

# Theatre of the Absurd/A Retail Financial “Ground Hog Day”

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## *Trapped in the past: can Canada’s retail financial services market deliver a future?*

A recent article in the National Post by Ellen Bessner (*or rather an excerpt taken from her recent book; “Advisor at Risk—A Roadmap to Protecting Your Business”*) argued that advisors and their organisations cannot be held responsible for portfolios and products blowing up in clients’ faces as a result of the recent financial crisis. It reiterated a standard legal defence of transaction led services: to paraphrase; “it was the client’s decision, it is his (or her) investment and all the advisor did was provide him (her) with the information on the investment that allowed the client to proceed with the transaction”.

### ***There are a number of issues with this stance:***

The first is that this would need to be clearly spelled out at the start of a client relationship and reinforced at pretty much every transaction point to be effective.

As far as I am aware, there are no disclosure documents that actually state it is the client who is responsible for making the decision, irrespective of the conflicting representation made by advisors at the time advice and recommendations are made. As such, there is significant room for misrepresentation of the service, the roles and the responsibilities provided by the client/advisor relationship.

The second issue is that by keeping the current status quo intact, limiting advisor roles and responsibilities to purveyors of information prior to transactions, and making the client responsible for transaction decisions, there will be limited qualitative development of advisory based wealth management service processes in Canada - this includes discretionary based process driven wealth management solutions delivered by client relationship managers/investment advisors.

Restricting the relationship to the transaction ignores the fact that effective and robust wealth management solutions (*construction, planning and management of assets to meet personal financial needs over time*) depend on complex processes and structures; such processes and structures are largely absent in a transaction by transaction based relationship and service process.

What is disturbing about Ellen’s prescription is that investors do indeed need to be able to accept the generic risk and return profile of a recommended solution and the impact of this risk profile on their financial security over time, but that the transaction driven service process does not provide the structure, the process, or the necessary communication on which the investor can base such a decision.

A structured process will have a specific portfolio construction methodology; this methodology will determine the split between lower risk assets and equities based on risk aversion, market and economic risk (*dependent on the philosophy*), and the net liability profile (*size and timing of inflows to and outflows from a portfolio*); the processes’ equity style and discipline will determine the allocation to markets, sectors, market cap, stocks/mutual funds and geographical allocation (*disciplines and styles may be*

*valuation driven or quantitative/statistical risk optimisation models, or a combination of both*); these models, their risk/return universe, investment planning decision and benchmark management decision rules will adjust allocation based on client risk profile and liability profile (*more or less defensive stocks, more or less yield, more or less international, more or less small cap, more or less growth etc*). The ability of portfolio structure and management style to manage risk is a function of the structure of the portfolio and the modelling of risk and return over time.

An investor cannot hope to make a reasonable decision on a security or portfolio without knowledge of the generics of the structure in which their portfolio will be managed, the options available to them given their risk profile and investment objective, the risks to which they will be exposed and the parameters of the risk events in which the portfolio will continue to remain relevant.

Much more information needs to be made available to investors than is currently provided and mandated by regulation in order for investors to be able to accept the risks of most portfolio solutions. As such, the main bridge between the client accepting the advisor's recommendations remains principally that of trust; there are nevertheless a good number of wealth managers that do provide clear and structured communication of their disciplines.

Unfortunately most advisors do not possess the expertise or the process (*or would not wish to compromise their own self interests*) to be able to deliver an effective, integrated wealth managed service solution and most institutions do not enforce a prescribed process for the delivery of wealth management services – this is the case even though they provide balanced portfolio solutions (*irrespective of their costs*) that are probably more appropriate than much of which their advisor sales force may be selling.

And here we have a proverbial Catch 22: wealth management solutions need processes and structures and effective communication of the two for clients to be able to accept the generic risks of the solution; without process and structures, there can be no acceptance and ownership of the decision and the responsibilities of the decision. The most we can have in a transaction based structure is ownership of the transaction, but not its impact on the whole (*to do this we need to incorporate all other assets, the size and timing of inflows and to and outflows from a portfolio, current market and economic risks, a portfolio construction planning and management methodology that can integrate all decision components and relationships*), and given the limited information about the asset allocation, risk and return profile of the transaction, little ownership of that either.

While I can see why the industry would want to limit the legal responsibilities of advisors in the context that many advisors are largely unfit to deliver higher standards, accepting this reality and enforcing the limited responsibilities of advisors and institutions is absurd in Camus/Theatre of the absurd sense of the word.

Investors can only be responsible if there is both **a)** a process supporting the recommendations and **b)** disclosure over the structure, options and risks of the recommended solution. Investors should be held accountable for options they have selected, but only where these options have accountable structures, and where the relevant fundamentals of these structures and processes have been disclosed to the client. The process and structure of constructing, planning and managing assets to meet financial needs over time, given the risks likely to impact a portfolio over time, are far too complex for individual investors to be able to independently model.

