IE INVESTMENT EXECUTIVE

Comment & Insight

Guest column: “Best interest” standard not needed

The carve-outs for any proposed best interest standard to avoid adverse market consequences would be extensive and complicated

By Ian Russell | February 2016

In December 2015, the Investor Advisory Panel (IAP) called on the Ontario Securities Commission (OSC) to prohibit the payment of embedded fees and commissions, eliminate conflicted compensation structures and introduce a client "best interest" standard or fiduciary standard for investment advice. While we at the Investment Industry Association of Canada agree that client needs are paramount, we do not agree that these needs can be properly met through a statutory or other formal best interest standard.

The IAP relied upon a Canadian Securities Administrators (CSA)-commissioned report from Douglas Cumming as justification for a conclusion that investors are being put into poorly performing funds "with conflicted remuneration designed to ensure advisors get paid."

The 2015 Cumming report (A Dissection of Mutual Fund Fees, Flows and Performance) undertook detailed research to provide technical background for the CSA discussion paper on Canada's mutual fund fee structure and the role of embedded commissions.

It is not the purpose of this article to review the research on mutual fund fees. Rather, it is to remind readers of what the CSA-commissioned, independent third-party research does not tell us with respect to the many considerations related to any proposed best interest standard.

The research does not explore the reasoning behind any embedded fee structure selected by an investor, including whether that structure was recommended by the advisor or preferred by the investor.

The research does not explore the appropriateness of the investment, separate from performance (which cannot be predicted), from the perspectives of asset allocation or risk tolerance.
The research does not explore investments other than mutual funds. The research does not explore the respective recommendations of different registration categories of "advisors." Are the recommendations made by portfolio managers? Exempt market dealers? Investment Industry

Regulatory Organization of Canada (IIROC) dealers or those licensed by the Mutual Fund Dealers Association of Canada?

The research does not explore the differences in these categories. For example, IIROC advisors are subject to a rule requiring them to address all existing or potentially material conflicts of interest between the advisor and the client in a fair, equitable and transparent manner, and *consistent with the best interests of the client(s)*. According to the rule, any existing or potentially material conflict of interest between the advisor and the client that cannot be addressed in this manner and *consistent with the best interests of the client(s)* must be avoided. *If* there is a problem with IIROC advisors consistently recommending more expensive funds to the exclusion of all other relevant considerations and solely for the advisor's compensation, the problem rests in the shortcomings of the oversight of rule compliance, not the need for a new rule. There is no empirical, reliable evidence of such a problem. The research with respect to fees is, therefore, an insufficient basis for concluding a formal best interest standard is required. It simply does not, nor was it meant to, address the myriad issues that apply to the standards imposed on investment advice.

A decision to introduce a best interest standard to remedy a perceived, unproven problem of recommending the highest fee-paying product for no good reason is moving beyond what is needed and would plunge the industry into another expensive bout of extensive and duplicative rule-making. This duplication would be unwieldy for an industry that has many clients who are *not* in a truly fiduciary relationship with their advisors. At best, the carve-outs for any proposed best interest standard to avoid adverse market consequences would be extensive and complicated. This policy would ratchet up the regulatory burden higher and impose even higher costs on investors.

Market participants would be better served by a thorough review of the client relationship model framework to determine whether specific rules need to be clarified so that all advisors, including those with exempt market dealers, are obligated to meet investor needs. The effective surveillance of advisors of all registration categories, particularly those outside the self-regulatory system, go hand in glove with this approach.

Finally, we encourage more continuing education courses in professional ethics and effective responses to an aging population and elderly investors. The industry remains committed to working with regulators to meet the needs of clients and reach the right result. This approach is the most effective way to address investor protection while smoothing out regulatory burdens and costs for investors.
Ian Russell is president and CEO of the Investment Industry Association of Canada.