



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.

Income Trusts

Income Trusts are the current issue but they are only an indication of much greater underlying problems. Seniors are losing their savings because the investment industry is developing products that create the illusion that they are safe investments with a good rate of return when in reality these products are risky and are being misrepresented to investors.

Long before Finance Minister Ralph Goodale made his announcement last year, many seniors had seen their distributions reduced or suspended and their asset values significantly reduced. Investors who were leveraged to invest in income trusts were particularly hard hit. Most responsible advisors would recommend diversification so that investors would not be over concentrated in income trusts and not be leveraged to invest in risky products. Diversified investors would suffer a decline in the value of their trusts but the loss would not be disastrous.

The Finance Minister's announcement that income trusts would be taxed in future, to even the playing field for corporations and income trusts, removed the incentive for firms such as Telus and Bell to convert to income trusts to avoid taxes.

However, there are arguments for and against this move and more recently a call to extend the moratorium from four years to ten years on imposing taxes on existing income trusts.

The consensus seems to be that it was necessary for the Government to take action. It is not easy to come up with a solution to a difficult problem. The situation was made more difficult because the investment industry was selling unsuitable business income trusts to seniors. Some were heavily invested and leveraged. There is lack of regulation and no one definition for distributable cash with the result that many of the business trusts were promising distributions that were greater than could be afforded. As a result many had to cut or suspend distributions.

There were plenty of warnings that investors should be careful with income trusts. Dr. Al Rosen has campaigned for several years trying to alert the public of the dangers of investing in business income trusts. I had the pleasure of spending a day with Dr. Rosen in Ottawa in mid 2005 when he tried to alert Government about the issue. Diane Urquhart has also been working tirelessly on the income trust issue.

The SIPA website income trust webpage carries alerts going back to 2003 to alert members.

Is the Situation Improving or Getting Worse

At times it seems there is no hope that the situation will ever improve when we see many of the provinces reducing limitation periods while the industry continues to mislead investors and regulators fail to provide investor protection.

Quebec's approach to regulation by creating one central regulator the Authority, and introducing a complaints department that can order restitution provides optimism and a model that one hopes other provinces will adopt at least until there is a national regulator. While it will take time it is almost inevitable that Canada will have one national regulator.

Recently Nova Scotia has revised its securities legislation that now enables the Nova Scotia Security Commission to order restitution if their investigations reveal wrongdoing. Nova Scotia is one of the provinces where the MLAs have taken an active interest in consumer/investor protection and do not blindly pass legislation without questioning how it will impact ordinary citizens. Unlike Ontario where the Limitation Periods were reduced without any consultation with consumer groups and without discussion in the legislature.

Quebec panel to urge investor protection plan

Influential leaders to unveil policy today

BERTRAND MAROTTE

MONTREAL -- A coalition of luminaries from Quebec's business, academic and political communities is calling for a sweeping new savings and investment policy to better protect consumers and help victims of financial scandals.

The group -- which includes Quebec Inc. pioneer Claude Castonguay, former provincial minister of finance Yves Séguin, former premier Bernard Landry and Claude Béland, the former head of giant financial co-operative Groupe Desjardins -- says there is an urgent need to reform the province's patchwork of rules and policies overseen by several different ministries and agencies.

The proposal aimed at restoring trust in what is said to be a badly damaged financial system is to be unveiled today at a news conference in Montreal. It is based in part on sentiment that there are too many deficiencies in the existing system that facilitate financial scandals such as the one that last year shut down mutual fund group Norbourg Asset Management Inc.

Also cited is the dizzying growth of income trusts -- many of which did not perform as anticipated and resulted in big losses for seniors -- and the move by Ottawa to finally clamp down on them.

The call to action is specific to Quebec but has the support of pan-Canadian groups, including the National Pensioners & Senior Citizens Federation, with the proposed policy viewed by some as a model for a national version.

Holger Kluge, the former president of Canadian Imperial Bank of Commerce, is among individuals from outside Quebec who support the initiative.

Among the 16 recommendations to be introduced today:

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The establishment of an anti-fraud indemnity fund to help promote confidence and reimburse investors in the case of fraud. "While critics may complain about higher costs for the industry, the costs are warranted, in return for a better regulated and more transparent market place," the coalition says in a statement.

A shift from an overemphasis on past performance of funds to a mandatory evaluation of management performance through a system of certification and rating.

The establishment of an agency to track major trends and prepare an annual report on the state of savings and investment.

Improved access to foreign funds to allow Quebeckers and Canadians to take greater advantage of U.S. investment vehicles, which boast the lowest fees in the world, whereas Canada's are among the highest.

