

# ETHICALLY SPEAKING

BY

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## TRADE SECRETS

(May 2008) **WE ASK** FCSI designees from coast to coast to help with your ethical conundrums—everything from culling clients to specific fund recommendations and a host of suitability issues.

In this month's column, hear what an FCSI designee suggests for this scenario:

Steve has asked his advisor, Mike, to buy shares of Fine Filter & Sons for his portfolio. The highly speculative stock would make up approximately 10% of Steve's portfolio. Mike's concerned because Steve has a low risk tolerance and isn't a sophisticated investor. Mike asks his branch manager, Ed, for guidance and is told to go ahead with the trade. Mike goes back to the client and influences him to increase his risk tolerance on his KYC before the trade is placed. Mike tells Steve not to worry about the change in his KYC status—playfully saying, "Relax, Buddy. Everyone should take a

risk now and then." Mike's office door is ajar and Maria, Mike's assistant, overhears the conversation.

What are the implications for the advisor and the branch manager? And what about Maria? If the client loses money and complains, how will this affect the firm's reputation?

**Response:** Most advisors have seen this movie. A client receives a hot tip from someone and feels he can't lose. But the tip isn't so hot and the shares fall in value, leaving the client with a loss and the advisor in a sticky situation.

It's always difficult to say no to a client, but as advisors we have fiduciary responsibilities to protect them. And sometimes this means we have to disagree with them—and our branch managers.

Several key mistakes were made. Steve is not a sophisticated investor and this change will make his

portfolio far more aggressive. Mike is immediately concerned about the suitability of the investment, so the first major mistake is taking the order at all. He has the option to refuse, even if it means losing the client. The second issue is Ed, who recommended Mike accept the trade in spite of the client's very low risk tolerance. His actions served the firm, not the client.

The change to the KYC was the third issue. There are many legitimate reasons to change a KYC—a change to a client's job status, divorce, or a death in the family. But making a change to accommodate the purchase of an unsuitable investment is not a good reason. If the client were to sue, he could claim he was both coerced into making the trade and into changing his KYC. Finally, there's Maria. She has a responsibility to speak up. If her manager's response doesn't satisfy her, she can take it a level above him.

If an advisor is uncomfortable with a client's request, the manager should back him up. In this case, the manager took the client's side. So the advisor needs to speak with his manager's immediate superior. While this may cause friction, in the end it's the client's capital and the advisor's career that are at risk. If the manager escalates the matter, either through threats or coercion, again the advisor has to involve his superiors.

As advisory products and services become increasingly commoditized, all that an advisor and firm can fall back on is their reputation. A client complaint about suitability would call into question any advice given by the firm.

If you have a plan in place for your client, these issues can be handled professionally. In the absence of a written plan, advisors still have to hold themselves to a higher standard. Sometimes doing the right thing will upset the client, but that is part of the job. <sup>AE</sup>

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If you have an ethical dilemma that you'd like to pose to one of our FCSIs, please e-mail it to [heidi.staseson@advisor.rogers.com](mailto:heidi.staseson@advisor.rogers.com)