SIPA Sentinel

January 2005

SIPA has a mission:

- **to aid public awareness of how the investment industry operates;**
- **to provide guidance to those who have a complaint about investments with a bank, broker, financial advisor, or other seller of financial products;**
- **and to pursue improvement of industry regulation and enforcement.**

Small Investor Protection Association - A voice for the small investor

SIPA Sentinel

The SIPA Sentinel is issued bi-monthly. From time to time we include articles and re-prints that offer opinions on subjects related to investing and regulation. These are meant to help increase investor awareness, and SIPA may not share these opinions.

Welcome new members!

New members should receive a membership card and User Name and Password to enable you to access the Member's Pages of SIPA's website at www.sipa.to.

Fraud in the Investment Industry

Several of our members have reported that documents shown to them during disputes have contained signatures that were not theirs. This constitutes fraud. This is a criminal activity. It is not uncommon.

On September 10th, 2004, the Nova Scotia Securities Commission reached a settlement agreement with an associate of an Approved Person of the M.F.D.A. The admitted facts include: the associate failed to obtain, record or update adequate KYC information for several clients, and submitted trading instructions knowing that the client's signatures had been cut and pasted from a copy held on the client file.

The text of the settlement agreement is available on the NSSC website.

If you have reason to believe that your signature was forged on any documentation regarding your investments, or are aware that your KYC (Know Your Client) form contained false information please contact SIPA.

SIPA is taking an initiative to have this issue addressed and needs substantiating evidence that will include a statement by the investor that the signature is not theirs.

Regulatory Action re Market Timing

Toronto, Dec 16 - A panel of Commissioners of the Ontario Securities Commission (OSC) approved four settlement agreements today that will result in $156.5 million being distributed to mutual fund unit holders who suffered harm from market timing activities in those funds. The settlement agreements, approved in the public interest, were reached earlier this week by OSC Staff with CI Mutual Funds Inc., AGF Funds Inc., I.G. Investment Management, Ltd. and AIC Limited. The text of the agreements is available on the OSC website.

Toronto, Dec 16, 2004 – The Mutual Fund Dealers Association announced a settlement agreement with Investors Group Financial Services regarding market timing. IG has agreed to compensate investors effected by their conduct by making a payment of $2.65 million, and will also pay a fine of $2.65 million to the MFDA as well as costs of the MFDA investigation of $50,000. The text of the settlement agreement is available on the MFDA website.

Toronto, Dec 16, 2004 – The Investment Dealers Association penalizes TD Waterhouse $20,698,713.38, RBC Dominion Securities $16,975,302.08 and BMO Nesbitt Burns $3,693,139.20 regarding market timing. The text of the settlement agreements is available on the IDA website.

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News Highlights since last issue

Woman Charged in $1 million Scam of American Seniors – Toronto, 20041118. Police have charged 25-year-old Annilla Anisa Ramkisson with fraud over $5,000.

Couple looted, lied, Lydia board alleges – Toronto, 20041118. The board alleges Jurgen and Emilia von Anhalt made false claims about finding diamonds and used shareholders money to "support their extravagant lifestyle".

Heavy penalties in fund scandal – Washington, 20041118. The two founders of the Pilgrim-Baxter mutual fund family have agreed to pay US$ 80 million each to settle regulators' claims of improper trading to benefit themselves and friends.

Millions lost in Internet scams – Toronto, 20041118. Consumer Minister Jim Watson said one con alone, called the Nigerian or West African scam, cost consumers more than $4 million in the first nine months of 2004.

Couple banned from securities market – Vancouver, 20041117. The British Columbia Securities Commission has banned Johnathan Lam Wai Tsang and Selena Ching Wan Tsang are barred from trading, acting as directors or officers of any issuer and engaging in any investor relations activities for at least seven years. They agreed to pay $10,000 to the BCSC with $1,000 representing investigation costs. The BCSC also permanently cease-traded RAB Energy Corp. (I) Limited, a Hong Kong-incorporated company with its head office in Vancouver.

