



**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.**

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## SIPA Sentinel

The SIPA Sentinel is issued bi-monthly. From time to time we include articles and reprints 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.

### **Joint (N.P.S.C.F./SIPA/U.S.C.O.) Submission to Ontario Ombudsman The Ontario Securities Commission (OSC) is failing to protect investors**

The Ontario Ombudsman, Andre Marin, is empowered to investigate Ontario Government organizations. He investigated the Ontario Lottery Corporation and published an Ombudsman Report entitled "A Game of Trust" in March 2007. We are asking that he investigate the OSC. In April this year SIPA submitted a letter to the Ontario Ombudsman. An investigator was appointed and met with a joint delegation representing the U.S.C.O., SIPA and the N.P.S.C.F. in July.

As a result, a joint (N.P.S.C.F./SIPA/U.S.C.O.) submission was prepared and will be formally submitted after Labor Day. A copy of the cover letter states:

*"The Retirement Security of Ontarians is at risk as Ontarians are losing billions of dollars of their savings each year due to widespread practices of wrongdoing and fraud that continue unabated due to the failure of our regulatory system to provide investor protection. ...*

*This report outlines our reasons for requesting an investigation into the Ontario Securities Commission and recommendations for necessary change to provide investor protection."*

Finance Minister Flaherty said:

*"I think enforcement with respect to securities is an embarrassment internationally to Canada. We need to better protect investors against breaches of securities law and we need to do that in our own country and not rely on other countries to do it for us."*

Many have been speaking out including Glorianne Stromberg, Dr. Al Rosen, Diane Urquhart, Ken Kivenko and a number of others including investor advocates, individual investors, and former registered representatives. The Ombudsman's investigator has asked us to provide names of individuals who will speak to the investigator.

We need your support. We need you to speak with the Ombudsman's investigator. It's not necessary to discuss your particular situation, if you prefer not to or have a gag order, or even to have extensive knowledge of the regulatory system. It's just a matter

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of having an opinion if the OSC really is protecting investors, and if there is an acceptable means of getting restitution when you have been wronged.

Even if you resolved your dispute and signed a gag order, you can help others. This is about the regulatory system failing to protect investors. I urge you to consider sending your name and telephone number even it is just to provide support for this initiative.

### Stop, Look and Listen Investing

By Al Rosen\*

One of the benefits of being a forensic and investigative accountant is that, under court rules, you get to see nearly all of the details behind many Canadian securities frauds. It never ceases to amaze me how quickly financial scams get recycled, and how similar many of them are in nature. These common threads should actually give hope to investors, because it means that many scams can be identified in advance, and avoided.

In a broad sense, I would say there are two types of financial scams artists. There are the penny-ante crooks making phone calls from shadowy "boiler rooms" and there are the so-called reputable firms with large staffs and multi-million dollar advertising budgets. Both have the same goal in mind – to separate you from as much of your money as possible. They often use the same tactics, such as making investment claims that are too good to be true, and luring in as many people as possible before a scheme inevitably collapses.

Having examined hundreds of made-in-Canada scams from the inside out, I wish to pass on some very frank advice, and review some of the current dirty tricks that are disadvantaging Canadian investors.

There are many reputable investment advisors in Canada. But, there are also those that survive simply on brokerage commissions. Their game involves simply churning your portfolio of investments. I cannot count the number of cases we've had of investors being too trusting of their investment advisor. Frequently, the lost money cannot be recovered.

Initial public offerings (IPOs) can be very risky. The best opportunities usually go to sophisticated investors first, such as pension fund and mutual fund managers. There's a saying: "retail investors don't buy IPOs – they're sold IPOs."

Ponzi frauds and pyramid schemes are exceedingly popular in Canada because securities commissions virtually never prosecute, and auditors rarely blow the whistle. In many senses, Canada is a prosecution-free zone. (For further details see my column, "Between The Lines," in every second issue of *Canadian Business* magazine.)

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\* Al Rosen is a forensic accountant at Rosen & Associates Limited in Toronto.  
[al.rosen@rosen-associates.com](mailto:al.rosen@rosen-associates.com).

Ponzi schemes involve borrowing money or selling more equity to pay dividends or distributions to earlier investors. This gimmick has been used recently in several business income trusts that were sold directly to retail investors. Eventually, the income trusts ran short of cash, cut their distributions, and the unit prices collapsed.

After the price collapses, some investors tried to blame anyone but themselves for falling for a scheme that was too good to be true. Some tried to blame a change in tax rules, claiming that they were fully invested in income trusts based on an election promise that the tax loophole would not be closed. For future reference, a politician's promise should not form the foundation of an investment strategy.