"The perceptions of high fees, lack of competition, the greatest-risk shift of retirement-planning responsibilities to individuals and a growing complexity of financial instruments have contributed to discourage people from investing wisely and efficiently," according to the coalition.

Stan Buell, the president of the Markham, Ont.-based Small Investor Protection Association, said in an interview he would like to see the coalition's proposal applied nationally through the introduction of federal legislation.

"We're saying that there should be an authority that looks after investors," he said.

"People are beginning to realize that there is a real issue out there and that relying on the provincial regulators isn't sufficient."



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Risks Inherent in the Complaint Process

The purpose of the current redress system is to provide the means for investors harmed by industry wrong doing to achieve fair and timely redress. The first step in this process is the internal complaint process with the firm. In some cases, the matter may be resolved with the client's investment advisor or branch manager. In other cases, the investor will need to contact the firm's Compliance Department.

Negotiating the internal complaint process at financial service providers is a perilous undertaking for many or even most investors. Exposure to risk is clearly recognized in an investment context, involving factors such as equity market risk and currency risk. Nevertheless significant exposure to risk also occurs within the redress system itself, especially at the most initial stage where the investor still has direct dealings with the firm. My previous analysis of this issue in terms of the principles of the Fair Dealing Model of the Ontario Securities Commission is posted at the SIPA website (www.sipa.ca/library/Documents/OSC-FDM-Reeve_040809.pdf).

In this paper, I apply the principles of the FDM to considering the client/representative relationship in the internal complaint process. When factors such as the nature of the relationship, conflict of interest, and transparency are taken into account, it becomes evident that investors are exposed to significant risk of harm in this process.

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The recently published Final Report of the Task Force to Modernize Securities Legislation in Canada, sponsored by the IDA, refers to a national investment literacy test that found that two-thirds of Canadians are “functionally illiterate when it comes to investment knowledge” (Final Report, p. 66). Normally this kind of statistic would be considered only in relation to investing. Nevertheless, financial literacy also has important implications for a client’s negotiation of the internal complaint process. Many investors in these circumstances will not have an accurate understanding of the merit of their claim beyond the fact that they have lost money.

The Ombudsman for Banking Services and Investments (OBSI) and IDA note that most of their complaints are about the suitability of investments. Suitability involves a relatively complex assessment involving consideration of the investor’s age, net worth, investment objectives, and risk tolerance. Many investors will be unable to evaluate this on their own. As a consequence, investors with this kind of complaint will have to negotiate a firm’s internal complaint process with an inadequate understanding of the merit of their claim. Unquestionably this will be problematic in an adversarial process where there is no third-party oversight.

Moreover, the investor may not even realize that the internal complaint process is adversarial. They may be referred to the firm’s Compliance Department for consideration of their complaint. What is a Compliance Officer? This is someone who exercises an ‘enforcement modality’ within the firm. The professional obligations of a Compliance Officer relate to ensuring that the services of the firm’s investment advisors conform to existing rules, regulations and standards. In view of this, a client with a complaint will see the Compliance Officer as exercising an enforcement function somewhat like a detective or police officer. The client will look to the Compliance Officer to investigate the complaint and determine whether wrong doing has occurred. Understandably, the client will see the outcome of the Compliance Officer’s investigation as reporting an objective determination and impartial decision about the matter. Should the client rely on this decision?

The OSC’s Fair Dealing Model concept paper recognizes that investors must be provided with sufficient information to be able to decide properly about investment options. It also recognizes that disclosure is an important tool for managing conflict of interest. For example, requiring the advisor to inform the client of a range of fee options prevents the advisor from directing the client to a compensation option that favours his or her interests. The International Organization of Securities Commissions (IOSCO) also recognizes the connection between information and investor protection. Its “Objectives and Principles of Securities Regulation” (May 2003) states that: “Full disclosure of information material to investor’s decisions is the most important means for ensuring investor protection.”

Clearly, investors also need to make a decision at the outcome of the firm’s internal complaint process, namely, whether or not to accept the firm’s decision about their complaint. Nevertheless, the investor is not provided with information relating to the applicable rules, regulations, and standards. How can the investor protect his or her interests if the relevant criteria are not identified and if inadequate reasons are provided for the firm’s decision? As mentioned above, many client complaints relate to the suitability of investments. How is the client to determine whether the firm’s Compliance Officer has fairly considered all the relevant factors? Under the circumstances, clients are exposed to the hazard of accepting self-serving outcomes and abandoning complaints with substantive merit or accepting inadequate offers.

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The current redress system offers various alternatives to clients who feel that the firm has not responded to their complaint in a satisfactory manner. How is the client to determine whether the firm's response is satisfactory? If the firm's Compliance Officer communicates that there is no evidence that the client's investments were inappropriate, how is the client to know whether to accept the decision?

