SIPA Sentinel

November 2009

SIPA's mission: To aid public awareness of how the investment industry operates, to provide guidance to those with an investment complaint, and to pursue improved investment 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 investment and regulation. These are meant to help increase investor awareness, and SIPA may not share these opinions.

HOW YOU CAN HELP – Beta Pro-Leveraged ETFs

Dr. Al Rosen, a forensic accountant with Accountability Research Corporation (ARC), has been exposing much of the "trickery" that has caused Canadian investors to lose money. For many years he has been exposing these issues. It was the ARC Report on Business Income Trusts that brought this issue to light. Dr. Rosen serves as an Expert Witness in many of the major cases involving business fraud, and regularly writes articles that are helpful for investors, many of which appear in the Sentinel and on the SIPA website.

Dr. Rosen is investigating Beta Pro-Leveraged ETFs and asks *"Do you know of any investors who lost money on any of their so-called ETFs? If so, could you please provide their name and address/phone, etc.?"*

If you have lost money with Beta Pro Leveraged ETFs please let me know or contact Dr. Rosen directly at: *al.rosen@rosen-associates.com*.

DO THE REGULATORS DECEIVE THE PUBLIC?

There has been discussion over the fact that the regulators register individuals as sales representatives while the industry passes them off as Investment Advisors, Financial Consultants or some other equally misleading title for a salesperson. When investors lose money the industry uses the argument that investors are responsible for investment decisions and the sales representatives only facilitate the sale.

As part of the deceit the regulators register certain individuals as "ADVISER". You will note that this is spelled with an "e" instead of an "o". In their minds the industry/regulators believe this distinction is sufficient. Unfortunately they are not as honest as Anne of Green Gables who said her name was "Anne with an 'e' " because this little girl realized that "Anne" and "Ann" sounded the same when spoken.

Now the CSAs have taken action by changing the registration to “dealer’s representative.” Is this an attempt to continue deceiving the public?

No matter what they call their representatives, the firms who provide advice and/or sell financial products should be held to a fiduciary responsibility when investors depend upon them for advice or guidance. Only the discount brokers who offer a service of facilitating trades should be exempted from fiduciary duty, but still have a duty of care.

THE U.S. PROPOSES MAKING FINANCIAL REPRESENTATIVES FIDUCIARIES

The media reports that the Dodd bill would make reps fiduciaries and says “The Senate Banking Committee's plan to overhaul Wall Street has received a cool reception in the brokerage world. The Senate draft, unveiled last week, eliminates the “broker-dealer exemption” from the adviser registration provisions under the Investment Advisers Act of 1940, effectively requiring brokers providing advice to register as advisers and be subject to a fiduciary standard. That standard would be the same applied to advisers and would require them to put the client's interests first.”

It’s time that Canada, or the provinces, takes similar action to ensure that those who are providing advice and selling financial products are held accountable as fiduciaries. For too long the industry/regulators have been playing with words and using legal jargon and fine print to deceive the public and deny responsibility.

There are issues which make it less than a simple fix as broker dealers that act as principles in a transaction could have a conflict of interest. Firms that raise financing will sell products to their clients that may not be suitable for them and are not putting the clients’ interests first.

What is needed in Canada is an Authority with a mandate to protect investors and the power to investigate and order restitution where appropriate in conjunction with an Investor Protection Fund from which restitution can be paid to victims.

These are issues which we must pursue.

OTTAWA PROPOSES CRACKDOWN ON WHITE COLLAR CRIME

There is little deterrent for white collar criminals. Whether it is the con artist preying on the public, a psychopath taking advantage of friends, family and affinity groups, or a registered representative taking advantage of clients, they have little to fear. The chances of getting caught are slim, the penalties imposed by regulators are insignificant and the chance of being sentenced to jail is remote. If they are sentenced to jail they can apply for parole after serving just one sixth of their sentence, and sentences generally are less than seven years. Call your Member of Parliament to support revised legislation with particular emphasis on white collar crime. You owe it to your children and future generations.

The recent publicizing of a large number of scams has convinced Government to toughen legislation to make it more difficult for the perpetrators to get out of jail quickly. There is no doubt that the Canadian public is getting angry and frustrated over the amount of white collar crime and the failure of legislation to protect the public. The recent Ottawa demonstration by Nortel retirees has focused attention on this issue and Government is proposing action to provide protection for retirees' pensions.