Many trusts collapsed not because of changes to tax rules, but rather because they were simply overvalued and misleadingly marketed on a so-called "yield" basis. The problem was that a false yield of 9% on an income trust should not have been compared to a cash yield of 5% on a bond. Too often, the 9% cash yield on the trust came not from corporate earnings, but rather from the unsustainable practice of borrowing money or selling more trust units to get the cash.

I'll have more scams to watch for at a later date. Meanwhile, stop, look and listen.

## LEVERAGED INVESTMENTS

SIPA speaks out against leveraged investments and alerts investors to the increased risk of leveraged investment. A previous Sentinel carried our comments outlining how the financial advisors, the dealers, the fund companies and the banks all benefit when investors are sold leveraged investments, but it is the investor who is at risk. There are some fund companies that sell their clients on leveraged investments even when it is totally unsuitable. An interesting article appeared on Advisor.ca by Bryan Borzkowski entitled "*Advisor-sold investment loans pose conflict of interest*". The article opens with the comment:

*Offering an investment loan to help finance a client's mutual fund purchases might seem like a good idea, but one Ottawa-based lawyer questions the practice. Harold Geller, an expert in financial advisor liability, says offering a client an investment loan can be a conflict of interest, pointing out that the more money advisors put into products, the more they make on trailer fees.*

*"The industry recognizes that these loans are advisor sold," he says. "Companies offering investment loans through advisors report a strong rise in these things being sold. That's a clear indication that the clients aren't questioning this; it's the advisors recommending it." The main problem Geller has isn't that advisors are making more money; it's that clients don't know about the extra commission. "The advisor doesn't explain how this is going to increase his compensation, and then they're offside."*

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*To solve conflict-of-interest issues, Geller says, it's imperative that the advisor tell the client he's getting a kickback when an investment loan is used to purchase additional funds. If the client is informed and agrees to the loan, then "it's not a problem as long as the advisor puts the client's interest first at all times." "The advisor has a duty to say, 'I'm going to be making more money off you taking more risk,'" he says.*

This practice of leveraged investing is defended by the industry because it is lucrative and there is little if any risk for industry even when the investor loses everything. The article writes about Geller's experience with victims and states;

*The lawyer cites one case where a woman in her 70s sold her farm, and the advisor put all the proceeds into a leveraged product. When the investment lost money, margin was called, eventually draining the woman's entire investment. "As a result, she was in her 70s and driving a school bus," says Geller, who acknowledges that this is an extreme case. "She's in her 70s, and it's ridiculous to think that she has a ten-year time horizon or longer."*

This article is particularly interesting because it brings out the fact that although the industry realizes the increased risks for the investors they continue to promote these practices and employ a poorly educated sales force to mislead investors while at the same time using legal staff and disclosure written in legalese to protect themselves when inevitably they will face aggrieved investors in civil actions.

Brian further elaborates when he writes:

*While avoiding huge risks for the average person might seem like a no-brainer, Geller says a lot of advisors don't know enough about the potential downsides to investment loans. He adds that he's been to many information sessions related to these products but has never heard a company discuss the associated risks. "Not once have I seen the downside risk illustrated in any of the sales material. They may explain it in small print, but even lawyers have problem reading the legalese. What about the average consumer?"*

...

*Geller's not so sure that education coming from the mutual fund company is giving advisors the full scope of the risks. He says the companies promote the positive aspects of the products without fully disclosing the risks and suitability requirements. He adds that companies fail to compare their products with ones from other firms, so advisors can't tell if their option is better or worse than someone else's. "That puts the responsibility on the back of the advisor to do expansive due diligence, or to have failed in their duties."*

Leveraged investments are just another one of the many predatory practices used by the investment industry to part seniors from their savings.

## **CANADA IS THE WILD WEST OF INVESTING - WITHOUT FRONTIER JUSTICE**

Canada has earned the reputation of being the "Wild West of Investing" but we seem to have no application of justice as they did in frontier days. The regulators try to create

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the perception that the industry is being regulated yet the financial predators escape with the loot with monotonous regularity. The SROs proudly disclose their disciplinary actions to create a perception of regulatory activity but the reality is the penalties are paltry and the victims receive no restitution. The fines are no longer collectible when the perpetrators have defrauded their clients of fortunes that enable them to retire. The situation is appalling. Below we contrast action in Canada and U.S. Action. In Canada actions which appear to be fraud are subject only to small fines. While the regulators claim they report all fraud to the police, their definition of fraud seems at best questionable. The production of false or misleading material by Altimum in the MFDA case below was not reported to police according to sources. It seems that Canadian fraudsters have nothing to fear except American Justice.