Richmond man banned from the securities market for stock manipulation – Vancouver, 20011116. – The British Columbia Securities Commission banned Hung Chi (Patrick) Woo from the securities markets, after he admitted to manipulating the stock market and trading for others without registration. Woo agreed to pay $40,000. The BCSC ordered Woo for 10 years not to trade, act as a director or officer of any issuer (except an issuer owned by Woo or his family) or engage in investor relations. On Nov. 10, 1999, Yeh & Woo General Partner Inc. created Ascent Investment Capital Limited Partnership. Woo was the chief executive officer and a director of Yeh & Woo. In December 1999, Ascent raised US$870,000 from eight investors for investment. Until December 2001, Yeh & Woo managed the assets. Woo directed the trading without registration in contravention of the Securities Act. The investors lost between US$600,000 and US$700,000 while Woo received a management fee of US$71,800.

Eron Mortgage Corp – Two former top executives of the financial company are to go on trial for allegedly defrauding, stealing and misappropriating investor funds in the 1990s. Brian Slobogian and Frank Biller are said to have bilked about 1,000 investors out of $32 million in six company Projects in B.C., Alberta and California from 1994 to 1997.

But about 3,000 Eron Eron investors lost more than $210 million on about 60 real estate projects. Receivers estimate that only about $41 million of that total has been recovered.

S.O.S – Save Our Seniors

The evidence collected by SIPA suggests that many seniors are losing their savings due to fraud and investment industry wrongdoing. The media is full of stories regarding leaders in government and industry acting for their own benefit at the expense of ordinary Canadians. Many of the issues that receive media coverage affect all investors but are rarely the cause of extreme loss.

Extreme loss is when the small investor loses a significant portion of his savings. This usually is the result of fraud in many forms or widespread investment industry wrongdoing.

Individuals with no affiliation with the legitimate investment industry can perpetrate fraud. It may be the sale of non-existent investment products such as Guaranteed Bank Certificates, Limited Partnerships for non-existent properties or properties that do exist but do not have the value stated, or simply a cash scam (known as a Ponzi scheme & supposedly named after the initiator of these schemes.

The more serious issue is that of widespread industry wrongdoing. Many seniors have accumulated substantial savings over their working careers, have no investing experience and relied upon income interest generated by GIC's, bank savings, Canada or government bonds, and Treasury Bills. Their capital was protected and they were able to manage on the modest interest earned.

With interest being reduced to historic lows and rates on savings accounts down to less than 1% and government bond returns reduced to unforeseeable levels, many seniors felt forced to move to other forms of investment offering higher rates of return.

Few seniors are prepared to risk the loss of their savings and they are assured there is little risk in following their advisors advice.

Often the advisors suggest or implement a strategy of leverage without explaining the increased risk of significant loss. Many firms have a corporate policy to leverage clients. They encourage mortgages, bank loans, and margin loans (loans form the investment firm guaranteed by the assets in your account). Sometimes these strategies result in highly leveraged accounts.

Leveraging can work in certain circumstances when the investor understands the underlying factors that can affect risk, but there is always risk of change in the investment market.

When advisors combine the selection of inappropriate investment products, and excessive trading to generate commissions, it is a recipe for disaster.

When mutual funds are churned deferred sales charge can be incurred on top of MERs and Trailer Fees.

Sometimes it is not easy for seniors to monitor their accounts because the statements provided are not easy to decipher.

While many statements will provide a value for this month and last month, few provide an annualized rate of return. Managed accounts will normally provide this information but registered and non-registered accounts often do not unless it is specifically requested.

So how can we Save Our Seniors?

- Speak with older friends and relatives about the need to be watchful over savings and investments.
- Help educate others about the danger of following an investment strategy that we do not understand. Seniors in particular should avoid leverage.
- Talk about the need for a statement that clearly shows where you stand and shows the annualized rate of return for your investments.
- Write to the Hon. Tony Ianno, Minister for Families and Caregivers, in Ottawa and express your concern about the lack of investment protection for senior investors.
- Also express your concerns to your M.P. and your M.P.P.
- Become more informed and support the journalists who are writing to help small investors. Send them letters of support.
- Make sure that you protect yourself so you will be in a position to help others.
- Support CARP/SIPA in their call for an Investor Protection Agency, TruthTeller Protection legislation and a firmer stand on white-collar crime.