The above does not mean that the industry has to provide robust and accountable wealth management services, but it does mean that those participants who want only to sell transactions and to limit their liability on the transaction, have to clearly disclose the actual service, their actual roles and the actual responsibilities of the client and the agent. Unless we mandate full disclosure, consumers will not be able to make a clear decision as to the type of services they want, and the responsibilities they are willing to accept.

By championing the minimum standards as stated, people like Ellen are effectively trapping Canadian retail financial services in a perpetual “groundhog day” regulatory based financial services funk: limited liability transaction based frameworks are allowed to present themselves as offering “effective wealth management solutions”, yet are not responsible or accountable for the outcomes provided (*through accountability and transparency of process and structure*), and regulators enforce and protect this perpetual loop. Processes, structures and service discipline need not be robust or enforced in such an environment. In evolutionary terms, the survival of the weakest is an optimal outcome.

Legal counsel for the industry appears to be ignoring the very real complexity of constructing, planning and managing portfolios to meet short and long term financial needs, while downplaying the responsibilities and accountabilities of those charged with financial service intermediation. This is dangerous if prescription is determined by those without the expertise to back up such. Regulators should not be hoodwinked by such subtle but absurd logically flawed arguments: that people should be responsible for decisions under transparent and disciplined structures and processes should not make them responsible in the absence of such.

The issue of the responsibilities of advisory based services was something that had been addressed in the original Fair Dealing Model. This model recognised that much of today’s advisory based services had a fiduciary type responsibility and were indeed delivering more than just transactions.

The ultimate wealth management solution depends on bypassing investment advisor input into the portfolio construction, planning and management process, relying instead on advisor input for the client interaction with the process. Wealth management solutions (*security selection, asset allocation, risk profiling, education, communication, reporting standards, portfolio management, risk/return assumptions and modelling/investment planning*) would all be determined centrally and distributed via systems and software. This would mean delivering either advanced advisory or discretionary type services through the current intermediary structure. This cannot be done under current regulatory standards, rules and structures for a number of reasons.

Canada needs to raise standards in its wealth management industry to meet the financial needs of its citizens and to provide a regulatory and competitive framework that realises the real client/advisor relationships and the complexities and realities of wealth management.

It should also be clear that regulating an industry split into clearly demarcated transaction based services (*where sophisticated investors are responsible for the transaction decision*), advisory based fiduciary type services (*where advisors and institutions are responsible for the structure and the process, and the investor for accepting the generic risks of the wealth management solution*) and full discretionary services should be much easier than the murky dark morass of the present. How do you regulate an industry where the potential for unsuitable recommendations, misrepresentation and misunderstanding of roles and responsibilities is wide to say the least?

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## Article Critique

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The red and blue comments are article excerpts; the normal black text is my commentary.

As a contextual point of reference it must be noted that the TAMRIS consultancy does believe investors are responsible for accepting the generic risks of well communicated and well constructed portfolios and that investors who have received appropriate risk profiling and education and a wealth management service supported by a robust and clearly communicated process, should have no cause for complaint.

Uncertainty and risk are a constant feature of investment, whether it be the short sharp risk of equities and higher risk corporate bonds, or the long slow decline (*but no less dangerous*) of nominal assets in inflationary scenarios. That said, the process of constructing planning and managing assets to meet financial needs is a complex one requiring of significant expertise in a number of different areas and advisors should be the conduit for that delivery. Advisors and their organisations need to be responsible for the process that underpins portfolio construction, planning and management and security selection.

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Q “What does an advisor say to a client concerning an investment previously understood to be low risk but has now been rated high risk and has lost considerable value? What if the client asks how a low-risk investment could have become a high-risk investment?”

A “Remind clients that their portfolio was well diversified and investments were suitable at the time of purchase.”

The above is fine providing **a)** the portfolio was well diversified and structured to mitigate risk, **b)** sufficient due diligence had been conducted on the investments at the time and **c)** that investments recommended really were suitable at the time of purchase and **d)** that the client received effective communication over a, b and c .

The processes assessing the risk profiles and fundamentals of products and investments need to be robust and accountable. You cannot just accept what the manufacturer of a product says about the product’s characteristics and risks; you or your organization need to do your own research.

Investors have a right to question the due diligence on products recommended; in other words a statement that investments were suitable at the time they were recommended is an insufficient response.

Failure to understand the product, failure to determine the underlying content of the products and failure to understand and assess the behavior of products and assets in a risk event are accountable omissions.

If an institution had placed a “low risk product” that subsequently turned out to be “higher risk” on a recommended list, then it “may” not be the advisor’s fault, but it is probably the institutions. More often than not, when a product turns out to be of a higher risk nature than originally thought, it is because it had been incorrectly labeled and inappropriately researched. I have been assessing products for more than 20 years and I know from experience that the industry will sell products with significant known flaws.

