News

Financial advisers could face tough new rules

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Canada's securities regulators have proposed a series of wide-ranging regulatory initiatives that would have far-reaching effects on almost every aspect of business conducted by securities dealers and advisers and their registered representatives, according to investment experts and securities lawyers.

The Canadian Securities Administrators, the umbrella group for Canada's provincial securities commissions, recently published a long-awaited consultation paper that asserts the "status quo must change," and is proposing two distinct categories of changes that will significantly affect the business model of registrants and drive up compliance costs, experts say.

In an effort to hold advisers to a higher standard in dealings with clients, the CSA is calling for a comprehensive series of "targeted reforms" to the rules of adviser conduct found in National Instrument 31-103. Regulators across the country unanimously agreed that some obligations advisers face in areas such as conflicts of interest, know your client, know your product and suitability need to be bolstered to improve the client-registrant relationship. In short, advisers are going to have to spend much more time and effort getting to know their clients to determine whether financial products are suitable for them, said Bernard Pinsky, a Vancouver lawyer with Clark Wilson LLP and chair of the firm's corporate finance and securities group. "It's going to make it quite a bit more expensive for brokers, dealers, and advisers to do business because of the compliance requirements," said Pinsky.

The targeted reforms signal a significant departure from the principles-based regulatory approach the CSA has almost always adopted toward a "very" prescriptive or rules-based approach, observed Darin Renton, a securities lawyer with Stikeman Elliott LLP in Toronto. "If you look at the suitability obligation in the current 31-103, that section has a couple of sentences," said Renton. If the targeted reforms pass, "it'll be a whole policy on what they think suitability should look like — that's a real change. It is clear that the CSA views that there are significant deficiencies in the industry's approach to these things, that they haven't lived up to their expectations."

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Clark Wilson LLP

Besides the targeted reforms, the CSA has once again raised the possible introduction of a regulatory best interest standard, a controversial proposition that has divided the regulators themselves even as the United States, Australia and the European Union have either implemented, or are proposing to implement, a regulatory best interest standard or fiduciary duty.

The Ontario Securities Commission (OSC) and the New Brunswick regulator are in favour of the standard, arguing that it would "materially enhance" the effectiveness of the proposed target reforms and strengthen the "principled foundation" of the client-registrant relationship. The B.C. Securities Commission is opposed to it and will not even consult members over it while the Alberta, Manitoba, Nova Scotia and Quebec securities commissions "share strong reservations" on the actual benefits of the introduction of a regulatory best interest standard over and above the proposed targeted reforms.

"What is striking is that this is an alarming example of de-harmonization after a decade or so of a really co-operative CSA where we had a high level of harmonization, particularly around registration issues. So this is a bit unsettling," said Renton.

There is little doubt however that the proposed new standard would lead to legal uncertainty, if not even investor confusion, exacerbating the expectation gap between clients and registrants, said industry observers. The CSA maintains that a regulatory best interest standard would not be a restatement or a formulation of a fiduciary duty because fiduciary duty remedies are potentially "too harsh" for all instances of registrant misconduct. The content of the regulatory best interest standard would also be more "comprehensive and tailored" to the client-registrant relationship than a statutory fiduciary duty would be, added the CSA consultation paper.

But investment and legal professionals are far from certain, pointing out that in a previous consultation paper, issued in 2013, the CSA viewed the best interest standard as a fiduciary duty. "But this time, as part of a compromise, they want to put in a statutory best interest standard but don't intend it to be a fiduciary duty so they backed a little away from that," said Renton. Pinsky believes that if the securities regulators are going to adopt it, "it's going to be hard to know what the differences (between a regulatory best interest standard and a fiduciary duty) are because they're similar. Eventually the courts may have to decide that."

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Michelle Alexander
Investment Industry Association of Canada

Investor advocates are not surprisingly hopeful the proposed standard will be adopted in spite of the fact the CSA as a group is divided and will not unanimously approve it. Echoing comments made by the OSC, the national non-profit advocacy group the Canadian Foundation for Advancement of Investor Rights (FAIR Canada) asserts that a regulatory best interest standard would be the underpinning foundation to all other regulatory reforms. "The targeted reforms, each of which would be advances, are good concepts," said Neil Gross, FAIR Canada's executive director. "But if you don't inject those rules with an animating principle that sends a message as to what the purpose of these reforms is and how they should be applied, then they may not work as well as you intend them to be." Even if the Ontario and New Brunswick regulators are the only ones to move forward, and though that would create "significant" practical challenges, Gross still insists that it's a "good idea" to implement it in those jurisdictions because "it's the principled approach." He added, "The changes that it would bring about are necessary changes, and important to safeguarding the welfare of Canadian investors."

But any move towards a best interest standard will face tough opposition from the financial services sector because of the negative consequences it would spawn, said Michelle Alexander, vice-president of the Investment Industry Association of Canada (IIAC). The new standard would engender "significant" costs, reduce access to financial products as well as have an impact on affordability and create uncertainty for advisers, she said. "Certainly the worst outcome for everyone, industry and investors alike, would be the adoption of this standard," said Alexander.

Much work needs to be done before the targeted reforms or the regulatory best interest standard is adopted, noted Pinsky. "I'm not sure all of it is going to end up in legislation or in policy," said Pinsky. "It's a good discussion paper but it needs a cost-benefit analysis with respect to all of its aspects."

Comments on the consultation paper must be submitted in writing by Aug. 26.

Judge: Fetal alcohol disorder 'endemic' to criminal justice system

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factor in sentencing and because it is seemingly the first appellate decision to clarify what constitutes rehabilitation, at least in FASD situations. "Trial judges must not fall into the easy trap that, if it can't be cured, it's OK to criminalize it," she says. "Even with a permanent cognitive disability, there are rehabilitation options in the form of behaviour control."

Sansregret adds the decision is particularly important because of the large number of FASD sufferers, mostly Aboriginal, in the criminal population. As Justice Monnin noted, "While it [FASD] may not be an epidemic, it is certainly endemic to our criminal justice system."

Toronto criminal appeals lawyer Jonathan Dawe agrees. "Part of the explanation for so many Aboriginals in jail relative to the total population is that many of them suffer from FASD," says Dawe of Dawe Dineen. "This judgment is noteworthy because it goes beyond reiterating the principle that FASD impacts moral culpability — it goes a step further and reduces the sentence as a result."

Lawyer Paul Lewandowski, who has experience with FASD clients, says the judgment's view of rehabilitation "adds another arrow" to the defence quiver. "It encourages counsel to look at options to prison," says Lewandowski of Paul Lewandowski Professional Corporation in Ottawa. "It's not a get-out-of-jail-free card, but if you can find treatment options, you can argue for a conditional sentence."

For her part, University of British Columbia Allard School of Law academic Isabel Grant says the case illustrates "one of the most pressing sentencing issues" facing the criminal justice system — how to deal with FASD and mental health sufferers who commit crimes. Says Grant: "We need a more systemic and systematic approach along the lines of the Gladue principle with perhaps conditional sentences for such offenders."

The Crown attorney who handled the appeal for Manitoba Justice declined comment.