SIPA Sentinel

June 2007

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

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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.

SIPA NEEDS YOUR HELP

SIPA is preparing a submission, but needs some case studies from members to support our submission. One of our concerns is the way complaints are handled by industry and regulators, and the time required. We need your stories outlining the steps you took, the attitudes you encountered, the time it took and the results you achieved. Most disputes are resolved out of court with gag orders. Tell us. We will not include any names (of investors, registrants or investment firms. Any information you can provide will be of great assistance for this initiative. We need your support. Even if your dispute is settled your story could help others less fortunate or still facing an issue. If you are aware of court decisions please let us know. Everything helps. Thanks for your support.

CANADIAN INVESTOR PROTECTION FUND (CIPF) & INVESTOR PROTECTION

The CIPF provides investor protection against losses due to bankruptcy for clients of firms participating in the CIPF. Investors who had invested with Graydon Elliot Capital Corporation should be aware that claims for loss must be submitted by November 30th, 2007. Whenever an investment firm declares bankruptcy you should check with the CIPF to determine whether you are protected. The following is a summary of a CIPF notice.

CANADIAN INVESTOR PROTECTION FUND - Graydon Elliott Capital Corporation
On February 26, 2007, the Investment Dealers Association of Canada ("IDA") announced that it has suspended the membership of Graydon Elliott Capital Corporation and ordered it to immediately cease dealing with the public. Customer accounts have been transferred to Global Maxfin Capital Inc. Customers should contact Stuart Bartley (604 331-4765) or Keith Punter (604 331 4780) at the Investment Dealers Association of Canada for additional information.
Customers with accounts at Graydon Elliott who have suffered or may suffer financial loss solely as a result of Graydon Elliott being or becoming insolvent may be eligible for coverage for such losses by Canadian Investor Protection Fund. Losses that do not result from the insolvency of Graydon Elliott such as losses arising from changing market values of securities, unsuitable investments or the default of an issuer of securities are not eligible for CIPF coverage.

OSC no deterrent to scam artists
Our markets are like casinos with no rules

Dr. Al Rosen, FCA

Wednesday, May 09, 2007

A surreal view into the disturbing world that is the Ontario Securities Commission comes to us via its own strangely titled publication, Perspectives. The recent Spring edition quotes commission chair David Wilson as saying, "Regulators must try to improve a public perception that misconduct is not being addressed." Surely, Mr. Wilson can't be suggesting that the public has incorrect "perceptions" of the OSC's abysmal enforcement record, can he?

Let's be clear: The OSC's enforcement actions against serious financial reporting manipulations are, shall we say, invisible. Likewise, insider trading convictions pale in comparison to the depth of illegal activity in our markets. Adding to the pain, we routinely turn a blind eye to executives who feather their nests with inappropriate insider deals. So why does the OSC seem more focused on creating perceptions of safety, rather than taking serious actions to create the reality of safety? Sadly, it's because the commission bows to a master far more powerful than mere public investors.

Without a public market for securities, there would be little need for the OSC. Thus, the commission bends to the will of companies that want less regulation, and a general veil of confidence in the market. When confidence does not naturally exist, "perceptions" of confidence are created by sweeping problems under the rug.

Canada is in competition with foreign markets to attract public companies to list here. As such, we offer looser regulations, and stick our heads in the sand all in the name of "confidence," or at least the perception of it, that is.

It's that false sense of security that is so bothersome, rather than the real risks of the market (the latter being essential to our economy). Without real security, our markets have turned into mere casinos in many ways, with one clear exception: casinos are more honest and straight-forward in their objectives.

The clear and stated purpose of casinos is to separate you from your money. In games of chance like roulette, craps and slots, the house always wins in the end. If you cared to know ahead of time, you could research how long it would take to lose your money based on your initial stake, game of choice, and betting strategy.

In games of greater skill like poker and blackjack, the house still takes its cut, but you're mostly trying to win money from other patrons. This is where the playing field is more level than our markets. Nowadays, it's almost impossible for players to cheat one another at a casino. Sadly, the same can't be said when buying or selling stocks.

Consider the following multiple and redundant casino protections, some of which are required by law and are monitored by outside regulators. First, identification can be required even for entry to the casino. Second, casinos have hundreds of video cameras with facial-recognition software watching for known scam artists. Security personnel who monitor the cameras direct floor personnel to suspicious areas. Indeed, enforcement personnel are so well trained they can spot many cheaters before they even cheat. Third, in the event these measures fail, the camera tapes are kept for several days, in case investigation is required. Last, and most importantly, these preventative measures are real to this world.