Many advisors do not have the experience or technical knowledge to be able to effectively judge the fundamental risk and return profile of a product. They should not be free to determine which products and securities are low or high risk.

***Incorrect allocation will compound ineffectual due diligence!***

A low risk product that turns out to be much higher risk or an excessive over allocation to a risky asset has much greater consequences for a portfolio than a straightforward out of context (*note a list of risks to which a product is exposed is an insufficient explanation of risk*) explanation of the generic risks might suggest. Wealth management service providers need to be accountable for security selection, portfolio placement and asset/liability modeling (*and management*) of the risk of an asset and asset combinations, including those assumptions that put those asset under stress.

If the communication made by an advisor has not contained an analysis of a stressful situation, and a stressful situation occurs, then the communication of the product's suitability is insufficient to defer responsibility to the client.

Ellen's article also skirts around the issue of suitability: just what are we talking about when we use the word suitability? Are we talking about an asset, product or security whose allocation within a portfolio relates to the client's short and long term asset and liability relationship, the size and disposition of all existing assets (*important if we are talking about a portfolio*) and market and economic conditions, and whose allocation is the result of a disciplined structured process, or are we talking about the suitability of a transaction on its own?

The first definition requires a much higher level of research, discipline and attention to structure, and hence a much greater degree of responsibility for the process and structure, and the second, quite often a lack of necessary process and structure, with responsibility limited to the transaction and not the wider more pertinent relationships.

As far as I know there is no strictly mandated communication (*in the sense that the reasons for recommending the product are placed in writing with a requirement that the letter deals with a specific number of suitability factors*) of a product's suitability to an individual investor's risk and liability profile. Additionally, under a transaction based service process, suitability may even be limited to the appropriateness of a product on its own. The industry cannot shift responsibility to the client unless disclosure over the limitations over the suitability decision is made.

A portfolio is not a combination of assets selected individually, but a structure which itself determines the allocation and management of individual assets, products and securities themselves. If you want to claim that an advisor is not responsible for providing a structure capable of managing risk, and that the process is not responsible for ensuring the robustness of structure and due diligence with respect to the components of structure, then you cannot call what you provide, a portfolio. Once you start talking portfolios, you start talking responsibility, structure and process.

It is therefore important that if the industry wants to restrict suitability to the transaction, then it needs to disclose this at the outset of the relationship and most likely repeated at every transaction. By the end of all this disclosure you will end up with a relationship and a service that is of little substance; after all, you can buy direct, take the consequences of your action but pay much less.

A - "Remind clients that this global financial crisis impacted products and issuers in a way that could not have been anticipated. Before September, 2008, **advisors could not have predicted** the fall of "blue-chip" names like Bear Stearns, Fannie Mae, Freddie Mac, AIG, Lehman Brothers, Washington Mutual and Merrill Lynch. These events have significantly impacted the market and client investments, directly and indirectly."

There are a number of issues here:

- Optimally, individual advisors in well structured service processes should be focused on a) the client advisor relationship, b) the investment planning and c) delivering and implementing the organization's wealth management service solution. They should not be responsible for analyzing risk in the financial system, markets, economies or products. While this is part of due process in a wealth management service solution, it is the responsibility of those specifically charged with economic, market, financial and product analysis.
- Someone or some component of an organization needs to be responsible for financial, market and economic analysis. Where resources and time are limited, organizations and/or advisors need to limit their focus on securities, styles, products and structures to components they can manage effectively with the resources to hand. Failure to match resources with the demands of the process and its components should have an attached liability: the resources and disciplines underpinning wealth management solutions need to be accountable.
- As far as the economic, market and financial crisis is concerned, while the timing was certainly difficult to call correctly, clues to the existence of significant financial, market and economic imbalances were readily available. While advisors may not have had the skill set to determine the risks, the organizations standing behind them should have, to lesser or greater extent. This was not a crisis that came out of the blue: the risks were in the market, the economy and in the financial system. Managing economic, market and financial risk is an important function of an organization's wealth management solutions.
- As with economic, market and financial risks, the risks were all in situ before the crisis bloomed and the blue chip stocks noted above no longer possessed the characteristics of blue chip stocks. That the downfall of many of these stocks came as a surprise has more to do with the mindset of an industry focused on self interest. The financial services industry ignored these risks, and while, it should be clear that your ordinary investment advisors could not be held responsible for these investments falling in value, there is a level of accountability within the system that is being ignored in Ellen's comments.
- Surely, given that cyclical market and economic risks are the principal cause of asset class risk that an assessment of such risk on products and securities is an important part of the suitability process.
- What of those advisors that held significant allocations in excess of the benchmark market allocation? If you take an excess allocation position you need a valuation, allocation and management structure to justify your position and you need to have undertaken due diligence with respect to those stocks. If you cannot support the allocation structure and the security selection, then you need to be held accountable. As such, organizations that allow their advisors

to select securities and allocations without an appropriate process and due diligence must also be held accountable.

