6 Ways to Avoid Legal Peril

James Heelan, Q.C., an IIROC and MFDA litigation specialist who acts in courts from BC to Manitoba, provides best practices to help all Advisors fulfil their obligations, and avoid the potential distraction and cost of litigation and regulatory proceedings.

Markets are healthy and clients are making money. What could possibly go wrong?

For the past 25 years, my practice has involved working with Canadian regulators, bank-owned and independent brokerage firms, and helping individual Investment Advisors (IAs). I often come across professionals who are doing their *jobs*, but ignoring *obligations*. In an increasingly litigious environment, the courts often hold that IAs have an inherent fiduciary duty if they seek and accept a client's trust and confidence, and undertake to advise that client.

Whether your regulator calls you a fiduciary or not is ultimately a distinction without a difference: if you have clients who never say no, always agree with your recommendations, and don't ever exercise their own judgment, you are, in effect, a fiduciary – even if you're not a discretionary portfolio manager. It's wise that *all* Advisors, regardless of channel or accreditation, adhere to fiduciary best practices in order to safeguard against the potential legal and regulatory pitfalls of running a business.

In common law, fiduciary duty typically means "to advise the client carefully, fully, honestly and in good faith and to carry out the client's intention."[1]

1. **Act like a fiduciary**
   If an Advisor wants to avoid ever having to meet a guy like me, he/she should act like a fiduciary – do all the things a fiduciary ought to do. Table stakes for regulators and the courts are certain behaviours: honesty, loyalty, and acting in the client's best interest, meaning...

   - **You're not driven by compensation**. While you're running a business, and deserve to be paid for the value you bring to a relationship, your actions are intended to benefit your clients. The ancillary benefit to you comes second.
   - **You inform clients about potential conflicts of interest**. Transparency is the new normal, and in this context refers to informing client should you suggest a proprietary product, how you are compensated, and whether you have ties or investments related to the proposed transaction.
   - **You provide full disclosure**. In other words, you can demonstrate that you communicated with your clients about your recommendations, and that they understood investment-related details such as risk, strategy, sector, and your fees. Disclosure forms might be thick and comprehensive, but many people don't read them, so they are not a substitute for conversation, education, and transparency.

The balancing act is to be able to run a thriving business, focus on your clients' best interests – and still protect yourself.

2. **Know your client – *today and tomorrow***
   Suitability isn't static. In fact, regulators deem it to be measured at the time an investment is contemplated. To ensure you fulfil your obligations, I suggest updating your Know Your Client (KYC) form annually – *and in person*. If I'm acting as counsel for an Advisor, there's a good chance he/she didn't fully grasp their clients' unique circumstances or changing needs, such as those impacted by a job loss, failing health, divorce, children, etc. Failure to keep up with changing personal and financial status can lead to unsuitable trades, regulatory complaints and lawsuits – where KYC forms are scrutinized for inaccuracies.

   Keep your KYCs current, correct, and reflective of a client's evolving objectives, so that portfolios – and individual transactions – remain "bespoke." On that note, I've spoken to Advisors who question this personalization, given a client roster with a somewhat homogenous demographic and level of affluence. It stands to reason that those client accounts will be similar, but I've had cases where every single KYC looked exactly the same and made it clear the Advisor did not truly know his/her client.

3. **If you don't understand it, don't sell it**
   It's incumbent on you to understand your product recommendations. If that sounds blatantly obvious, think back to the Advisors in the news – *and the courts* – who put clients into asset-backed commercial paper without understanding the product or the ramifications. What gets contentious is acting on a tip or trend, versus *relying on a system*, which might ultimately result in putting a risk-averse, or financially uneducated, client into a complicated investment.

   Do your due diligence, lever your wholesaler for product education, and keep a research file to justify your recommendations. In the eyes of the courts, *once unsuitable always unsuitable*, so if a solution is out of line with what you've offered a particular client in the past, you'll need a valid reason, consistent with your obligations, *that's been relayed* to them.

4. **Obtain informed consent**
   If you have an ongoing dialogue with your clients, it will not only enhance your relationship, but will also serve as a regular platform to openly discuss product benefits and risks. Required practices dictate that you tell clients the type, number, and price of shares bought/sold; other available options; and changes to investment strategy, eliciting *informed* consent.