At a SIPA meeting Glorianne Stromberg said the situation would not change unless small investors speak out. SIPA is one voice for small investors. We need many voices speaking out.

We estimate that Canadian investors are losing billions of dollars each year due to fraud and industry wrongdoing. We believe that industry wrongdoing is the cause for the major portion of this loss.

Seniors are suffering from the loss of their life savings. Their lifestyles are compromised in their Golden Years. Often their health, hope and happiness are destroyed.

Help to **Save Our Seniors**. Become active in supporting the need for better investor protection. Write your M.P.P. and your M.P. Become involved. Support SIPA.

Small Investor Fights and Wins

Many of SIPA's members have had some degree of success with their disputes. In most cases they have relied upon professional help. A few have also pursued resolution on their own. Some of these have settled for resolution by Ombudsmen. One small investor decided that it was important to have their dispute resolved even though the response of industry and regulators was not very helpful. The following is Jocelyne's story.

I am a small investor who like many of you was betrayed by a person I trusted. My case involved unauthorized and unregistered trading of mutual funds by my financial advisor. I attempted to resolve the matter through regular procedures, from a meeting with the branch manager and a formal complaint to the company's compliance department while also dealing with the Securities Commission and the Mutual Fund Dealers Association. While I believe there was sufficient information to support my claim, documents were either not requested or not questioned by the company and the regulators. My attempts to point out discrepancies in the advisor's story and prove my case were ignored.

My options were to drop the matter or take legal action. I tried to find a lawyer and after months of unreturned calls and excuses, I realized no lawyer would ever take on such a case given the legal costs relative to my losses. Unwilling to let the bad guys win, I represented myself in a civil suit against the advisor and the company. I recently settled out of court and as is typical, the amount did not cover my losses and costs, not to mention the personal toll. Despite the time and stress, I would do it again and I would encourage anyone in a similar situation to do the same with a Warning: do not proceed if your only goal is a satisfactory payout or you will be disappointed; prepare to take a crash course in legal procedures; learn to type and use the Internet, and seek out sources for help. Surprisingly, the most helpful people offered their services at no charge, from community legal education agencies to industry experts, reporters and of course SIPA. I also learned that lawyers will try every intimidation tactic out there especially knowing you are legally illiterate and emotionally fragile. While this may be just another case to a lawyer, to you it's a very personal battle that stays with you long after your dispute is settled.

Everyone who has been wronged by the industry has a different story. Mine is different in that my advisor was gradually transferring third party funds into the company's more profitable proprietary (in-house) funds. I believe, as others do, that this was a widespread practice in this company. Whether or not clients consent to such trades, advisors and companies are not acting in the best interests of clients and a conflict of interest clearly exists. Some investors may never discover this wrongdoing, may find out when it's too late or choose not to pursue the matter for reasons already mentioned. Although I alerted the Securities Commission to my concerns, to my knowledge no action has been taken.

In 2001, a fund analyst Dan Hallett wrote about this company, "From a corporate standpoint, the dealer seeks to maximize profits. One of the biggest factors in its profitability is the growth of proprietary (i.e. in-house) products. From 1995 to 1998...financial advisors grew in number by 1,613 percent while assets in in-house products grew by 563 per cent. By growing assets in its proprietary products, there is the potential for a nine to sixteen fold increase in operating margins. Frankly, its corporate goal of maximizing profits is great for shareholders but it conflicts directly with the interests of most of its clients. There simply is no getting around that, but it's a reality of which investors need to be aware because it's a strongly growing trend in this industry." Financial companies who sell their own funds and the advisors/salesmen who peddle them have a common motive - it's all about the money.