NORTEL WORKERS ABUSED BY JUSTICE SYSTEM

It's time for Canadians to demand change to our legislation. Canadians are regularly being abused and they are not protected by the law. It is little wonder that Canada has gained the reputation of being a haven fro crime and criminals.

The laws favour big business and the rich and powerful: the average Canadian pays the price. Canadians are losing their savings and retirement security at an amazing rate. The recent Ontario Appeals Court decision reaffirms the failure of our legislation to protect the average Canadian. Nortel's restructuring under Canadian bankruptcy laws has brought this issue into the limelight once again. The Canadian Press reports ""After the bankruptcy filing, Nortel workers who lost their jobs, severance payments or pensions are considered lower level creditors and typically receive their payments if any money is left after repayment of debts owed to the banks, trade creditors and bondholders."

Canadians must stand up for their rights and demand changes in legislation or accept that their retirement security will continue to be at risk. Whether they have retirement savings or pension plans with long established companies they are at risk of losing that security because they are not protected by legislation.

NORTEL APPROVES MORE EXEC RAISES – from CBC News

*Technology giant Nortel has been selling off its units since falling under bankruptcy protection in January. (Rebecca Zandbergen/CBC)*Management at Nortel Networks Corp., already under fire for handing out executive bonuses, approved a plan this fall to give another round of raises to its top managers, according to an internal corporate document obtained by CBC News.

The raises, in the form of increases in salary, investments or bonuses, are part of the company's plan to retain employees as it restructures after filing for bankruptcy protection in January.

But they come at a time when many laid-off and retired Nortel employees are having to fight the company in court for their severance packages, pensions and disability payments. The former employees contacted by CBC were outraged at what they say is another example of corporate greed.

"I am shocked," said Melanie Johannink, who worked for Nortel for 18 years before being laid off in the spring. "It kind of makes you wonder where the money is going."

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Before departing in August, Zafirovski had already riled up retired and laid-off employees when he proposed $45 million in bonuses to key executives. The bonuses were approved by a U.S. bankruptcy court in March, a month after the company announced 3,000 job cuts.

*"Former Nortel Networks president Mike Zafirovski appeared before a House of Commons finance committee in June. Zafirovski defended the company's decision to pay out bonuses to top executives soon after thousands of jobs were cut. (Sean Kilpatrick/Canadian Press)*Zafirovski defended the payments, saying they were necessary to retain vital executives who might otherwise flee the flagging company as it tried to maximize the sale of its assets and pay off creditors.

However, he told a House of Commons finance committee looking into Nortel's situation that the company's constrained cash resources and competing creditor claims meant it wasn't possible to pay severance to laid-off employees. He also said the company decided to trim the value paid out for pension benefits to reflect the pension plan's current funding levels."

"Zafirovski further enraged retired Nortel employees when he made a filing in October with a U.S. bankruptcy court naming himself as a creditor and claiming more than $12 million US from the company, about half of which was for pension benefits. That claim is still under review."

Not only Nortel employees, but all Canadians should raise their voices with their Members of Parliament to improve retirement security.

PICKING THE RIGHT ADVISOR

Madhavi Acharya-Tom Yew writes in the Toronto Star *"Getting the right advice is crucial, but picking the right advisor is most important."* She writes that although do-it-yourself investing is on the rise Canadians feel more comfortable with an investment advisor and writes:

So how do you select one?
The short answer is: Carefully.

She also provides sound advice when she writes *"Interview several advisers, and ask questions about their style and what services you can expect to receive to receive."*

We believe it is essential to check with the provincial securities regulator in your province to ensure that the proposed advisor and the company are registered and what products they may sell. At the same time you should enquire whether they have been disciplined for any infractions.

Madhavi quotes Michael Walker, Vice President and Head of Branch Investments at Royal Bank of Canada who states *"You are hiring them (advisers) to look after arguably one of the most important things in your life. You are trusting your wealth to this person to manage on your behalf."*

She also provides good advice in suggesting that you *"Ask your adviser how he or she is compensated, whether it's a salary, a fee for specific services, sales fees and commissions or a fee based on the amount of assets under management "* and *"Find out how often you will get together."*

We believe it is essential that you ask about the reporting on your account. It should show you how your account is performing as compared to an appropriate benchmark.

