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Corporate Tax Centre - Vern Krishna describes fiduciary duty, the importance of fiduciary relationships, and questions whether duties should be entrenched in securities legislation or decided on case-by-case in the courts.

The Fiduciary Duty of Investment Advisors (Vern Krishna)

Date: June 5, 2014

The Fiduciary Duty of Investment Advisors

By Vern Krishna

In the wake of the financial debacle of this decade, there is heightened awareness in the financial community on the scope and extent of duties of investment advisors to their clients. There are fiduciary duties at common law that depend upon the nature of the relationship between the parties. Dealers can offer simple trade execution functions (for example, discount brokers) or act as investment advisors, with or without discretionary powers. Should the duties 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 tradition of the common law?

The concept of fiduciary duty in the law of equity 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 between classes of fiduciaries. For example, a 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.

In *Hodgkinson v. Simms*, [1994] 3 SCR 377, for example, the Supreme Court of Canada described a fiduciary duty as "but one of a species of a more generalized duty by which the law seeks to protect vulnerable people in transactions with others" The concept of vulnerability is at the heart of the duty. Although the classes of fiduciaries are not closed, there are certain "traditional relationships" that the courts always recognize as giving rise to fiduciary obligations—for example, trustee-beneficiary, director-company, agent-principal, and solicitor-client—and the onus of proof is easier to discharge.

The overarching concept of fiduciary obligations is faithfulness, which, at the very least, implies a duty of loyalty to the vulnerable person. The precise duties 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. There are some who say that investors already have sufficient protection 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 and class actions. Under either approach, we need to awaken retail investors to the nature of their financial relationships and the scope of the duties of investment advisors to their clients.

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