Small Investor Protection Association

Welcome new members!
You should receive your membership card and your User Name and Password to enable you to access the Member's Pages. If you have not received them please contact **SIPA** by e-mail or post.

From time to time **SIPA** will be including articles that offer opinions of the author on subjects related to investing and the regulatory system. These are meant to help increase investor awareness and **SIPA** may not share these opinions.

The Motley Fool
On SIPA's website in the Investors' Corner on the Investor Information page a link is provided to the Motley Fool website at: www.motleyfool.com with the notation: *Educate/Amuse/Enrich. Offers advice & portfolio tracking.*
While information is presented in an amusing way, the language is simple, clear and direct. It should be a part of each investor's education. The Fools website contains sections regarding Investment Advice, Index Funds, Mutual Funds and Financial Advisors.
This issue SIPA draws members' attention to a couple of sections. The first regards monitoring your investments.
Set Expectations & Track Your Results states *"We live in a society that pays a lot of attention to some pretty weird stuff, but one thing we don't seem to pay much attention to is how our investments are doing compared to the market's averages." The Fools provide the reason:*
"Because nobody ever taught us how, and because no one who is selling investment advice has had it in their best interest to show us how to account for our investment performance." They continue stating:
"Professional investors just don't want you to pay much attention to how they're doing. It gives them a lot of room for error."
Then they provide some good advice:
"Fools propose that unless you're going to take the time to measure your results, you shouldn't put investment dollars into anything but an index fund -- a mutual fund that tracks the market, step for step. Don't buy stocks, bonds, gold bullion, heating oil futures, or (especially) managed mutual funds. If you can afford to put money away for five years, but don't have the time to keep tabs on how you're doing, buy an index fund and leave it at that."
A second section on the Fools website offers good advice regarding funds:
On mutual funds states *"Would it surprise you to hear that some three-quarters of the equity (i.e. stock) mutual funds that are thrown at us from brokerage houses, banks, and insurance agencies perform worse than average each year?*
At first, it's shocking to think that the achievements of paid professionals are so significantly shy of mediocre. But on second consideration, those numbers shouldn't come as any surprise at all. Managed mutual funds charge their investors average annual fees of 1.5%, partly to "fund" their active and national marketing plans.
That's 1.5% of the total assets in your account, not just the "earnings" (if there are any). And most fund managers have enough to do -- golf, tennis, cocktail parties, and foxhunting immediately come to mind -- without having to spend time pondering growth stocks, ever-changing allocation models, and their consistent, predictable, and enduring market underperformance.

If that sounds harsh, it's meant to be. Bad and overpriced mutual funds deserve much poking, and since they don't provide much in the way of results, they should at least be recognized for their vast capacity to amuse. But we're here to do much more than that, we hope. Finding problems in the financial "services" industry isn't much of a challenge. It's tacking on useful solutions that makes things difficult."

The Wise Persons Committee Report

The Wise Persons Committee Report was issued December 13th, 2004. It was prepared in response to the MacKay Report calling for a review of the securities industry. There was intense industry input but very little input to present the small investor's view. SIPA made a submission as did a couple of SIPA members and a couple of investor advocates.

SIPA members should make an effort to submit their opinion whenever there is an opportunity. It will take many investors voicing their opinion to make change.

The WPC Report recommends a single Canadian Securities Regulator. This is a position that SIPA supports; however there is sufficient opposition that it is unlikely this would happen in the near future.

For the benefit of members the Summary of the WPC Report is printed in this issue:

7. It's Time

It's time for Canada to have a single securities regulator. Capital markets around the world are continuing to integrate and become more competitive and important to economic growth and prosperity. Canada is now at a crossroads. Others have moved faster in adapting their regulatory structures in response to these trends. Either we can continue with a fragmented regulatory structure that has served Canada adequately in the past but that is ill suited to current realities, or we can choose to create a regulatory structure that helps Canadian capital markets become a source of comparative advantage in the increasingly competitive global marketplace.

"Canadians should not settle for anything but the best they can achieve."
Canadian Bankers Association

We believe the choice is clear. Canada cannot afford to stand still. We therefore call on the federal and provincial governments to participate in the creation of the Canadian Securities Commission. Canadians are seeking increased federal-provincial cooperation in addressing important public policy priorities. Both levels of government now have an opportunity to come together and act in the national interest.

Other countries have already done this. In Australia, a federal state with regional diversity and shared constitutional authority over securities regulation, the federal and state governments worked together to create the ASIC, a single securities and market conduct regulator, in recognition of the fact that a single regulator was in Australia's national interest. We believe the same spirit of collaboration can, and should, animate the creation of the Canadian Securities Commission.

We believe the federal and provincial governments should implement our recommendation without delay.