   Equally important: you're not an order-taker. If a client comes back from the golf course with a hot tip and insists on an investment you think is detrimental, you might want to suggest they take it elsewhere (e.g., a discount brokerage). Should you decide to proceed, take notes and discuss with your branch manager if a risk letter/email is appropriate, so that you're not held accountable in the event of a loss. Which leads me to...

5. **Paper! Paper! Paper!**
   Many Advisors view detailed notes as a hassle, until faced with the unfortunate situation of having to rely on memory – often years later. Take advantage of your CRM software to integrate post-trade documentation into your process, and follow up on recommendations with an email reiterating the product, strategy, and risk you discussed. This not only enhances client understanding, but also gives them another opportunity to react. Simply put, when you take action, *take notes*.

"We are focusing our compliance resources on conducting focused reviews of firms doing business with senior investors."

~ Ontario Securities Commission, July 2017

6. **Keep current with trends and regulations**

   - **Treatment of elderly and vulnerable clients:** Regulators have a very conservative idea about what's suitable for seniors – loosely defined as those close to retirement. Even if your aging client has always had a higher risk tolerance, and remains investment savvy, you should be aware that regulators, *and adult children*, may have another point of view, which could be particularly difficult for you when your client passes away and isn't there to explain.

     As suggested, document your investment strategy to alleviate any after-the-fact third-party concerns; revisit the KYC and alter the course in the event of deteriorating health; and, as many of you are doing given the current transfer of wealth, try to involve the family in your planning process, if appropriate.

   - **Conflict of interest issues:** Keep an eye on what's happening in the U.S., as trends there (e.g., the Department of Labor's "Conflict of Interest" regulation) are often a precursor to what happens here. Case in point, I recently attended an IIROC compliance conference where a panel was discussing conflict of interest and compensation. One subject discussed whether or not it's an issue to award Advisors a holiday when they reach a threshold on a book of business. I think we're reaching a time, post CRM2, when attention will continue to turn to scrutinizing how Advisors are paid.

     If you're not already reading OSC, IIROC, MFDA, and/or AMF industry notices, bulletins from your compliance department, and insights from your product providers – start now.

   - **Social media:** Social media is a critical marketing tool for many, but Advisors should use it prudently, particularly from a risk point of view. Read before you share; know the source of what you're sharing; and if you need to (e.g., if *all* clients have access to an article about a certain portfolio solution) – use disclosures. Make sure compliance and management approve.

While the way many Advisors do business has evolved from stock-picking to a managed money approach, and/or from commission-based to fee-based models, what's remained the same is the drive to add value and enhance the client relationship. That impetus is completely aligned with fiduciary duty, the spirit of which is to help clients understand the investment strategy that you've put in place in their best interest – and for you to stay current on any life events that may alter the course.

[1] Maghun and Maghun v. Richardson Securities of Canada Ltd., Klaus and Botham, (1986) 18 O.A.C. 141 (CA).

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James has extensive experience in a broad range of litigation and regulatory matters. His practice has a particular focus on: Corporate/Commercial disputes; Representation of financial institutions and investment advisors; Employment matters; and Professional negligence matters with a particular emphasis on representing physicians.

James has appeared before all levels of courts in Alberta and courts in several other provinces. He has also appeared before various arbitration panels, public inquiries and regulatory bodies, including the College of Physicians and Surgeons of Alberta, Securities Commissions, the Investment Industry Regulatory Organization of Canada (IIROC), the Mutual Funds Dealers Association of Canada (MFDA) and the Alberta Human Rights Commission.

As a former managing partner of the Edmonton office of Bennett Jones, James brings considerable management experience and a business perspective to client issues.

He serves as a Director of the Friends of the Jubilee Auditoria and a Director with the Tour of Alberta (Alberta Peloton Association). He has formerly served as a Governor of the University of Alberta, a Director with Covenant Health, a Governor of Newman Theological College and a director of Prospects Literacy Association.

He was appointed Queen's Counsel in 2005.