**The Mutual Fund Dealers Association – Investigating Altimum and Portus**

In the MFDA summary of facts they indicate Altimum is registered as a mutual fund dealer and a limited market dealer in Ontario and entered into a referral arrangement with Portus Alternative Asset Management Inc. In February 2005, the Ontario Securities Commission issued orders requiring Portus and its affiliates to cease trading in securities because of apparent breaches of the Securities Act. Bankruptcy and enforcement proceedings were commenced against Portus. Altimum repaid about \$117,000 in referral fees to its clients.

In March 2004, Altimum produced two pamphlets to solicit investments in Portus securities and similar exempt securities. One of the pamphlets promoted an investment product referred to as the Retirement Security Investment Plan ("R.S.I.P."). The other pamphlet described and promoted the merits of what appeared to be a unique investment tool called the Portfolio navigator. Neither the R.S.I.P nor the Portfolio Navigator investment process existed. Both concepts were the creation of Altimum designed to induce clients to invest in Portus securities.

The Respondent sent the RSIP Pamphlet and the Portfolio Navigator Pamphlet to approximately 150 clients and displayed the pamphlets in one of its offices and on its website, where clients or potential clients could obtain copies. Of the total amount of \$3.3 million invested in Portus securities by clients of the Respondent, more than \$2,750,000 was invested by approximately 70 of the 150 clients to whom the Respondent mailed copies of the pamphlets.

Altimum paid a fine of \$10,000.

**Investment Dealers Association investigates Donald Little of TD Waterhouse**

The investigation revealed that Mr. Little's client, LJM a widow over 90 years of age, gave him a cheque in March 2006 for \$500,000 payable to him personally. Mr. Little liquidated securities in LJM's account of approximately \$1.1 million representing virtually her entire net worth (generating approximately \$45,000 in deferred service charges), and transferred the proceeds of the sale of securities to the chequing account of LJM. Mr.

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Little then deposited the cheque for \$500,000 from LJH into his personal account at TDW. This issue came to light when employees at LJH's bank questioned this transaction. (Deferred sales charges for seniors appears to be accepted practice.)

Mr. Little was assessed a fine of \$15,000.

### **High-flying con man lands in U.S. prison**

Randy Boswell of CanWest News Service writes:

*A Canadian who seemed to be living the American dream on the California coast -- a yacht, a 2006 Ferrari, a sprawling, multi-million-dollar mansion in a wealthy enclave at seaside Monterey -- has been jailed for 24 years for a massive swindle.*

We continue to see the U.S. sentencing perpetrators to jail for scams and frauds while the Canadian regulators fail to protect investors and fail to prosecute the perpetrators.

Boswell writes:

*Zubick was a popular and trusted investment advisor from Toronto, who'd made a great life for himself and his family in his adopted U.S. The 42-year-old business whiz was running a marathon investment swindle. The scam lasted seven years and drained some US\$16-million from the savings of 29 victims in the U.S. and Canada.*

In Canada financial predators rarely face jail time, penalties are ridiculously weak, and perpetrators are allowed to escape with the loot while victims are left on their own to try to gain restitution. South of the border, the U.S. seems to take a more realistic approach to financial crime. Boswell writes:

*In one of the harshest punishments ever given in California for a white-collar crime, Zubick was sentenced on Thursday to 24 years and eight months in jail -- the maximum allowable sentence, minus a few months for time served. Moreover, he will face deportation back to Canada the day he gets out of prison. Zubick was also ordered to pay restitution of about \$12-million to his victims. Ms. Michaels said the amounts lost by Zubick's victims ranged between \$25,000 and \$6-million. Retirees have been forced back to work and young couples have lost their homes.*

### **Serial swindler unmasked - Canadian Behind What Prosecutors Called One Of America's Most Devastating Investor Frauds**

In a recent National Post article, A. Humphreys rites about Canadian Barnabe:

*In 1995 in Ontario, he pleaded guilty to selling unregistered securities, and in 1999 in Quebec, he was convicted on more securities infractions. By the time of his Quebec conviction, however, he had already moved to Grenada and was training those who were selling the bogus bank investment to pensioners and credulous investors in Canada and the United States.*

*Between 1996 and 2000, Barnabe and several colleagues set up and ran a series of offshore banks with respectable-sounding names, including Fidelity International Bank and First International Bank of Grenada. Their brochures were slick and*