There is a remarkable momentum for change, shared by capital market participants, governments and regulators. There is an unprecedented opportunity to improve Canada's securities regulatory structure.

It's time to act.

OSC Fair Dealing Model

The OSC has issued a Press release on the much-heralded Fair Dealing Model. Initial reports suggest it is much watered down due to industry input. Although the iniative appears well intended, it is impossible to pass judgment until details are released later this year. The Press release follows:

OSC Chair David Brown unveils "Fair Dealing Model" to regulate relationship between the financial services industry and investors

TORONTO - The Ontario Securities Commission is considering significant changes to the way it regulates the relationship between the financial services industry and individual investors. OSC staff, in consultation with a group of investment industry leaders, has developed an outline of a new "fair dealing model".

The new framework would, among other things, seek to better define the rights and responsibilities of each party, reduce conflicts of interest in the provision of advice, and ensure greater transparency of adviser services, qualifications, compensation and other fees.

"A fair dealing model can result in a stronger financial services industry, enhanced competition around quality of advice, and clarity in provider-client relationships," OSC Chair David Brown said in a speech to kick-off Investor Education Month. "And it would cut unnecessary compliance costs, ensuring that providers and investors receive maximum regulatory value for every dollar spent."

The OSC and its advisory group have studied business models in the financial services industry and recognized that the current regulatory model has become outdated. For example, securities regulations assume that advisers are compensated based on trading activity, yet most firms now take a wealth management approach where trading and advising are no longer viewed as separate activities. The proposed regulatory model is more flexible and would better reflect market realities.

Changes being considered include the following:

- *requiring more complete information on how service providers are compensated, including clear disclosure of whether they receive payments or incentives from product issuers;*
- *replacing existing account opening documentation with a new form that clarifies the nature of the provider-client relationship and seeks to improve clients' understanding and acceptance of investment risk;*
- *placing clearer responsibility on firms, including liability for losses, for any improper activities of their officers, employees and agents;*
- *replacing current registration categories with a single service provider license which makes no distinction between trading and advising; and*
- *reducing certain regulatory requirements to improve small investors' access to a variety of investment opportunities and increase market access for new types of service providers.*

Staff plan to expose the new "fair dealing model" to a wider group of stakeholders later this spring, and publish detailed proposals by the summer.

TruthTellers

In a previous issue SIPA suggested that whistleblowers or TruthTellers might be more effective than the regulators. The Telegraph in the U.K. recently published an article that relates how a TruthTeller alerted Eliot Spitzer to the widespread wrongdoing in the mutual fund industry. Some excerpts from that article follow:

Wall Street's whistle-blower

Noreen Harrington exposed widespread corruption in America's mutual funds. In her first UK interview, she tells Abigail Hofman why she made her fateful call to the New York state attorney-general

Noreen Harrington is the woman you were never meant to know about. Eliot Spitzer, the New York state attorney general, said he would take her name to his grave.
It was Harrington's anonymous call to the attorney general's office last May, which led to the unveiling of widespread corruption at the heart of the US mutual fund industry. In an exclusive interview with The Telegraph, Harrington explains how she discovered the wrongdoing and why she made that call.

Spitzer has praised the 47-year-old Harrington on prime time American television as "a spectacular individual who did an amazing job for all investors in this nation".

Spitzer and his colleagues took Harrington's tip-off seriously because of her background: she had 20 years' experience in the financial industry, including an 11-year stint at the leading investment bank Goldman Sachs (where she achieved managing director status) and had worked both on Wall Street and in London (initially for Goldman and then for Barclays Capital).

She started asking questions because she believes "that's your responsibility as a senior person in the business".

Harrington talks about "one crowning moment" that pushed her over the edge - when she was asked to review her elder sister's evaporating 401(k) pension pot. Most pension monies are invested in mutual funds.

"My sister is one of the hardest workers I know," Harrington says. "Suddenly I saw her as a victim of this crime. Up until then, I hadn't really thought about the human toll: all those Americans whose only liquid asset is their 401(k). And after I looked at it from the bottom up, then I couldn't sleep at night. I knew I had to call somebody."

And that's what she did. In May 2003, Harrington contacted Spitzer's office. Initially, she just left an anonymous voice-mail. Then, realizing that her original message had been too vague, she called again and spoke to an executive who persuaded her to go into the office for several meetings.

"The basis for that was they would investigate and no-one would ever know who I was," she says. She told none of her friends or family about her dealings with the attorney general's office. "I truly hoped my name would never come out. And so the right number of people to tell in those circumstances is zero."

SIPA recognizes Noreen Harrington for her courage as a TruthTeller.

globeandmail.com

Mutual fund rules to be unveiled

Investor advocate says industry pressure 'gutted' proposed governance regime

By KAREN HOWLETT
Friday, Jan. 9, 2004

Securities regulators in Canada will today unveil proposed governance rules for mutual funds that investor advocates say have been watered down to make them more industry friendly and do not go far enough to protect ordinary Canadians.