- It was not that products and securities acted in ways that could not have been predicted, since a credible stress test would have produced similar consequences, but that little or no credible stress testing of products and securities' portfolios was ever entered into. Most Monte Carlo simulations used by the industry used normal probability distributions and historic risk return assumptions which could hardly be considered stress tests and there are significant flaws in value at risk (VAR) analysis.
- Again, as discussed previously, the due diligence that took place prior to product selection needs to be made accountable, as does the process by which products are included within portfolios and wealth management solutions.
- Instead of allowing organizations and advisors to hide behind minimal due diligence and risk assessment, we need to be placing higher levels of accountability with respect to product selection.
- There needs to be disclosure when market, economic and financial risk assessment comes from the sell side of a firm. Perhaps we need those analysts responsible for purchasing and recommending solutions for investors to be in a separate unit where sell side conflicts do not impinge on client interests. This part of the process should also be accountable.

*“A change in product risk might be directly associated with the underlying product or with the market but it is not the advisor's fault or the fault of the dealer for placing the product on its list of approved products, so do not take the blame, or blame others, for the reduction in value or the change in risk rating.”*

Again, this is very much a question of due diligence and due process: if due diligence has not addressed the asset allocation component of a product, the risks associated with a significant market and economic risk event, then advisors and or dealers should be held accountable for placing a product on an approved list. Due process is the way in which the product is incorporated within a client's portfolio.

If you have merely taken another's word for the risk rating of a product, then you should be accountable for your omission, especially where the consideration for the advice and service provided comes from the recommendation of the product.

***The ease in which blame can be passed for failure to correctly assess the behavior of a product or an asset under stressful conditions is of concern. This should not be a standard get out clause.***

Ellen's comment is only correct if the risks associated with the product and its relationship with market risk are clearly pointed out, and the product was suitably and appropriately included within a portfolio within a process which was able to manage and accommodate the risk (*note risk event parameters need to be documented*) of the product.

If, however, the risk of a product had not been fully assessed, then it is likely that the risks of the product will only have received a passing mention, if at all, in the sales process.

An incomplete representation of risk and return is a misrepresentation of the nature of the risk and return of a product.

***We cannot absolve those who recommend and produce products from blame when they fail to fully disclose all material risks and the magnitude and triggers for those risks.***

We must remember that many product providers and institutions have an interest in generating product and transaction sales and that by allowing omissions in this process we are further weakening the efficient allocation of capital in the market place, further reducing the transparency that efficient markets depend on and further strengthening the position of one, the intermediary and product provider, at the expense of the other, the consumer of products and services. In other words, this article is effectively an incitement to anti-competitive market practices.

We should be looking to improve due diligence, to improve standards, transparency, efficiency and the value derived from the market place. Ellen's comment risks further lowering already basic minimum industry standards at the further expense of transparency and investor protection. Regulators should also be concerned over the role of lawyers representing industry interests from shaping regulatory policy and investor protection standards.

*Remember: An advisor's role is not that of a guarantor; it is to advise. You cannot guarantee that the market will perform consistently, or at all, and advisors should be very careful not to deliver any message to clients indicating that they are a guarantor."*

There are many marketing brochures with incomplete and misleading illustrations and communications concerning risk and return, costs, benefits and features as to tacitly endorse actions and statements that omit factors key to the type of balanced communication that would prevent the use of the word guaranteed. We only need look at communications with regard to long term equity returns: note charts that showed equity returns from the early 1980s (*the bottom of the previous market cycle for most advanced economies*); note the failure to communicate the type of sustained low returns that equities can provide following market and economic peaks and many other embellishments and omissions. If these are failures in documented communications, then what of the failures in verbal communication?

Importantly, within the context of Ellen Bessner's article, we are talking in the main (*although not exclusively*) about advisors who receive a return for a transaction as opposed to a fee for advice. If the return for "advice" can only be obtained on completion of a transaction we do have a conflict of interest in terms of a balanced representation of the true risk/return profiles.

**Just what is a false guarantee?** A false guarantee is a form of undue influence: one of many possible misrepresentations of the facts or failure to disclose material negative factors.

An investment advisor's role in a transaction based industry is to sell products and transactions; the advice that is dispensed is to better help sell those products and transactions and the information provided to shed those investments in as good a light as possible. I have not read Ellen's book, but I presume that a robust definition of the word advice is provided. If the advice is to buy an actively managed closet index tracking mutual fund with an MER of 2.5%, is this good advice compared to the cost of an index exchange traded fund with an MER of .025%?

The problem is that the industry and regulators are ignoring the fact that there is systemic misrepresentation of service, roles and responsibilities in the retail financial services industry, aided and abetted by a lack of clear direction of transparency and disclosure and regulation of such. We know that if we do not regulate transparency and accountability it will not happen: worse if we condone practices that dumb down disclosure and transparency, reduce the accountability of actions, then we move further and further away from optimal outcomes.