Although I did not lose my life savings as others have, as duped investors, I think we all wonder the same thing. How can people lack the moral consciousness to take advantage of our savings and our trust for their own financial gain? The corporate criminal has been compared to a psychopath as someone with "the inability to feel remorse, a grossly inflated view of oneself, a pronounced indifference to the suffering of others, and a pattern of deceitful behavior." This comparison does not excuse the behavior of corporate crooks but it may help to understand it. Do these people belong in prison or is a mental institution more appropriate?

Jocelyne

John Lawrence Reynolds is a member of SIPA since 2003. He is a dedicated writer and thorough with his investigations. A previous book Free Rider, the story of Michael Holoday, is an award winner. I recommend the Naked Investor as a good read for all investors. It is enlightening and should help to increase awareness of how the investment industry operates. It could even save you from losing your money!

THE NAKED INVESTOR –

The Good, the Bad, the Ugly, and the Encouraging.
John Lawrence Reynolds

Writing *FREE RIDER*, **the tale of Bay Street broker and convicted fraudster Michael Holoday, was an eye-opener to me.**

I was struck by the number of Holoday's clients who blamed themselves for falling prey to his schemes, losing much of their retirement nest-eggs in the process. "How could I be so stupid?" many of them wondered.

They were not stupid. They were trusting. They trusted both their broker/advisor and the brokerage firms profited from his schemes through commissions and fees. Both firms employing Holoday during his five-year career resolutely denied any responsibility for client losses suffered from his actions, declaring the clients were "authors of their own misfortune" for trusting him. One sued two of Holoday's clients for $10 million. Their crime? Signing a document Holoday presented to them saying it was "a mere formality."

Even more enlightening (and disturbing) were the responses, or lack of them, from organizations claiming to provide protection for small investors. Over three years after Holoday was dismissed by his firm (and six months after he was formally charged with fraud and embezzlement), the TSX informed the brokerage that, in its opinion, the firm had properly supervised him and thus bore no responsibility for his actions.

While investigating Holoday's activities and writing the book, I was told by the TSX on several occasions that no documentation existed on this matter, even while I held a copy of this letter in my hand. The letter was reproduced in *FREE RIDER*. **Perhaps now the TSX will finally admit it exists.**

The entire exercise alerted me to the fact that Canadian investors – especially older RRSP and RRIF holders with substantial balances in their portfolios – are poorly served when it comes to protecting them against industry abuses. Lacking both a national securities commission and an Eliot Spitzer, we are forced to rely on organizations such as SIPA and on our own vigilance – not just against out-and-out fraudsters but against more subtle actions on the part of advisors, including the recommendation of investments designed primarily to line the advisor's pockets and bolster the firm's bottom line.

I decided to research and write a book highlighting the human cost of our flawed investment industry. Statistics may reveal the scope of the problem, but they do not plumb the pain suffered by those who misplace their trust in advisors and the system.

The result is *THE NAKED INVESTOR – Why Almost Everybody But You Gets Rich on Your RRSP,* **including true tales of Canadians whose trust in the investment advice they received was betrayed and who received little compassion and less assistance from the investment industry.**

Researching and writing the book revealed the dark side, the book's publication has proven enlightening and even encouraging. A number of industry people have sought me out and congratulated me on pulling the curtain back on the operation of various factions – the Investment Dealers Association, the Ontario Securities Commission, celebrity gurus who function like carnival sideshow barkers, mutual funds that skim excessive fees from investors, brokerage executives who pressure advisors to promote products whether they suit investor needs or not, and much more. The number of advisors who take pride in their work and feel shame about certain aspects of their industry is substantial… and reassuring.

A few, of course, are convinced that I seek to taint and even destroy an entire industry. I do not. We need a strong, well-functioning investment industry to serve our economy. And the majority of RRSP and RRIF investors need qualified counsel and advice in making investment decisions. I see no conflict between these two goals.

