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Post CRM: Where do we go from here?

A renewed focus on firm culture is the most productive future direction

By Ian Russell | November 2015

Within nine months, the final phase of the client relationship model (CRM) will take effect, marking the culmination of a four-year effort to build a comprehensive regulatory framework for the client/advisor relationship. The CRM as a whole will change professional advisors' practice for the better and provide full transparency around the investing process, fees, advisor compensation and portfolio performance. The investment industry will move to a common standard, engendering greater investor confidence and participation in the capital markets. Canada's progress compares well to its international counterparts.

The question now is: "Where do we go from here?" Having mobilized substantial resources and spent large sums to comply with the new requirements, has the industry built a rule framework to meet an acceptable standard of professionalism and transparency?

Some regulators believe the rule framework does not go far enough. What more is needed? Is it more rules and/or better advisor conduct? The longer the regulators fail to signal next steps, the greater the uncertainty.

The regulators could move in four broad directions:

1. More rules. This would seem the least productive approach after years of extensive rule-making and building the CRM2 rule framework. Industry operating costs have increased by an estimated $300 million-$350 million over the past three-and-a-half years, mostly related to compliance with CRM and new international tax rules. We anticipate significant cost increases for large and small dealers in the retail business through 2015 and 2016 as the final stage of CRM implementation takes effect.

However, reviewing the new rule framework may make sense, if only to assess it for regulatory gaps and greater rule clarity. For example, the Canadian Securities Administrators (CSA) is conducting several research projects on embedded fees and advisor compensation. Finally, standing back from the completed CRM2 project is not just about examining for gaps and clarity; it also is to determine whether the new rules have significantly improved behaviour and whether they have created unintended consequences.

2. Heavier sanctions and increased regulatory oversight. Greater regulatory oversight makes sense, particularly for registrants dealing with the public outside the self-regulatory system, to ensure full compliance. This is especially so for exempt market dealers distributing the high-risk and complex, unlisted private equity of small companies to so-called "accredited" or sophisticated investors.

3. Increased continuing education requirements and higher advisor proficiency standards. The Financial Conduct Authority in the U.K. has moved in this direction. Mandatory continuing education courses in Canada, particularly in new areas such as dealing with the new suitability rules and with elderly clients, would improve the quality of investment advice.

4. Improving the culture of firms and advisors in the wealth-management business. This is the most productive direction, but it must be done carefully, placing minimal burden on firms. Culture is unique to individual firms, but it has four common characteristics: tone at the top, such as encouraging industry associations to develop specific measures, including putting the client first, zero tolerance for wrongdoing, full-rule compliance and sound ethical conduct; accountability, requiring firms to be accountable for their advisors' conduct and senior management to be held accountable for wrongdoing; measures to strengthen communication throughout the firm; and incentives properly aligned to meet the client's broad needs.

All firms dealing with retail clients, including investment counsel/portfolio manager (ICPM) firms and exempt market dealers, as well as self-regulatory organizations (SRO), would benefit from measures aimed at improving internal culture.

For example, while ICPMs are subject to a fiduciary standard, a set of practical measures to improve culture and client conduct would encourage investment managers to become more aware of their clients' broader needs, such as financial planning.

Creating a culture that is a strategic asset requires straightforward procedures. These can be addressed at a high level and adapted throughout an organization. Most investment dealer registrants already have such practices in place - formally and informally. Formal implementation would strengthen the client/advisor relationship and boost investor confidence.

Now that we have reached the end of the CRM trail, it is important that the CSA and SROs stand back from the new rule framework and decide next steps. The answer is not more rules. It is improved culture.

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