But Ellen is right about the fact that an advisor's role is not to provide any guarantees, and this should stand even when these are provided by product providers or debt issuers. Advisors should question many of the embellished promises of products.

*“Remind your clients that while there is no guarantee they will recover their losses, unless and until investments are sold, most losses are just paper losses which may be recoverable, and not real losses until sold.”*

Inappropriately structured portfolios will mean that investors may be forced to realize paper losses: excess and inappropriate allocations, high charges, mismatches between size and timing of income and capital liabilities and the asset allocation and maturity/liquidity/credit risk structure of the portfolio may force investors to sell. A loss is also a realized loss if there is an opportunity cost: note that many investors with inappropriate portfolios and poor planning and structure will be forced to cut expenditure; a cut in expenditure is a loss of consumption/immediate purchasing power, a mirror of the actual loss in the portfolio itself.

**Q - What if a client asks whether he should continue to hold an investment to see if it improves, or sell it and take a (big) loss?**

*A - The client must be reminded that it is his account, his investment and his decision. This may mean having to make difficult decisions in an uncertain and unpredictable environment, but this is the client's decision.*

This is all fair and well providing the client was told this (*that it is the client decision and the advisor is not responsible for this*) at the time the transaction and/or relationship was established and either b) the client is capable of making these decisions (*has internalized the process and possesses all relevant information needed to provide a professional solution*) or c) the advisor has provided proper process and structure and the outcome is one expected with the risk profile selected given the liability profile of the investor.

However, if the advisor's influence and knowledge was instrumental in the sale, then it must also be instrumental in the sale or retention of the investment; otherwise, the transaction to purchase must come with disclosure over responsibilities on the eventual sale.

More detailed education over the risk and return of investments, and realism over risks and returns, needs to become a standard feature of client/advisor communication, whether the client is to take responsibility for transactions or not, and particularly so if clients take responsibility for anything other than generic risks of suitable securities and portfolios.

Unfortunately, higher levels of education and risk awareness conflict with transaction driven returns: the more information you give the longer it takes to sell, the more you need to sell a process and a structure which can manage those risks.

Take the limited information provided in the proposed point of sale disclosure document: these documents do not address the benchmark performance of the funds, the sector and market cap relative to the market, P/E and other price relatives, turnover and the investment discipline and other factors that would be considered part of the fund selection decision process. Without this information, all an investor is receiving, is broad information about a fund, but insufficient information to make a portfolio decision about risk, return, costs (*even though the MER is displayed, the long term impact of these costs and the ability of a fund to compensate for these costs are not*), value added, style and asset allocation. The point of sale document might be passable if it was the advisor that was responsible for the structure, planning and management of the portfolio, but even here the document is light on the generic risks as they might impact the client's portfolio and financial objectives.

A robust suitability process would relate a recommendation to the client's existing assets, risk and performance preferences, financial needs and, depending on the portfolio construction methodology used, current market conditions.

Other issues here are obviously the costing and organization of process: delivering higher levels of education and process via a transaction based business and service structure is more complex and costly.

The Fair Dealing Model recognized many of the issues discussed in this document and recommended that the industry be split into pure transaction based models (*for sophisticated investors*), an advisory based model with fiduciary type responsibility for those dependent on advice and structure and the current discretionary based model.

If legal counsel for the industry is defending itself on the basis that investors are responsible for the transaction decision, then regulators must do three things:

- They must make sure that this information is disclosed at the start of the relationship and at each subsequent point of sale.
- They must regulate the processes by which products and securities are deemed suitable (*including due diligence*) and make this process available to the consumer, noting its limitations and the requirements needed to be fulfilled by investors.
- They must make sure that investors are aware of the processes they need to go through to validate the suitability of a recommendation made on a transaction by transaction basis.

I think it also worthwhile drawing attention to the Canadian Securities Administration document on [mutual funds](#) that states advisors need to make clear and specific recommendations, explain the reasons for the recommendations and point out the strengths and weaknesses of potential investments. The content in Ellen's text states that with respect to sales, at least, advisors cannot provide clear and specific recommendations for a sale. Surely this needs to be pointed out in the CSA document.

One other point: optimal recommendations and advice re buying and selling can only be made with respect to the entire portfolio, market and economic relationships (*dependent on theory*). If the advice to buy was based on the advisor's model and the decision to sell is that based on the client's, we have a

clear mismatch of disciplines and structures, one which is sure to impact the balance and structure of the recommended balance of assets.

*Clients often want their advisor to simply tell them what is going to happen and what they should do. However, the advisor's job is to provide relevant information, along with informed opinion and recommendations, to assist and guide the client in making his decision.*

It is unclear from this just what “*provide relevant information, along with informed opinion and recommendations*” provides in terms of content and direction as opposed to “*tell them what is going to happen and what they should do*”. Surely, relevant information includes what they should be doing with the investments the advisor recommended; does this not match up to the CSA’s recommendations for advisors to provide “clear and specific recommendations with explanation of the reasons for those recommendations” as per the CSA document on mutual funds?