Both will be achieved when investors become aware of basic investment principles... retain realistic expectations in their long-term investment strategies... understand how the investment industry functions... and retain both an innate sense of trust and a necessary degree of speculation.

Good financial advisors – men and women who told me how appalled they were by certain excesses and practices in their profession – support me and the message in the book. I think all of us in SIPA should take some solace in their response.

... and from the U.S.A. – More cautionary advice on mutual funds.

Funds: Love, hate and mutual funds

Mon Jan 3, 2005 11:14 AM ET
By Linda Stern

WASHINGTON, Jan 3 (Reuters) - If you want to hear someone trash the mutual fund industry, log onto FundAlarm (http://www.fundalarm.com).

With wit and irreverence, publisher Roy Weitz has been spearing the titans of pooled investing in his online newsletter since 1996. "I started out kind of cynical and skeptical, and now I am even more cynical and skeptical," he said. "People in the financial services industry can be snakes ... and investors really need to protect themselves."

Oh, and here's one other thing to know about Weitz: He invests his own money almost exclusively in mutual funds, both index and actively managed. At the end of the day, Weitz loves them and says the industry is "cleaner and much more investor-friendly and consumer-friendly than it has ever been."

He's not unlike the investing public. When New York Attorney General Eliot Spitzer slammed the industry in late 2003, individual investors expressed distrust and confusion -- and went on to throw $269 billion in new money into long-term mutual funds in the 14 months which followed.

For good reason. Mutual funds remain a great product for most investors. They allow little guys access to the great financial markets with no fuss and no muss. Through mutual funds, individuals can make investments as small as $50 that expose them to the breadth of the world stock and bond markets, or target their cash to very specific slivers: small Brazilian companies or semiconductor shares, for example.

Investors who do a bit of homework can do all this at a very low cost, without worrying about where their money is or what to do with it the next day. And under the glare of that Spitzer-focused spotlight, there's been some housecleaning.

But maybe not enough. With so much money in funds -- almost $8 trillion by the latest count -- some was bound to slop off into the wrong buckets.

Some in the industry still are fighting the biggest reforms, including rules that that would require appointing fund board chairmen who are independent of their parent companies, and would force redemption fees on all funds to discourage fast trading.

The biggest stain on the industry -- the myriad, sometimes sleazy relationships between funds and the brokers that sell them -- remains unlaundered.

So investor emptor remains the order of the day. Embrace funds for their ability to offer inexpensive, smart diversification, but be careful. While you're waiting for the industry and the SEC and Congress to finish fighting over final regs, protect yourself by following these guidelines:

- **Unless you yourself are a market timer, stay away from funds that don't have redemption fees on fast turnaround trades. This will protect your money from those hyperactive investors who swoop in, sweep up some profit and leave before you've even looked up the daily price.**

- **Be vigilant about keeping fees low. All the research on funds shows that performance can be ephemeral, but the lower the cost of the fund, the better its bottom-line performance will probably be. You can find expense ratios for funds on many Web sites, including Morningstar (http://www.morningstar.com).**

- **Avoid funds with 12(b)1 fees if you can, Weitz says. These fees initially were aimed at compensating brokers for marketing new funds; now they are sometimes tacked on to funds that do no marketing and are even closed to new investors. They drain fund money annually, often for no good reason.**

- **Avoid funds that overpay for trading. More than a penny a share usually means the fund is kicking back cash to the broker. You can usually find this info buried in the prospectus.**

- **Avoid funds that have gotten too big for their mission. For Weitz, a small-cap stock fund becomes too big at more than $2 billion, a mid-cap at more than $5 billion, and a large-cap at more than $50 billion.**

- **Seek funds whose managers are rewarded for long-term performance and have put their own money in the portfolios they oversee.**

- **When you're investing in foreign funds, stick to those that guarantee a "hard close" at 4 p.m., allowing no late investments and pricing the fund at the prices effective around the world at that moment.**

- **Finally, if you must buy funds from a full-service brokerage, find out how much your broker is getting to recommend that fund, and whether that's more than he or she would receive for recommending a competitor.**