Investor advocates have argued for several years that Canada should follow the United States, which for well over a decade has required mutual funds to report to a board of directors. They say the need is even more pressing in the wake of trading abuses in the United States uncovered by regulators and law enforcers, led by New York State Attorney-General Eliot Spitzer.

"Against all this background, you'd think a regulator would want to take no chances and do the minimum by putting in things that makes sense like a board that actually looks at these issues," said Ken Kivenko, an investor advocate and author of a newsletter called the Fund Sentinel.

In his November newsletter, Mr. Kivenko accused the regulators of "caving into intense industry lobbying and ignoring investor needs" with a "gutted" proposed fund governance regime.

The proposed rules, to be released for comment today, will require mutual funds to set up committees to monitor conflicts of interest, rather than full boards of directors. The committees will not have the power to overrule fund managers. Nor would managers be required to abide by the committees' decisions.

Industry observers said the Canadian Securities Administrators, an umbrella group representing provincial and territorial regulators, backed down on its initial governance proposal in response to pressure from mutual fund companies. The CSA published a concept proposal in March 2002, saying it planned to require funds to set up independent boards of directors to monitor mutual funds to ensure they act in the best interests of investors

Stan Buell, head of the Small Investor Protection Association, said Canada needs another Mr. Spitzer or legislation that protects investors. "Spitzer has turned the world upside down there," he said. "We feel we don't have sufficient investor protection in Canada or adequate enforcement."

Mr. Buell said the regulatory landscape for mutual funds in Canada is tilted in favour of the industry because the regulators get inundated with comments from fund companies, banks, stockbrokerages, lawyers and industry associations every time they invite the public to respond to proposed rule changes. At the same time, he said, there are not enough representatives of small investors to challenge the powerful industry, which manages more than $430-billion in assets. His association has grown to 440 members since its creation in 1998.

"They're not hearing the voice of the clients," Mr. Buell said. "They're hearing the voice of the people who are selling the products."

Securities regulators received 57 submissions responding to their concept proposal on fund governance, many of which vigorously opposed the creation of boards of directors. The Investment Funds Institute of Canada, which represents the industry, and many fund companies, said there should be some type of quid pro quo as a condition to imposing mandatory governance regimes.

"We are amenable to considering the implementation of some manner of fund governance regime," IFIC says in its written response. "However, as an industry, we cannot endorse or otherwise support this initiative in any form unless it is accompanied by a concurrent relaxation of the regulatory restrictions that a system of fund governance would render either moot or redundant."

IFIC officials could not be reached for comment yesterday.

Mutual fund companies also launched an aggressive lobby to stop proposed regulations that would make it easier to fire fund managers. A government-created committee headed by lawyer Purdy Crawford set up in 2000 to review Ontario's securities laws, proposed giving independent boards representing investors the power to fire a manager.

Both IFIC and many companies, including RBC Asset Management Inc., a subsidiary of Royal Bank of Canada and the country's largest mutual fund company with about $41-billion in assets under management, said investors can "vote with their feet" and leave the fund if they lose confidence in the manager. However, selling a fund within a few years of purchasing it often triggers a deferred sales charge for investors.

"We are of the view that the independent governance agency should not have the ability to terminate the fund manager under any circumstances," RBC Asset Management said in its comment letter.

RBC Asset Management is in favour of the CSA's proposed rules. "We support the elements of what is going to be released," said spokesman Graeme Harris.

Mr. Kivenko accuses the regulators of moving at a "glacial pace" to enact reforms. It has taken the regulators nine years to come up with draft governance rules, initially proposed in 1995 by Glorianne Stromberg, a former commissioner at the Ontario Securities Commission.

OSC spokesman Eric Pelletier suggested yesterday that the draft rules could be just a first step. "Once the requirements have been met, we'll see how effective they are. If it's necessary to revisit and possibly add some other requirements, we could consider that in the future."