If the advisor is pushing a transaction, then they must provide the relevant information, along with informed opinion, but they should not be making a recommendation if they are unable to make a later recommendation regarding sale and or retention.

Surely, these comments underline the fragility and weakness of a transaction based retail financial services industry that close to 50% of that which is conducted cannot be advised on. If this is the only way to buttress the current industry mode of operation, then we clearly need change.

If, however, the advisor is pushing a service, and is posing as an advisor providing a wealth management service that provides wealth management solutions (*portfolios, investment planning etc*), then their role is that of an advisor providing recommendations regarding buying, selling and or retention.

*Be very careful to not simply "tell" the client what to do. Doing that (or setting the client up to claim you did), can result in you owning any future losses because the client "did exactly what you told them to." Clearly explain all relevant pros and cons.*

If simply had been in inverted commas, this would have meant that you could have told your client what to do as long as it was prefaced by a robust explanation of the reasons for such a change. Instead, the word tell was in inverted commas, meaning that the emphasis is on not to tell the client what to do. The text then goes on to say that advisors must “clearly explain all the relevant pros and cons”: this does not mean telling a client what to do, just providing them with the information for them to make the decision, which as discussed in the preceding comment, is problematic. But, just what are the relevant pros and cons? Is this enough information for the client to process and structure the decision, or enough information for the client to understand the advisor’s process and structure? The latter would not absolve the advisor if his structure and process was flawed or negligent.

Providing you have a structured approach that correctly explains the risks and benefits of a transaction then a recommendation should not result in an advisor “owning future losses”. Failure to provide a structured approach, to complete due diligence on product and security recommendations and to misrepresent the nature of a service or a product/security would however involve liability. I can see all manner of issues with the present state of regulation:, too many real paradoxes and grey areas that can never be logically resolved.

*Emphasize there is always an element of uncertainty as to what the future holds. That applies to the markets generally and individual securities. Informed advice and recommendations are part of how that uncertainty can be managed. But recommendations, no matter how well informed or intentioned, will never be a guarantee of outcomes.*

**Why does an advisor recommend one investment over another, one in preponderance over another?**

Because the risk and return outcome is deemed to be superior! If you are significantly over weighting one asset class or security at the expense of others then you are moving outside of uncertainty and into the realms of relative certainty. In order to do this you need a process and a structure that validates this decision – indeed, you are taking a level of discretion over a recommendations which you would not otherwise do if you were trying to absolve yourself from this risk.

Taking outside bets without a structure and process acknowledges the risks that would occur if the uncertainty of outcomes is to the downside for those securities, effectively guaranteeing greater losses in such circumstances.

Informed advice and recommendations cannot manage uncertainty without a structure and a process that effectively transfers responsibility for the decision to the advisor. Merely providing information on a set of recommendations that exposes an investor to uncertainty also effectively transfers responsibility for the decision unless the responsibility the investor is taking on and the consequences of such are explained – please note this issue is dealt with in many instances in this document.

*In relation to a specific security, an advisor should communicate and discuss with the client what the analysts and other experts covering the security, such as credit-rating agencies, are saying. This should include the issuer's perspective -- if an issuer is saying its securities are high risk, so should you.*

If the current belief is that the product will never recover fully, or at all, then the advisor should share that assessment with the client so he can make an informed decision.

As with most of the comments made, this may be fine if the nature of the service, roles and responsibilities were made clear at outset, and even then, it is still a vastly sub optimal solution which leaves the ignorant investor at the whims of the retail financial services industry. Merely providing the client with “the information” to make an informed decision is insufficient, if, indeed, the information is insufficient, and the investor not adept at processing the structural decisions needed to incorporate this information into a valid decision.

Other issues:

- If you were to hold an indexed investment, you would continue to hold all stocks in that index, in index proportions, irrespective of whether the market viewed them high risk or not. When we are talking of advisors, we are often talking about representatives who are selling products and securities; what the advisor decides to sell the investor (*his or her set of securities*) is key to defining responsibility for the transaction. An investor (*unsophisticated without knowledge of the universe they want to inhabit*) is forced to choose from this set. As such, the sale transaction will be relevant to the advisor universe, not necessarily the market universe, and to the advisor process and rationale for the selection of his set of recommendations.

- Does the above excerpt relate to the clear and specific recommendations requirement made by the CSA? Arguably not.
- By the time the consensus is that the product will never recover, the realizable value will be at or close to zero.