Many of the issues that occur in a complaint context involve considerations similar to those that occur at the investment level: disclosure, management of conflict of interest, transparency in communications and investor education. Compliance Department reviews of client complaints are a regulated service. Are investors adequately protected from biased, self-serving outcomes in this context?

Not every claim has merit. But, given a claim with merit, the risk of accepting a biased decision is significant: unrecoverable financial loss. My recommendation to any investor going through an internal complaint process is to get an independent opinion on the merit of your claim.

Pamela J. Reeve, Ph.D.

Performance Measurement: Why Investors Need It and Why They Do Not Get It

Measuring Performance Is Important For the Small Investor

Investors need good information to make the right investment decisions. The better the quality and timeliness of the information, the better the decisions. Investors need external information about the factors influencing stock prices and mutual funds as well as personal information concerning their own portfolio, such as the risks the portfolio is exposed to, the asset mix, and the historical performance.

Measuring performance is a critical part of the investment process

The professional money managers, who manage hundreds of billions of dollars of pension plans, and the money of wealthy families, would not dare to meet with one of their wealthy clients and not be prepared to give performance information. In the institutional world everyone knows the importance of measuring performance. It is one of the most basic but critical parts of the investment management process. Performance measurement information helps to determine what adjustments are needed as managers continue to try to outperform their benchmarks. Performance is their measure of success. Those who perform well get rewarded with more money to manage and/or increased compensation.

Performance measurement is important to the small investor for the same reasons it is important to larger institutions. In fact, the less you have the more important it is that your money is well managed.

Reasons for lack of performance information

Industry participants have given us two reasons why we shouldn't have, or can't have performance information.

- o Investors Can't Handle the Truth
- o Companies Can Not Afford It

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The Real Reason

The real reason the performance information is not given is because the law does not require it. There is no question that if the industry participants believed providing performance information would improve profitability, it would be done in a heart beat. The only logical explanation for the failure to deliver this information is that the industry believes the bottom line will be better if clients do not have performance numbers. Apparently the industry also wants to avoid full disclosure and transparency of fees and commissions. The irony is that the industry participant that first starts to treat investors with respect is going to get enough good publicity to gain significant market share.

Performance measurement for the small investor .

What can a small investor do if they want to keep track of the performance of their investment portfolio?

Ask your advisor/salesman or financial planner/mutual fund salesman to calculate it for you. (the silence and excuses would be deafening)

Go to www.showmethereturn.com, and use that calculator to show you your return. While there you can sign the petition.

Wrap programs and fee based accounts generally will have performance measurement as part of the program. Investigate this possibility.

Simplify your portfolio so that performance measurement can be simple and straight forward. Buy some low cost mutual funds or ETFs (exchange traded funds) and track the performance yourself.

Consider using a professional money manager who will manage your portfolio for a fee. Go to www.investmentcounsel.org/index.asp for more information and list of managers.

Conclusion

The historical performance of an investor's portfolio performance is critical information for those who want to manage their money wisely. Most small investors do not receive that information because the majority of companies in the financial service industry don't provide it. Investors who want to manage their money have a few choices: they can invest their money with a firm that will provide this information, they can calculate it themselves, or try to effect change by signing the petition at www.showmethereturn.com.

Ken Hawkins, Vice President Research and Development
Second Opinion Investor Services Inc - www.secondopinions.ca

Brokers Hall of Shame

In 1999 SIPA published its first website and soon had published a Brokers Hall of Shame. The webpage listed registered representatives who had been disciplined by the regulators of who had been reported in the media. Only information that was publicly available was published. SIPA took this action because none of the regulators published an alphabetical list of disciplined persons. Soon SIPA had 250 names of "Bad Brokers" listed alphabetically and this aroused attention from the industry. We received a number of complaints and after receiving a few threatened lawsuits we removed our alphabetical list from our website.

Small Investor Protection Association - A voice for the small investor

By that time the BCSC also has an alphabetical list of disciplined persons. The BCSC list today has over 600 names listed. The following is from the BCSC website:

"The following individuals have been sanctioned by the British Columbia Securities Commission since 1987. This list is intended to assist the public and the securities industry in conducting due diligence. Sign up for BCSC's new e-mail subscription services for immediate notice of additions to the disciplined persons list.

You can check the payment status for financial penalties sanctioned since our incorporation on April 1, 1995 using the Sanction Payment Status Report. The report is updated each Monday by 4:00 pm."

Although other regulators claim that information on disciplined persons is available on their websites they do not provide alphabetical lists. If they did provide alphabetical lists it would be possible for investors, as well as industry to do some due diligence when searching for an Investment Advisor.

