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Business

Investment industry demands clarity on best interest standards | Nadia Campion

If Canadian Securities Administrators proposals are adopted, regulators will have to do a better job of providing guidance

By **Nadia Campion**

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(March 27, 2017, 12:05 PM EDT) -- On Dec. 6, 2016, investment industry stakeholders from across Ontario participated in a roundtable discussion with the Canadian Securities Administrators (CSA) in respect of its proposed introduction of new regulatory standards aimed at enhancing the duties and obligations of investment advisers, firms and other registrants toward their clients.

The roundtable represented the culmination of a three-year consultation process focused on exploring the question of whether to impose a new statutory best interest duty on non-exempt registrants in the retail context.

The CSA's new standard is intended to supplement the existing duty of registrants to deal fairly, honestly and in good faith with their clients. It would require registrants to also act in the "best interest" of their clients. The CSA describes the new standard as including, among other things, the avoidance or control of conflicts of interest in a manner that prioritizes the client's interests, the full, clear and timely disclosure of information and the duty to act with care. Boiled down to its basics, it is a "client-first" standard. The conduct expected of a registrant will be measured according to that of a "prudent and unbiased" registrant "acting reasonably."

One of the major concerns permeating the roundtable discussion was that the adoption of a best interest standard will fragment the regulatory environment in Canada because not all provinces are willing to adopt and implement it. So far, only Ontario and New Brunswick's securities regulators have bought into the CSA's proposed best interest standard. The decision of other regulators to forgo implementation of the standard will result in a patchwork of different standards across Canada.

As the number of interprovincial financial transactions increase and geographical borders in capital markets become a relic of the past, a lack of uniformity will inevitably create confusion among industry participants, investors and, of course, the lawyers who advise them.

Uncertainty will be the name of the game, and as one participant from the banking industry pointed out, the lack of consensus among provincial regulators will create serious challenges for institutions carrying on business across the country. Mixed in with these concerns were questions from banking representatives in respect of how the new standard

would apply to different business models including discount brokerages, the sale of proprietary mutual funds, RESPs and other advisory-type platforms offering options trading and initial public offerings.

The Ministry of Finance's representative suggested that certain lines of business could be exempted from the application of the new standard, including discount brokers and sophisticated institutional clients. However, the details of these exemptions still have to be worked out. Others worry that the imposition of a statutory best interest standard will have significant implications for investment firms that may move away from commission-based payment structures to avoid compensation related conflicts of interest.

The Investment Advisory Panel expressed the view that compensation-based conflicts can be managed through a best interest standard. But this will inevitably require investment firms to step up their monitoring technology, account opening procedures, record-keeping and general compliance operations to keep a close eye on compensation grids, high-commission products and advisers reaching compensation ceilings.

The Investment Industry Association of Canada (IIAO) questioned the meaning of the new standard, asking: "How do you discharge your responsibilities [as] an adviser in an appropriate way to meet the best interest standard?" The IIAO emphasized the need for regulators to clearly define the responsibilities to not only protect clients but also advisers who have discharged those responsibilities.

While the CSA made it clear that it does not intend to raise the new standard to one equating a fiduciary duty, some find it hard to imagine how "best interest" can be anything other than a fiduciary standard. Courts may interpret the new standard as rising to the level of fiduciary duty because the alternative is to simply apply the standard that currently exists – honesty, fairness and good faith in dealing with clients.

The obvious question is whether the new standard is meant to be a "third standard" falling somewhere in between the current standard and a fiduciary standard. Ultimately, the roundtable did not produce a consensus among Ontario's industry participants as to whether a best interest standard is necessary and if so, how it will be implemented. However, one thing is clear, if a new standard is created, regulators will have to do a better job at providing direction and guidance to registrants.

As currently drafted, the language is vague and unclear. It will create confusion among participants and their lawyers, give rise to inconsistent interpretations and likely result in unpredictable enforcement decisions. In the absence of increased clarity, it will be very challenging for registrants to take the necessary risk mitigation steps associated with operating in what may be an entirely new regulatory regime. As stated by the IIAO representative, "you need to put some meat on the bones."

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