*Tell the client no one can accurately time the market and so we do not know if we are at the bottom of the market with improvements to follow shortly or whether the market will fall further. If the market improves and if the client has sold, they will lose the opportunity to recover the losses but the market may fall further and there is no telling whether it will ever rebound sufficiently for client accounts to recover completely.*

The weaknesses in all these statements are all the same, and ignore many aspects of the problem:

If the advisor had recommended a set of securities that differed from the market, then he or she is exposing their security selection to this uncertainty, the consequences of which are directly related back to the choice the advisor provided the investor.

The only way an advisor can take advantage of the uncertainty of timing and the uncertainty of risk and return without a process and structure and communication that validates the recommendations and effectively takes responsibility for the process and structure, is if the advisor recommends what could be termed the market portfolio: the market portfolio could well be a balance of indexed allocations to bonds and domestic and global equities.

As it is, the advisor may have provided clients with an imbalanced security set, furnished them exclusively with the information set relevant to those securities, and then absolved themselves of the liabilities associated with such when decisions over sale or retention need to be made. This is surely perverse and absurd.

*The advisor should try to gauge the client's present risk tolerance and financial situation to determine whether he can withstand more losses. This will extend beyond just asking the client this question. Clients are motivated by fear (and greed) and the major challenge is to help clients determine whether it is fear or change in risk tolerance that is motivating the client to want to sell.*

Many advisors are motivated by fear and greed too!

The assessment of the ability to accept and bear risk should be carried out before the risk event and a structure recommended that can manage risk. In fact, robust stress testing of portfolios will assess the ability of investors to bear risk as will effective analysis of cyclical market and economic risks – future returns are lower and short term risks higher the more advanced a market and economic cycle and vice versa.

In a financial market and economic crisis it should really be the advisor that recommends whether or not the portfolio/product/security selection remains appropriate and to reaffirm the rationale behind those views. If the client is still not comfortable with this and wants out then an advisor would optimally need to move to a structure that meets the clients' wishes whilst explaining the fundamentals and risks of such a move.

- But, if the advisor is unable to take responsibility for a transaction decision (*sale and purchase*), then he or she is held hostage to the demands of the client. As such, the retail client is exposed to the vicissitudes of the market place, wanting more at the peaks and wanting less at the troughs, with the advisor disposed to offering whatever they want.
- Again, this might be fine, if all advisors really did (*in general*) counsel caution at the top, limit their product selection for sale to securities that would mitigate part of these risks, and if many advisors and services did not promote their offerings as something much more. But, we know this not to be the case as products of the moment and flavors of the month are marketed strongly to investors.
- Additionally, if the advisor set of recommended securities is unrepresentative of the universe and imbalanced relative to the universe, then the decisions of the investors are likely to be influenced and skewed towards a position that will exacerbate changes in risk, changes that are in truth coloured by the actions and recommendations of the advisor in the first place.

Indeed, the industry needs to be able to offer more than Ellen Bessner is saying it can do; it (*the industry*) attempts to do so, whilst retaining the protection afforded to a transaction by transaction based service, where the investor is accountable for the transaction decision.

In the end, we are left with the worst of both worlds: neither a true limited transaction service, nor a true advisory based service.

Admittedly, part of what an advisor should be able to do (*through his or her own rationalization of the current recommended structure*) is to allow clients to rationalize the present in the context of the ups and downs of the past. But this is insufficient to engender an optimal retail financial services outcome if the structure and the process are not there in the first place.

*Try to help the client gain perspective by telling him the percentage of the account that the product in question represents, as well as the dollar value, and discuss what impact, if any, a total loss would have on the client's financial well-being. The stress alone may be too much for the client to withstand, and if that is the case, then he should sell those investments that are least likely to recover in the near future. Listen carefully to what the client says and test the answers. Of course, take detailed notes.*

Theatre of the absurd springs to mind;

- There is no mention here of the asset's place in the portfolio and its rationale for being there.
- There is no accountability for the recommendation of the asset in the first place, given that its timing and selection as part of the advisor product/security offering was at the discretion of the advisor/institution; after all, the recommended product list is only a small preferred subset of all market products and securities.
- There is no mention of the absurdity of failure to acknowledge actual the roles and responsibilities (or enforced absence of) in the dynamics of the relationship.
- There is no mention of the process and structure needed to make such a decision or the lack thereof on both sides of the decision.

- There is no mention of the absurdity of the decision being entered into; “..then he should sell those investments that are least likely to recover in the near future”. Are we recommending that we sell assets that are most likely to be hit by current market sentiment but are likely to recover eventually? Are we recommending that we realize paper losses? If this is the case, this advice risks exposing the client to the worst of all worlds, and risks leading the client into a course of action which may have significant adverse long term consequences.

There are so many issues here that are being missed, skipped over or ignored. To name but a few Just what is the role of an advisor, just what is the role of an investor?