Tougher penalties and other remedies will help protect Nova Scotians from investment losses due to illegal activity by a public company

Finance Minister Michael Baker introduced amendments to the Securities Act November 2, that will help to protect Nova Scotia investors and harmonize Nova Scotia securities regulation with others across Canada.

Amendments to the Securities Act, will make it possible for investors in the secondary market to sue public companies when those companies fail to make timely disclosure or misrepresent public information. A secondary market is the term used when an investor purchases an existing investment product through, for example, a broker or investment dealer.

Changes to the act will also give the Nova Scotia Securities Commission the power to order repayment, up to \$100,000, of money lost through illegal or improper trading practices. As a result, some investors will no longer have to undertake costly legal action to recover their losses.

"It is important to give Nova Scotians greater protection against the wrongdoing of others," said Mr. Baker. "It is also important to have a way to seek compensation that does not add to the financial burden of those already affected by the misconduct of others. The changes we are introducing today in this legislation will do both."

Tougher penalties for those found guilty of illegal or improper conduct are also being introduced. Amendments are being made to provide for fines of up to \$5 million and imprisonment of up to five years less a day. The current legislation provides for fines up to \$1 million and imprisonment of not more than two years.

Other amendments will make it possible for Nova Scotia to meet its commitment to other provinces and territories to move toward harmonized securities laws and regulation, and create a single window access to capital markets, referred to as a Passport System. Changes will allow for the harmonization and streamlining of, among other things, definitions and various reporting and registration requirements.

Small Investor Protection Association - A voice for the small investor

Market crime fight failing**Senators to hold inquiry. Enforcement of securities laws not working: expert**

Theresa Tedesco writes in the Financial Post on Monday, November 20, 2006; "The influential Senate Committee on Banking, Trade and Commerce will examine Canada's lacklustre record of prosecuting securities violations. Senator Jerry Grafstein says the committee is "very unhappy with enforcement" and "sensed that for a long time, there hasn't been vigorous prosecution" of crimes in the securities sector.

She reports that the senators decided to hold hearings early next year, after they were "startled" by blunt comments made during a recent lunch meeting in New York by John Coffee, one of the 12 members of the Task Force to Modernize Securities Legislation in Canada.

According to Mr. Grafstein, Prof. Coffee, who teaches law at Columbia University, gave a less flattering assessment of Canada's enforcement regime than the one outlined in a 3,000-page report released on Oct. 6 by the task force."

Ms Tedesco writes "According to Mr. Grafstein, the American securities expert cited examples of testimony he gleaned during extensive public consultation during their meeting.

For example, Market Regulation Services (RS), the watchdog that oversees trading activity on Canada's major stock exchanges, told the task force it had referred 99 cases of possible securities violations to the RCMP's Integrated Markets Enforcement Teams (IMETs) in the past couple of years. To this day, the senators were told, no regulator had received any feedback on the status of the referrals. "We found that to be a shocking revelation," Mr. Grafstein said. "The entire [Senate] committee was taken aback that almost 100 alleged violations have been reported and we don't know what, at this stage, if anything, has been done about them."

As a result, he said the Senate committee is "going to examine enforcement provisions minutely to find out if they are working, and if not, why not."

Ms. Tedesco reports that Prof. Coffee said "The problem in Canada is not so much that cases are being tossed out by courts that don't understand them -- but rather no cases are being developed to the point that they can be taken to trial."

She also writes that a task force member said the sensitive issue of tougher enforcement may have been "downplayed, not whitewashed" in the task force report. "We have a problem with enforcement in Canada not because we're lacking regulations or laws, it's because we don't have an enforcement apparatus that enables us to get at transgressions," said the official.

SIPA's Activities

In August Stan Buell was a guest speaker at the United Senior Citizens Annual General Meeting in Kitchener, Ontario, where some 300 representatives from across Ontario assembled.

In September SIPA (Stan Buell) and U.S.C.O. (Marie Smith, President) made a joint presentation to the Ontario Standing Committee on Justice Policy regarding the Limitation Period.

Also in September, Stan Buell met with the OBSI Board upon the invitation of David Agnew. We said that SIPA could no longer recommend investors with a dispute pursue the OBSI option in provinces with reduced limitation periods.

In October the Senate Standing Committee on Banking Trade and Commerce invited SIPA to make a presentation in Ottawa on the Income Trust Issue. This is postponed.

In November SIPA and the NPSCF joined the Coalition for the Protection of Investors to support a submission to the Quebec Government. Also Stan Buell appeared with Dr. Al Rosen on Linda Leatherdale's Moneyline show November 29th regarding income trusts.