There are no phony policemen or fake cameras aimed at bending people's "perceptions" of the security level. Why have a fake camera when your budget can afford a real one? Without investing in real security, you can't create a level of actual deterrence. This is what our securities commissions have gotten completely backwards.

The OSC is simply not investing enough in enforcement initiatives to create a real level of deterrence for scam artists. While nobody will cheat you at a casino, it has become abundantly clear that you can be robbed blind investing in Canada.

Executive self-dealing is still alive and well in Canada, including inappropriate sales of services by executive-owned entities to TSX-listed companies. Similarly, controlling shareholders have much too easy a time pawning off underperforming assets onto minority shareholders, with the help of so-called fairness opinions from conflicted parties. These unsavoury related-party dealings come in addition to the regular financial reporting and insider trading scams that go largely unpunished in our market.

The full extent of self-dealing transactions only comes out through litigation, which is a costly way for investors to take on a public company. Unfortunately, the lack of publicized disputes allows our regulators to conveniently pronounce that there aren't any problems.

Perhaps our current predicament is not all that surprising. The former OSC chair had a similar attitude. In May, 2006, he said: "We don't seem to have seen here in Canada the high-profile failures that they have in the U.S." Yes, it's certainly amazing what you don't find when you don't look.

In the end, any relief for investors will need to see the OSC relieved of its duplicitous mandate of supposedly protecting investors, while at the same time, making things as easy as possible for listed companies. It never seems to fail that the so-called balancing act continually falls in favour of corporate lobbying powers. Unfortunately, this fundamental conflict seems to be clouding some people's perceptions of reality.

Al Rosen is a forensic accountant at Accountability Research Corporation, an independent equity research firm. alrosen@accountabilityresearch.com

SIPA is pleased to re-print Dr. Rosen's comments on the investment industry. We are particularly concerned that the regulators are misleading the public by saying they provide investor protection when it is so evident they do not. The OSC continues to try to create a perception, or would their efforts be better defined as an illusion.

Investors are simply Grist for the Mill of the Investment Industry

Investors should read Jim Daw's article carefully and realize that they are not protected from investment industry practices that appear to be obscene by people with morals. Many investors are unwittingly leveraged to invest without understanding the risks of such a strategy or the implications if the investments don't turn out as predicted. Be aware that borrowing to invest can result in catastrophic loss.

TORONTO STAR
www.thestar.com

Borrower beware: Lesson on loans learned in court

May 19, 2007
JAMES DAW

Twenty-two investors now in their 60s and 70s borrowed money to buy mutual funds late in the 1990s. Before long, they suffered losses.

Without the loans, they could not have afforded the mutual funds. On the flip side, they could not afford the loans when stock prices fell.

But stock markets had been roaring ever higher – as in the past four years. Investment seminars drew big crowds, and many advisers pushed people to buy funds using loans secured by the funds, or by home equity.

After all, went the mantra, most of us borrow to buy homes and cars. The big difference with loans secured by mutual funds or securities is that, when the investments fall in value, lenders will usually demand an accelerated payment to reduce their own risk of loss.

Concerns about the risks of leverage led the Ontario Securities Commission, in the wake of the 1987 market crash, to require that mutual fund dealers and salespersons provide investors with a standard explanation of those risks.

For these 22 investors, though, the surprise came when the banks demanded the accelerated payment; they had never read the loan agreements.

While markets have since recovered, two of the investors were eventually driven to bankruptcy, and others came close to insolvency. Most have been left with nothing but their homes and modest savings.

On the advice of experienced securities lawyers, they joined together to sue their advisers, securities dealers and fund management companies.

They also went one step farther. They sued three major banks and three trust companies for lending them the money, arguing the lenders knew full well the investment loans were inherently risky.

The courts have not been sympathetic to the novel argument that the banks owed a duty to care for the investors, to provide a warning or refuse to lend. Now the investors have discovered how risky court battles can be.

Without even holding a full trial, Judge James Spence of the Ontario Superior Court of Justice ruled in favour of a motion the lenders brought in late 2005: "There are no genuine issues of fact for trial."

The loan agreements in question varied in their wordings, but generally required the borrowers to accept responsibility for any losses or damages, and to acknowledge they had received no advice to invest or borrow.

Spence later accepted it would be an undue hardship for the investors to then pay the $1.14 million in legal costs the lenders sought to recover.

He limited his cost award to $440,000, an average of $20,000 per investor or $40,000 per couple, acknowledging they deserved a discount because of the novelty of their arguments and the inevitable overlap in work done to defend the investors' claims.