*To summarize, risk ratings of some previously highly rated products have been severely impacted by the demise of major U.S. industry players. This was not predictable. Advisors must communicate regularly with clients through these turbulent times. They must gauge clients' risk tolerance, and consider their time horizon and financial ability to withstand future losses. Consistent discussions, well documented, will better protect the advisor.*

## Summary

So, according to the article, the role of the financial advisor during market and economic downturns is to protect themselves against investors, to communicate regularly with clients explaining a) how it is the client's investments, that they and their institution are not responsible for the consequences of their recommendations, b) that they cannot recommend what to do with the investments they recommended (and received consideration for), but can discuss issues that will help their client come to terms with what best to do, c) that a crisis that has its roots in the self interest of a number of product manufacturers was not predictable by those who exercised that self interest, while somehow finding ways to sell new products and securities, as they must in order to remain viable.

The TAMRIS Consultancy believes that the industry already knows that what it needs to deliver: a service that takes responsibility for the strategy, the structure, the security selection, the planning, the management, the portfolio theory, the risk management, the economic and market analysis, the management of significant market and economic risk and financial needs, and the options from which a client can choose, and a client that takes responsibility for accepting and understanding the risk/return profile they have selected.

The TAMRIS Consultancy also believes that the industry does not want to fully relinquish the transaction driven structure and has yet to fully commit itself to moving towards a process driven, disciplined structured approach. Yet, it is developing an image that states that it has moved beyond the transaction to the provision of sophisticated wealth management solutions, solutions that require a structure and an expertise that cannot be replicated and modeled by the consumer of wealth management services. Again, this is something which the FDM recognized and which legal counsel for the industry appears to be ignoring.

A change in regulation of advisory based services, higher mandated disclosure and transparency would allow firms to specifically market more advanced, more responsible and accountable structured services based wealth management processes.

## A cursory look at on line marketing and service promises

I do not believe that the retail financial services industry actually wants to portray Ellen Bessner's views of advisory based services to the investor: if you read the marketing blurb on their websites you would not overtly find the restrictions noted in Ellen's article. I note below a list of quotes from a number of websites; I failed to note any obvious or prominent warnings advising investors of the reality of the relationship that is expressed in this article under discussion.

### RBC Dominion Securities

*"Your relationship with us starts with your personal Investment Advisor. A dedicated professional, your Investment Advisor devotes time to fully understand your financial situation, life goals and tolerance for risk when **creating a strategy that is right for you**.... Develop thoughtful **solutions tailored to your objectives, drawing from a wide selection of world-class products and services**..... your Investment Advisor is able to **provide the solutions you need—today and tomorrow**. Working closely with you, your investment Advisor will help you define and achieve your investment objectives with a custom-designed portfolio that reflects your personal objectives".*

### TD Waterhouse

*"TD Waterhouse Private Investment Advice is a **premier full-service brokerage** ideal for investors who want a **one-on-one relationship** with a dedicated and professional Investment Advisor. You will receive **comprehensive and personalized investment advice** while staying involved in the key decisions about your portfolio."*

**"TD Waterhouse Investment Advisors can give you -**

- Sound financial advice through all life's stages
- Personalized advice that reflects you and your family's unique needs and goals
- **A customized investment and retirement strategy"**

### Investment Planning Counsel of Canada

*"Our team can help you to **create an understandable saving and investing strategy designed to provide a favourable retirement outcome**."*

### Scotia Mcleod

*"Partnership Plus - At ScotiaMcLeod, we understand that each investor is unique. We recognize the importance of creating differentiated solutions. We invite you to experience the long-term commitment and access the investment expertise that are the cornerstones of Partnership Plus.*

*Your ScotiaMcLeod advisor's top priority is gaining a comprehensive understanding of your needs, so that **he or she can develop a strategic plan to help you reach your goals**."*

### Wellington West

*“Whether you and your family choose to work with one of our full-service investment advisors or one of our financial planners, **we will provide a personal, thoughtful and intelligent strategy, delivered by a highly-qualified professional you can trust.***

***We provide** innovative investment ideas, with a full offering of managed investment solutions as well as expertise on individual security selection including equities, fixed income, currencies, mutual and exchange-traded funds, alternative investments and hedging strategies.”*

#### **BMO Nesbitt Burns**

*“You can trust in our [expertise](#) to help you build a wealth management strategy **uniquely designed to achieve your wealth management objectives.**”*

#### **CIBC Wood Gundy**

*“Do you want to go it alone? **Or do you want to get expertise on your side to help you devise an investment strategy that can work for you – no matter what you're investing for?**”*

#### **Canaccord**

*“...we give our Investment Advisors the freedom to match your investment needs with the most appropriate investment alternatives available in the marketplace.*

*Canaccord also has a full array of proprietary products and services, any of which may be suited to your wealth management strategy. Our Investment Advisors, however, are under no obligation or pressure to recommend them unless they feel they are appropriate to your financial goals. “*

#### **Assante**

*“Our advisors work closely with the investment management and wealth planning professionals at our sister-company, United Financial Corporation, **to deliver customized investment solutions and integrated wealth plans that meet the diverse financial needs and goals of our clients.**”*