

# Should advisors become fiduciaries?

*Client confidence may be enhanced by the formal designation of advisors as fiduciaries*

**T**HE RECENT FINANCIAL CRISIS and its recessionary aftermath have led to an increased focus on regulatory reforms aimed at improving investor confidence and market participation. The effort has been more intense in the U.S. and Britain, countries in which the collapse of large financial services institutions reverberated through the investor community. **Renewed investor confidence is critical to market growth and economic recovery.**

The reform process has been multi-faceted, embracing efforts to improve the transparency of derivative securities, raise professional standards for advisors and impose stricter rules on financial services institutions. Britain's regulators have raised investment advisor standards through several incremental measures, including increased proficiency requirements, a code of ethics and reform of compensation practices. The initiative that has caught the eye of the regulatory community, however, has been efforts in the U.S. to extend the obligation of a fiduciary standard beyond investment advisors managing client money on a discretionary basis to all advisors dealing with the investing public, including broker-dealers.

The Canadian securities industry, through the **Investment Industry Association of Canada** and its individual member firms, has been following these U.S. regulatory developments. The IIAC has been involved in the rule-making process with

**GUEST COLUMN  
BY IAN RUSSELL**

the **Canadian Securities Administrators** and the **Investment Industry Regulatory Organization of Canada** in recent years and contributed to reforms that are underway.

These include higher professional standards for advisors and better disclosure of the investment process, as well as improved transparency of investment products ranging from derivative asset-backed commercial paper to mutual funds. Although Canadian regulators have made significant improvement to the calibre of regulation — and contributed to greater investor confidence — the concept of imposing a fiduciary standard still commands interest. The recent conference organized by the **Canadian Foundation for the Advancement of Investor Rights** (FAIR Canada) and the Hennick Centre for Business and Law provided a useful forum to explore the issues related to the fiduciary standard.

Any proposal to extend a fiduciary standard to advisors in the wealth-management business requires answers to some fundamental questions. First, what do we mean by a “fiduciary standard”? A key issue is how conflicts of interest in the advisory business should be addressed. Does imposing a fiduciary requirement necessitate a fundamental change in the way the advisory business

is carried out, or can the requirement be imposed through incremental adjustment to existing rules — notably, enhanced disclosure of conflicts? Should all conflicts be treated in the same way, or do some conflicts merit prohibition and others just disclosure?

The answers to these questions have important implications for investors and the complexity of the rule-making process. If the advisory business must be circumscribed to eliminate conflicts, investors will obviously face reduced choice of available products and services. Regulators must then decide if these negative consequences actually outweigh the benefits of the business prohibition. U.S. Senate banking legislation would impose a fiduciary standard across the securities industry by removing the exclusion of broker-dealers from the Investment Advisers Act of 1940. The U.S. Senate is proposing further study of the brokerage and investment advisory industries, prompted in part by the debate about prohibited activities.

Another important question is whether a fiduciary standard is necessary for Canadian investment advisors. The intensive rule-making process in Canada that began before the 2008 global financial crisis has made considerable progress, in terms of higher standards of proficiency and disclosure for IIROC-registered firms and their advisors, increased disclosure requirements for investment products and supervisory requirements for firms. The client relation-

ship model has tightened suitability requirements, adding more detail to disclosure of the investment process and requiring more frequent monitoring of accounts and better conflict-management procedures.

The **Ontario Securities Commission's** Rule 31-505 requires that investment advisors deal fairly, honestly and in good faith with their clients. Moreover, National Instrument 31-103 imposes an obligation on advisors to identify and develop a means of addressing conflicts. Given these requirements, would a fiduciary standard go further? Would it mean incremental rules and some restrictions in business activities?

The answer to these questions may turn on the purpose of a fiduciary standard in the first place. One key consideration is to bolster investor confidence. If investment advisors already meet, or are close to meeting, a fiduciary standard, confidence may be enhanced by a formal designation.

On the other hand, if confidence-building is a key objective, it is important to recognize that reputation and client confidence is not so much about new rules and regulations as it is about meeting the full spirit of existing rules. Investment firms and their advisors must be ingrained with a culture of putting clients first in all dealings. **IE**

*Ian Russell is president and CEO of the Investment Industry Association of Canada.*