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*colourful with an alluring slogan: "Offshore investing: Legal, safe, simple and wise." They promised outlandish rates of return without risk. The pitch was perfect. Thousands of investors ploughed millions of dollars into the banks that promised "safety and liquidity through insured and guaranteed high-yield investments." ... Prosecutors in Oregon describe the scheme as one of the most devastating investor frauds in America and this week Barnabe, 68, was sentenced to six years in prison, ordered to pay US\$26-million restitution and forfeit money in Canadian banks.*

**THE CONCLUSION**

It is little wonder that the Finance Minister is interested in having a Canadian Securities Regulator rather than the mish mash of provincial regulators that are failing to provide investor protection now. It must be embarrassing for any Government official when they talk with other countries about investment. It seems Canadian fraudsters, whether they are small time independents or big time working for the banks, are able to commit fraud, or at least commit actions that appear to ordinary individuals to be fraud, and escape incarceration. Instead they escape with the loot and either pay small fines to continue operating or retire and avoid paying the assessed fines.

Canadian scams are occurring with irritating regularity. At least the media is exposing this chicanery to the public. Now the public must act to force politicians to take action to clean up the investment industry and provide some investor protection or else seniors will continue to have their retirement security at risk.

Too many Canadians are falling prey to similar schemes and industry practices that are not far removed from this type of blatant fraud. There is an extreme lack of enforcement in Canada and our legal system appears incapable of dealing with these issues.

When will Canadians wake up and demand a regulatory system that protects investors? It's time that we demand Government take action to revise our regulatory system, establish a national regulator, establish a national tribunal for dealing with financial crime, and prosecute the perpetrators. The investment industry must be made to pay for an insurance to protect the victims of the pervasive practices that deprive seniors of their retirement security.

**Federal finance minister repeats call for a national securities regulator**

From Canoe Money, August 30, 2007

CALGARY (CP) -- Finance Minister Jim Flaherty repeated his call Thursday for the creation of a national securities regulator in order to improve Canada's international reputation, especially in the area of enforcement.

"A common securities regulator could serve as a single contact for law enforcement agencies because quite frankly, our reputation abroad is not strong and, I'm putting it mildly, it is not strong with respect to securities enforcement," said Flaherty in a speech to the Canada West Foundation.

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"We need a regulatory framework that is world class," he added. Flaherty has told his provincial counterparts that the existence of 13 separate securities regulations for the various provinces and territories in Canada is inefficient and makes it difficult to enforce the rules.

The problem, says Flaherty, is that with 13 jurisdictions operating independently, often using different police forces to conduct investigations, there is little co-ordination and sharing of information.

Canada's has historically had a poor record in identifying and prosecuting white-collar crimes, especially when compared to the U.S., where recent high-profile prosecutions have include Martha Stewart, Enron officials, and Canadian-born former newspaper baron Conrad Black.

In one of the few high-profile cases that have gone to court in Canada, former Bre-X vice-chairman John Felderhof was acquitted on eight counts in the biggest stock market swindle in Canadian history.

Investors were duped out of an estimated \$6 billion after it turned out that the so-called world's largest gold find was actually an elaborate hoax to drive up the company's stock.

In June most provincial finance ministers turned down Flaherty's proposal to quickly move to a single regulator with uniform national rules, instead opting for the "passport system" which tries to co-ordinate and harmonize securities laws across jurisdictions.

"The reality in securities regulation in Canada today is that Ontario regulates 85 per cent of the securities in this country through the Ontario Securities Commission and the Toronto Stock Exchange," said Flaherty. "This is an opportunity for all regions of Canada to have some real influence in the regulation of securities and the enforcement of securities."

Flaherty said the passport system that's being proposed by all the provinces and territories except for Ontario still leaves in place 13 regulators with 13 sets of laws and 13 sets of fees. He intends to go ahead with a plan to name an expert panel in the near future which is expected to recommend approaches for improving the current system.

"We have a strong financial services sector and it has a great reputation generally speaking abroad. The world sees that potential but we have a capital markets regulatory system that is holding us back," he said. "It's a great opportunity that we're missing."

Canada has poured \$120 million into an RCMP securities enforcement project with nine teams across the country. But the teams have laid few charges and the government appointed Nicholas LePan, a former superintendent of financial institutions, to make recommendations on how to make them more effective.

## QUOTATIONS WORTH REPEATING

*"I think enforcement with respect to securities is an embarrassment internationally to Canada. We need to better protect investors against breaches of securities law and we need to do that in our own country and not rely on other countries to do it for us."*

Finance Minister James Flaherty (Article from the Canadian Press – August 2, 2007)