The novelty of their arguments won them an audience before the Court of Appeal for Ontario last September. But the three justices ruled unanimously that Spence's reasons for tossing out the lawsuit were "a model of excellence."

The judges referred to the loan documents, which were presented to the investors by their advisers, and which absolved the lenders of responsibility.

They noted the lenders had no reason to assume the borrowers would fail to read the loan agreements, and that the investors had no reason to think they could get out of paying the loans.

It is well established in law that lenders have no special duty to protect borrowers from their own decisions, where there is no special relationship or exceptional circumstances, and where the terms of the agreement "that give rise to the special risk have been fully disclosed."

"It is the borrower who decides to take the loan and so creates whatever foreseeable risk may thereby arise," the court responded to the investors' claim that it was the lenders that were negligent.

"The case law recognizes that advisers have a duty of care in respect of advising, but it is not recognized that lenders are advisers," the court wrote. "The plaintiffs went to the financial institutions, not for advice, but for loans."

The lenders promoted their investment loans to the advisers, not to the investors, the court ruled. When the investors accepted the loans, they were seeking to advance their own interest and should have expected the lenders to do the same.

A request to appeal the ruling in the case of Baldwin v. Daubney has now been denied by the Supreme Court of Canada. Both appeal courts have ordered the investors to pay the legal costs of the lenders.

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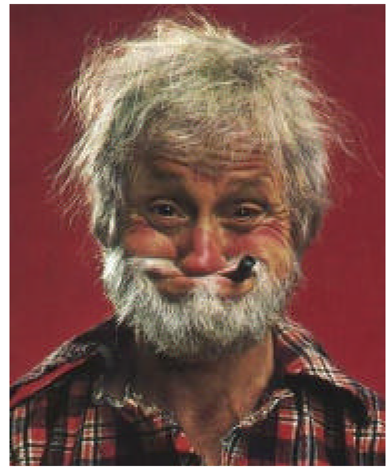
INVESTMENT RISK – INVESTOR BEWARE

By A. Nonymous – June 2007



A. Nonymous – Money Pundit

With investment there is risk, but the risk varies with the type of investment, the strategy of investment, and the investment advisor. Generally lower risk investments provide a lower rate of return, and higher risk investments offer the possibility of a higher return but increased risk of loss of capital.

Government bonds and bank G.I.C.s are low risk products with rates of return about 4% for bank G.I.C.s and 5% for government bonds. Investments offering higher rates of return will generally have higher risks of losing your capital.

In addition to market risk associated with various products such as shares, corporate bonds, mutual funds, segregated funds, or other structured products such as principal protected notes, income trusts, and managed futures, thee is also risk related to investment firms and their established practices, such as leveraged mutual fund investment.

Leveraged investments result in increased risks for investors. When markets go up the increase in a leveraged investment account is reduced by the cost of borrowing, and when the market goes down the loss in a leveraged account is increased by the cost of borrowing. The cost of borrowing is currently generally greater than 6% but with interest rates on the rise this will result in leveraged investors facing increased costs.

If you are a leveraged investor you must monitor your investments to determine whether your investment returns are sufficient to warrant the increased risk of leveraged investing. Leveraged investing may involve:

- A bank loan to provide money for investing
- A mortgage on your home to provide money for investing
- A margin loan from your investment firm to provide money for investing

Leverage can be increased if your investment firm provides margin loans guaranteed by the borrowed money you invest. Leverage is good for the banks because the loans are guaranteed by your assets. Leverage is good for investment firms because it increases their assets under management. Leverage is good for financial advisors because it increases the assets on which they can earn commissions. However leverage increases the risk of loss for investors.

If this borrowed money is then invested in leveraged products such as futures, this can result in high risk investment with catastrophic losses in short periods of time.

Small (retail) investors should be wary of becoming involved in leveraged investment if they do manage their own investments and depend upon others for investment advice, particularly if they do not pay for the advice and it is provided by commissioned sales people.

The ultimate question for investors is how much return do they need on their investment and how much of their assets are they prepared to risk losing. If a return of 5% is sufficient for your needs why do you want to risk loss for additional return that is not guaranteed? Many investors have learned that anticipated returns from principal protected notes and income trusts did not materialize and they have suffered loss of their capital.

Investors will often take some risk and use diversification to mitigate the risk of capital loss. One rule of thumb for investors is to invest a percentage equal to their age in secure investments such as government bonds of bank GIC's, and diversify the remainder in equities or other investments that may provide a higher return on investment. Some investors will allocate up to 10% for higher risk investments if they feel they can live with total loss of the 10%.

