Vern Krishna: Understanding fiduciary relationships

VERN KRISHNA | May 21, 2014 6:56 AM ET
More from Vern Krishna

The concept of fiduciary duty, which is at the apex of all legal duties, is intended to protect vulnerable persons and beneficiaries who must rely upon the trust and confidence of their advisors, writes Vern Krishna.

Photo: Drew Hasselback

In the wake of the financial debacle of this decade, there is a heightened sensitivity in the financial community on the scope and extent of the duties of investment advisors to their clients.

Financial advisors come in various forms and sizes, each subject to varying legal standards of responsibility to their clients. Investment fund managers, for example, must act honestly, in good faith and in the best interests of their investment fund. Other advisors may be supervised by self-regulatory agencies applying different standards, and some may not be regulated at all.

Retail investors, who invariably believe that their advisor is acting in their best interests, are particularly vulnerable. The legal standard that applies depends upon the nature of particular relationships. Should the legal duties of advisors to investors be entrenched in securities legislation, as it is in corporate law, or left to the courts to resolve on case-by-case basis in the common law?

There are some who say that investors already sufficiently protected in the common law and self-regulatory oversight bodies. Others would like to see the duty entrenched in legislation, which could have significant consequences in securities litigation. Under either approach, retail investors should awaken to the nature of their legal relationships and the scope of the duties of their investment advisors.

Duties at common law depend upon the nature of the relationship between the client and the financial advisor. A dealer may be a simple trade execution agent (for example, discount brokers) or act as an investment advisor, with or without discretionary powers. Each of these relationships triggers different legal duties.

The concept of fiduciary duty, which is at the apex of all legal duties, is intended to protect vulnerable persons and beneficiaries who must rely upon the trust and confidence of their advisors. The duties and responsibilities that flow from the relationship are an important, indeed crucial, element of corporate governance and the capital markets.

A fiduciary relationship arises where one party places his or her “trust and confidence” in another and the latter accepts — expressly or by operation of law — to act in a manner consistent with the reposing of such trust and confidence. We often use the terms “fiduciary” and “trustee” interchangeably. This is because the concept of fiduciary duty first arose as an equitable remedy in trust law. There are, however, significant differences even between classes of fiduciaries. For example, a corporate director need not comply with the Trustee Act.

However, the important common thread is that the fiduciary must act in the best interests of the intended beneficiary and not for his or her own personal interest. The concept of vulnerability is at the heart of the duty, wrote Justice Gérard La Forest of the Supreme Court of Canada in a 1994 case, *Hodgkinson v. Simms*. “From a conceptual standpoint, the fiduciary duty may properly be understood as but one of a species of a more generalized duty by which the law seeks to protect vulnerable people in transactions with others.”

Although the classes of fiduciaries are not closed, there are certain “traditional relationships” that the courts always recognize as giving rise to fiduciary obligations, among them trustee-beneficiary, director-company, agent-principal, and solicitor-client. The overarching concept of fiduciary obligations is faithfulness, which, at the very least, implies a duty of loyalty to the vulnerable person or intended beneficiary. Where there is an established class of fiduciary relationship recognized in law, it is usually easier to discharge the onus of proof if there is a breach of conduct. In a lawyer client relationship, for example, a conflict of interest is a breach of the duty.

The precise duties between parties depend on the nature of the relationship and the reasonable expectations of the parties. However, at the very least, a fiduciary has a duty of faithfulness, loyalty, honesty, full disclosure, and must exercise prudence, care, and skill. Neither the fiduciary’s motive nor the actual result of the departure from the duties is relevant.

Corporate directors owe their fiduciary duty to their corporation. Moreover, where a director of a business corporation is also a shareholder, his rights as shareholder should be subservient to his duty of loyalty to the corporation and, hopefully, its shareholders in general. This is so regardless of whether it is a non-profit or for-profit (business) corporation. For non-profit corporations, the fiduciary duty to the corporation is found in common law. In the case of business corporations, federal and provincial statutes impose an obligation to act in the best interests of the corporation.

The responsibilities that flow from fiduciary relationships are an important, and, indeed, crucial, element of governance and the integrity of our social institutions and capital markets that depend on the trust and confidence of their participants to remain effectual. Retail investors are vulnerable to the complex and intricate machinations of financial markets. Making their relationship with their advisors an accepted class of fiduciary duties in securities legislation will protect them and enhance the integrity of the capital markets.