Reprinted from the globeandmail.com

InvestorCanada.com
Thursday, January 15, 2004

Proposals on Fund Governance Will Hurt More Than Help

Interview by Donna Guzik

Proposed changes to governance rules for the mutual fund industry won't eliminate conflict of interest issues. Rather it just removes the obligation of securities regulators to pay attention to it, says Ontario Securities Commission Former Commissioner Glorianne Stromberg

IC: Welcome to InvestorCanada.com. I'm Donna Guzik. Canadian security regulators are proposing new rules aimed at improving the governance standards for mutual funds.
Under the proposed rule, each mutual fund manager is required to establish an independent review committee to review any matters involving self-dealing and conflicts of interest.
For more on this, I'm joined by Glorianne Stromberg. She is a former commissioner with the Ontario Securities Commission.
She also authored a report calling for reforms in the fund industry.
Glorianne, first off, what are the rules as they exist right now for governance of mutual funds?
Stromberg: Well, there aren't very many rules that exist right now for the governance of mutual funds and this is one of the concerns that I had in my report.
So I made extensive recommendations. What's happened is that the industry has resisted most of these recommendations and the proposals that the securities regulators released last week reflect a very different type of regulation than what we've had in the past and what I think we need in the future.
IC: So right now, what happens if there is a conflict of interest or there is some form of self-dealing by a mutual fund manager? What happens to the manager? What's the recourse? What's the punishment?
Stromberg: Well, right now the rules are framed so that self-dealing and related party transactions are prohibited and what the proposals are is to repeal or revoke all of the statutory provisions and the rules and securities legislation that prevents these self-dealing transactions or other transactions where the manager has a conflict of interest.
IC: So when we say self-dealing and these other conflicts of interest, what are we exactly talking about?
Stromberg: When we're talking self-dealing, that is an expression that is used to describe the situation where the manager might buy securities of an affiliated company, a related company, whether they were debt securities or equity securities where they, for example, they might lend money to the parent company of the manager and that under current rules is prohibited.
I think a way for investors to understand what is being proposed is to analogise it to somebody coming forward and saying we're going to revoke all the rules of the road.
We're not going to have red lights, green lights, yellow lights, driving on the right-hand side of the roads. We're just going to leave that up to each person who wants to use the road and we'll let the public, the private sector sort it out.
So it's really taking away all the existing rules that have made mutual funds a relatively straightforward and safe investment for a lot of people.
IC: What does it mean in terms of these proposed rules that they have to establish an independent review committee?
Stromberg: Well, what they're saying is if you can get three people who will look at what you're doing and say that's all right, then anything that they say is all right becomes all right.
And the only constraints they're putting on the independent review committee is that the members of it be "independent".

And independence is defined in terms of simply not being a director, officer or have some other kind of a relationship with the manager or any affiliate of the manager.

It doesn't really go to what expertise these people have, what knowledge they have of the industry, or its practices, of how things work and doesn't really give them very many constraints under which to review what the manager may come to them and say this is what we are proposing to do.

So it leaves it up to each fund to set its own rules. Now, this may sound all right in theory – it doesn't to me, but to some people, it may – but when you combine this with the investor's unwillingness to read prospectuses, read annual reports, understand what type of fund they're investing in, how it works in that, I think it's a recipe for disaster because when you have people who are not paying attention to what they're investing in and you have no fundamental rules of the road, I think you can rapidly get into a lot of difficulties.

We're talking about people's savings, we're talking about what they're planning to have available to them to live in retirement and to manage their lifetime well-being.

IC: Well, how would these committees actually work if they're set up, say there's three people who are independent and it's been deemed that they're independent? What power does a committee have?

Stromberg: They only have the power to speak out and in the proposed rules. It isn't even clear that it has to be publicized, so that the public knows that there is a disagreement and that the manager may or may not be following what the recommendations are. All that's required is that there be a summary of recommendations. Well, by the time you get to a summary, a lot of water has gone under a bridge.

IC: So how would this possibly eliminate the possibility of a conflict of interest?

Stromberg: I don't think it does. It just removes it from the obligation of securities regulators to pay attention to it.

It's another way of downloading responsibility for regulation onto the shoulders of an investor, but it gives them very little power to do anything other than to not invest.

But by the time that an investor finds out that there are problems, it may well be too late for that investor's savings.

IC: Is there any sense from where you sit of the reaction of fund managers who look at this proposed rule? Is it something that they are welcoming or something that they think this is just another hassle I've got to now deal with setting up some committee?

Stromberg: Fund managers are welcoming this. They negotiated very long and hard for this. So they are very pleased.

Another reason they're pleased is that the cost of having this so-called independent review is now clearly borne by the fund investors rather than the manager.

So mutual fund investors are having to pay the costs of keeping the manager honest in effect.

IC: So are fees or expenses likely to go up for which investors will pay to see his happen?

Stromberg: To have less protection. They will pay to have less protection.

IC: Now, these rules are proposals. What is the likelihood that these rules will go through and become rules as they exist in their current form?

Stromberg: If investors do not very vocally object to these rules, the likelihood of them going forward is great. If no one speaks out against them, then they will go through.

These rules are just extraordinary at a time when in other areas, we're seeing that independent directors are no protection against wrongdoing in the companies in which mutual funds invest, and when we're seeing the problems that are coming to light in the United States in their mutual fund industry, to think that we would be going this direction at this time is just extraordinary.

Reprinted from InvestorCanada.com