The reality is that most investors who suffer significant loss of their savings were not diversified, had all their money invested in products with risk of capital loss, and were leveraged.

To protect your savings that are meant to provide retirement security you must monitor your investments on a regular basis. As guidance in assessing you account performance suitable benchmarks are government bonds with minimum risk of loss currently provide a return of about 5%, while the Toronto stock market has provided a return of 100% over the last four years. An ETF that follows the TSE also provided a return of about 100% over four years. If your returns are less than government bonds you should get a second opinion on your investments.

All investors should ask their investment advisor to provide a monthly statement that shows the annualized rate of return for their accounts so they can monitor the returns against appropriate benchmarks. You should not rely upon statements that show only:

- Market Value this month versus Market Value last month – this provides no historic information to enable you to evaluate performance
- Market Value compared to Book Value – this is even worse as it is subject to manipulation by selling losing investments to reduce book value

Many investors ask the question "Why does my statement show I am making money when I know the current Market Value is less than the totals of money I invested?" It is widespread practice in the industry to provide such statements so investors are not aware of the poor performance of their investment accounts. How many investors have a statement that compares their overall rate of return to a comparable benchmark, or even to the rate of return for Government of Canada bonds?

If you have questions regarding your statements or investment returns write to A. Nonymous at SIPA, P.O. Box 325, Markham, ON, L6B 1A8.

More on Income Trusts – from Advisor.ca

Income trusts continue to be an issue for many investors in spite of the warnings that have been published by investor advocates since 2003 when Atlas Cold Storage was featured in the media. Dr. Al Rosen is one of the most outspoken critics of business income trusts and independent analyst Diane Urquhart continues to point out the many income trusts that have failed investors while the industry attempts to lay the blame on Finance Minister Flaherty for the fiasco that was

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created by industry in their efforts to create illusionary products to tap seniors wealth. We provide excerpts from an article from Advisor.ca that quotes Cecelia Mo, manager of Fidelity's Income Trust Fund.

From Advisor.ca - ***Farewell to trusts*** *- Mark Brown*

Mark Brown writes "Cecilia Mo is as soft spoken as they come. In front of a packed audience of advisors attending the final leg of Fidelity Investments' latest road show last week, she sat uneasily on stage with both hands tightly gripped around a microphone as she shared her views on income trusts. While she is quiet and anxious in front of a crowd, her words are sharp and her views almost callous as she assesses the trusts sector and the way many of these companies are run.

"There are 257 names out there and at least 120 of them I wouldn't touch," she says. "Half of them are just pure junk, to tell you the truth." These aren't the sort of comments one might expect from the manager of Fidelity's Income Trust Fund and co-manager on the Fidelity Monthly Income Fund, but she stands by her words.

Earlier in the month, during Fidelity's swing through Calgary, the headquarters for most of Canada's energy trusts, she told some of the executives of those firms that she wouldn't touch them with a ten-foot pole. "The energy trusts by and large are an inferior asset," she says.

Mo values trusts the same way she values a company, which is why she wasn't compelled to sell a single unit the morning after Finance Minister Jim Flaherty's announcement of his plan to tax trusts. "The way you've got to look at this sector is to go back to the fundamentals," she says. "Ask yourself, if this income trust were to convert to a common stock tomorrow, would you still like it. If the answer is yes, then it should be a keeper in your portfolio."

Instead of cashing in her units, Mo was using her fund's 9% cash reserve to buy business trusts she felt were oversold. Some of the companies on her list include Yellow Pages Income Fund, Golf Town Income Fund, IBI Income Fund and Cineplex Galaxy Income Fund.

Notably absent from Mo's shopping list were real estate investment trusts, which were excluded in Flaherty's announcement. While she admits she's made a lot of money off of Canadian REITs this year — and although she still owns a few — she doesn't see much upside to them, as she expects the Bank of Canada will cut interest rates.

As frank as Mo is when sizing up individual income trusts, she is just as bold in her prediction of what's next for the investment structure itself. "Income trust in the current format is not going to survive," she says. "By 2010, with the exception of REITs, most of them will be converting to common stock."

From *"A new kind of Street fighter"* by William Hanley in the Financial Post

Over coffee, he (Stan Buell) offers some advice to investors: *"I wish everybody would say, how much money do I need? Do I need more than I have? And if I need more, then am I prepared to risk losing what I have? And if I'm not prepared to lose what I have, how should I invest?"*