REASONABLE STANDARD

The IDA and MFDA compel firms to establish policies and procedures, but are advisors legally accountable if they don't follow these guidelines?

By Ellen J. Bessner

When a judge hears a case against an advisor, he must decide whether the advisor was negligent. In other words, the judge must determine what was reasonably expected of the advisor in the specific circumstances of each case. To determine negligence, the judge first determines what standard the advisor had to fulfill to meet the required duty of care. Then the judge determines if the advisor met the required standard.

In this highly regulated industry, you would expect that standards would be clearly enunciated by the IDA or MFDA. And you would be wrong. The regulations, by-laws, policies and rules are not clear, even to judges and lawyers. The language is general and is frequently described as a "minimum" requirement.

The IDA and MFDA compel firms to establish internal policies and procedures that often exceed the standard set in the applicable by-laws, policies and rules. These procedures and policies are prepared by the firms and circulated to the advisors. Managers and compliance officers supervise advisors in an attempt to ensure compliance.

In court, a firm's internal policy manual is among the evidence clients' lawyers rely upon. If an advisor didn't meet the requirements set out in their own firm's internal policies, the client's lawyer argues the advisor was negligent. There have been judges who have accepted such a theory.

The result is member firms must guess how much higher than the "minimum" set out in law is required to avoid a judgment against the advisor.

But firms and their advisors should not be held accountable if they do not meet standards they set beyond industry requirements. If firms are held to the standard they set in their internal policy manuals, this will discourage firms from setting a high bar in their company policies.

> Let the law set the standard required and let company standards help advisors provide exceptional service.

Furthermore, if the standard is set by the internal manuals of each firm, the standard will vary from firm to firm, inviting inconsistent standards. Finally, isn't setting the standard by firms usurping the role of the self-regulating organization by elevating the company manual to that of the standard of law?

If our goal as an industry is to increase standards to improve investor confidence in the market, then holding firms to the standard set in internal manuals is counterproductive, as firms will set lower standards out of fear that these standards will be used against them.

If firms are held to that standard in a court of law then the requirements in the manuals will be set below what they would otherwise be set at.

Don't we want firms to set high goals for advisors without worrying these goals will come back to haunt them in court? If firms can set high goals without worrying that they will be held to those standards in court, then that will encourage firms to set those higher standards and attempt to achieve them. This can only be of benefit to clients and the industry.

It is not in the best interest of clients or the industry to discourage firms from setting their sights at a standard higher than what is required by law. Therefore, it is contrary to the interest of the industry to elevate those company policies to the standard of law. Let the law set the standard required and let company standards help advisors provide exceptional service. AE

Ellen J. Bessner is a lawyer at Gowling, Lafleur, Henderson. She practises in the area of brokers' liability and offers compliance training to brokerage firms. The above is intended for a general audience and should not be considered legal advice.