investors place substantial trust, confidence and reliance on the financial advice they receive**

- 98% of CFA Institute members recently in a survey say there is a lack of trust in the financial industry;

[http://www.cfainstitute.org/about/research/surveys/Pages/global\\_market\\_sentiment\\_survey\\_2013.aspx](http://www.cfainstitute.org/about/research/surveys/Pages/global_market_sentiment_survey_2013.aspx)

- Canadian financial industry scandals are comparable to those in UK, Australia and Europe and US.

Country	Scandal	Canadian Equivalent Scandal
United Kingdom	Payment Protection Insurance - \$20 B Pensions Personal v. Company - \$20 B LIBOR Unregulated Collective Investment Schemes	Employer disability insurance - \$5 B  CDOR Uninvestigated Mutual Fund Market Timing - \$1.3 B Unauthorized -unnecessary FX - \$2.5 B
Europe		
Australia	Storm Financial - \$3 B Opes Prime - \$630 M Trio Capital - \$175 M	Investia-Money Concepts Sbaraglia & Mander - \$40 M Mont Real - \$130 M Earl Jones - \$50 M Brost & Sorenson - \$400 M Norboung - \$80 M Norshield - \$500 M
US	CDOs/CDSs Auction Rate Securities - \$60 B	Non Bank ABCP - \$4 B retail sold Income Trusts - \$40 B

- **amounts invested often constitute a major portion of investors' wealth and responsibility for funding the costs of living during old age is shifting more to investors.**

- only 2 in 10 private sector employees are in a defined benefit pension plan. New and younger employees have defined contribution pension plans at work or must save on their own through RRSPs.

- **there is often information and financial literacy asymmetry between advisors/dealers and their clients**

- 40% of respondents were categorized as low investment knowledge (0-3 correct answers), 34% as medium investment knowledge (4-5 correct answers) and 26% as high investment knowledge (6-7 correct answers) in 2012 CSA Investor Index Survey;
- 17% of investors had realistic expectations (about 4% investment return), 33% had unrealistic expectations and 51% of respondents said they did not know in 2012 CSA Investor Index Survey;

- 9 investment dealers reached settlements of \$140 M on regulator's allegations of mis-selling Non Bank ABCP at full value after they knew it was worth considerably less due to US subprime and leveraged CDS exposures.

- **these issues are compounded by the increasing complexity of financial products and the fact that many financial products must be “sold” to, not “bought” by, investors,<sup>135</sup>**

- two thirds of energy and business income trusts were mis-sold on the basis of a deceptive cash yield, where about one third of the cash yield was the return of your own capital; two thirds of these income trusts eliminated or slashed their distributions, with an average cut of 70%; about \$40 B of investor losses on the \$200 B of this income product sold in the marketplace;
- 13% of the Non Bank ABCP was sold to retail investors directly and through money market mutual funds, this was \$4 B out of \$32 B, the loss was 100% during the financial crisis prior to the cash settlement obtained in the CCAA court proceeding;
- mis-selling by group benefit advisors of employer sponsored disability insurance administered by licensed insurers, 7% or 1.1 M employees covered by this unsafe insurance, \$ 6 B underfunded, \$642 wage loss replacement cost per employee per year with devastating losses of disability income for disabled Canadians at corporations in bankruptcy.

- **advisor and dealer compensation arrangements can create a conflict of interest between the interests of advisors and dealers and their clients, and**

- mutual fund management fees are taking over half of the investment return over a 30 year savings horizon;
- fiduciary duty standard for advisors will require that they demonstrate the care, diligence and skill of a reasonably prudent person, which means retainer fees can only be received for work done and value being added to the investing client.

**Diane A. Urquhart**  
**Independent Financial Analyst**  
**Mississauga, Ontario**

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