The advice dilemma

Since the release of the CAP Guidelines last year, plan sponsors have debated the issue of offering advice to their members. Is it the right thing to do?

By Kam Kwong

A large dilemma seems to be confronting plan sponsors of group RRSPs, defined contribution pension plans and other capital accumulation plans (CAPs). The issue is deciding whether or not to retain a qualified service provider to provide investment advice to plan members.

When the Joint Forum of Financial Market Regulators—comprised of pension, insurance and securities regulators from across Canada—released its proposed regulatory principles for CAPs in April 2001, there was widespread industry sentiment against making the provision of investment advice mandatory. Many plan sponsors and industry insiders said it was too risky to provide investment advice because it could expose plan sponsors to litigation in the event of poor investment performance.

The Joint Forum listened, and in the final version of its *Guidelines for Capital Accumulation Plans*, clarified that the provision of investment advice was optional.

Ironically, since the release of the CAP guidelines one year ago, questions have been raised about the risks of not providing advice. Therefore, it is best to explore the pros and cons of providing and not providing this type of advice.

BENEFITS OF ADVICE

CAP members, like many individual investors, may lack the experience, knowledge, inclination or patience to manage an investment portfolio; in fact, many may want advice and assistance with their plans. Appropriate advice can help a plan member structure and manage a portfolio so as to maximize the benefit of the CAP. This, in turn, can result in the member's greater appreciation of their employee benefit and thereby enhance the sponsoring employer's objectives of attracting and retaining staff—the reason such plans are often established.

Advice can also help to protect a plan sponsor against potential liability by reducing the risk of poor performance due to bad investment selection and management. There is a perception that litigation will ensue if advice is provided, but this fear may be exaggerated. If the advice is provided by a registered professional who satisfies industry and regulatory standards, the chance of successful litigation resulting from the questioning of the advice provided "in hindsight" is probably limited. Industry consultants have said that a strict adherence to the CAP guidelines would help a plan sponsor should litigation become a factor.

DISADVANTAGES

Some CAP sponsors fear that if they give plan members investment advice, they will be the "deep pocket" that members will reach into if they experience poor investment performance.

If advice is provided, the sponsor may not have much control over the nature and quality of the advice, as the relationship will be between the advisor and the plan member. However, despite this lack of control, members could still seek to blame the sponsor for the advice received and the plan's performance.

Plan members may also be concerned about giving the advisor the information necessary to satisfy the suitability review requirements (e.g. assets, liabilities and retirement objectives). This is because they believe their employer might gain access to this information, not realizing that failure to provide these details could adversely affect the advisor's ability to assist them. If the advisor is unable to conduct a proper suitability review, there is a risk that investment performance may not meet the needs or expectations of the plan members.

The CAP guidelines clearly indicate that if a CAP sponsor retains a qualified service provider to provide advice to plan members, another level of responsibility and ongoing monitoring of the service provider will be expected. The CAP guidelines require that the sponsor establish selection criteria for choosing advisors and then monitor the chosen advisors in accordance with these criteria.

However, there are a number of obstacles to monitoring advice, including: additional costs, staffing and resources, expertise, and the restrictions of privacy law. Sponsors are also required to consider any "real or perceived" lack of independence of the advisors they select and any legal requirements that such advisors must satisfy (e.g. registration). Any failure (or alleged failure) to satisfy these obligations could expose sponsors to the risk of being sued by disgruntled plan members.

POTENTIAL CLAIMS?

By not providing advice, a sponsor could avoid potential claims that poor investment performance was the result of poor, inadequate or improper investment advice. Sponsors could also avoid the cost and risks associated with advisor selection and monitoring and the additional cost of the actual advice. A CAP sponsor that does not provide advice may also be better positioned to defend themselves against accusations they have assumed responsibility for investment performance.

One potential disadvantage of not providing advice is that a plan sponsor could face a greater risk of litigation if the plan performs poorly. Many people are unable or unwilling to invest the time and effort necessary to structure and manage an investment portfolio and the process of investing is not for everyone. The regulators seem to recognize this. They require that retail investors receive advice from registered professionals who are subject to regulatory proficiency requirements and monitoring.

If the chance of poor investment performance increases the potential for claims against the CAP sponsor, then the goal should be to reduce the chance of poor performance. This is even more important in a compulsory plan, since members could argue they were forced to make investment decisions for which they were not prepared and without appropriate assistance.

If it is reasonable to conclude that the chance of a CAP member having poor investment results will decrease if they receive investment advice, and that the provision of such advice should reduce the risk that the CAP sponsor will be sued.

CAP sponsors who choose not to provide investment advice may be assuming greater risk with respect to plan design and the selection of investment options. In the event of poor performance, members may question the quality of a CAP's investment options. This may be especially true with respect to default investment options for individuals who are unwilling or unable to choose from the available investment options. The risk may increase further if a sponsor is aware that a relatively high percentage of plan members are ending up in the default option.

THE DILEMMA REMAINS

The decision to provide investment advice is a fundamental governance issue for a CAP. Whether or not investment advice is provided, there is always a risk that poor investment performance could lead to litigation.

There are two questions plan sponsors need to consider:

1. Could you mitigate the risk of litigation by providing investment advice? The CAP guidelines do not require that you provide advice, but they expect sponsors to at least "provide investment information and decision-making tools to help CAP members make their investment decisions in the plan." Are the chances of poor investment results greater if you provide advice to your plan members or if you only provide them with "investment information and decision-making tools?"

2. If investment advice is provided, will a claimant's chances of success be reduced in the event they decide to sue? As a CAP sponsor, you cannot prevent plan members from suing, but you may be able to reduce the likelihood of success if investment advice is provided. Reducing the threat of litigation is not only beneficial if a lawsuit has begun, it may also discourage plan members from choosing to pursue such a course of action in the first place.

Investment advice can be accessed through a qualified service provider who can provide direct and individual advice to members. Through this qualified service provider, the goal can be to educate members so that they can plan and take control of their financial future.

Unfortunately for the plan sponsor considering what to do in the arena of investment advice, there is no single answer. It is up to the individual CAP sponsor to weigh the pros and cons and to decide whether providing investment advice is the right answer for their particular plan. **BC**

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