Her last bit of good advice is *"Now you need to ask yourself a few questions: do I trust this person, does he or she understand my financial goals and is this financial plan we've developed right for me? Of course steer clear of anyone who is making guarantees about investment performance, or any promise that sounds too good to be true."*

The Investment Industry creates products that are good for the industry but often cause grief for the investor. Even mutual funds which were believed to be a good concept in that they offered diversified investment have been created so some of them can be very high risk. As a result many investors have seen their investment in mutual funds prove quite unsatisfactory.

Business Income Trusts have been a bad experience for many with distributions being reduced or suspended and as a result the unit prices have suffered. In some cases the businesses have gone bankrupt and investors have lost their money.

One of the products created is the Principal Protected Note. Once again although the concept seems good in that the principal is guaranteed, the real problem lies in the fact that the guarantee applies only at maturity. If the payments are suspended and you wish to cash out before maturity you will take a significant loss. The following e-mail outlines this particular issue.

ANOTHER PONZI SCHEME – THE BCSC TAKES ACTION

There has been exposure of numerous Ponzi schemes since the market meltdown. The British Columbia Securities Commission has announced action taken with regard to a Ponzi scheme. The following notice appears on the BCSC website, but there is no mention of any criminal action.

Vancouver – A British Columbia Securities Commission Panel has permanently banned four B.C. residents, and ordered them to pay $26 million in penalties and to disgorge $16 million for operating a Ponzi scheme.

On Aug. 4, 2009, a BCSC panel found that Hal (Mick) Allan McLeod, David John Vaughan, Kenneth Robert McMordie (also known as Byrun Fox), and Dianne Sharon Rosiek violated securities laws when they fraudulently distributed securities and made misrepresentations through Manna Trading Corp Ltd., Manna Humanitarian Foundation, Legacy Capital Inc., and Legacy Trust Inc.

The panel found that McLeod created the Manna scheme, and he expanded it with Vaughan's help, and later more aggressively expanded it with the assistance of McMordie (who used the name Byrun Fox) and Rosiek. The panel found that McLeod, Vaughan, McMordie, and Rosiek fraudulently used investors' funds to enrich themselves before the scheme collapsed in 2007.

Noting that Manna's 800 investors lost up to US $13 million, the panel said, "Nothing strikes more viciously at the integrity of our capital markets than fraud, and this case represents a particularly aggressive and flagrant assault on the public's confidence in our markets."

In its sanctions decision, the panel fined McLeod $8 million, and ordered Vaughan, Rosiek, and McMordie to pay penalties of $6 million each. The panel also ordered each respondent, including the companies, to disgorge the $16 million the scheme obtained from investors.

In addition, the panel permanently banned McLeod, Vaughan, McMordie, and Rosiek from trading securities or exchange contracts and from being a manager or consultant in connection to the securities market. They are also prohibited from being a director or officer of any issuer, registrant or investment fund manager, being a registrant, investment fund manager or promoter, and from engaging in investor relations activities.

The panel also permanently cease traded the securities of Manna Trading Corp Ltd., Manna Humanitarian Foundation, Legacy Capital Inc., and Legacy Trust Inc., and permanently banned the companies from trading securities or exchange contracts.

The B.C. Securities Commission is the independent provincial government agency responsible for regulating trading in securities within the province. You may view the decision on our website www.bcsc.bc.ca by typing in the search box Hal (Mick) Allan McLeod, David John Vaughan, Kenneth Robert McMordie, Dianne Sharon Rosiek, or 2009 BCSECCOM 595. If you have questions, contact Ken Gracey, media relations, 604-899-6577.

Learn how to avoid investment fraud at the BCSC's investor education website: www.investright.org.

ARE CANADIAN INVESTORS GETTING SMARTER?

IFIC reports that Canadians took $291.4 million out of mutual funds in October as net redemptions outpaced net sales. Still fund assets totaled $573 billion up from $522 billion in October 2008.

The concept of mutual funds providing diversified investment is essentially good but industry has developed a proliferation of funds which make it difficult for most investors to select suitable funds. Even the best funds have Management Expense (MERs), sales commissions and trailer fees which cut into performance for investors. As a result many mutual fund investors find that they make very little with their investments and sometimes lose money, particularly when they have leveraged mutual fund investments.

Although we believe that Exchange Traded Funds (ETFs) are a better investment vehicles than mutual funds for most investors because the management fees are much less than funds and they can be freely traded without redemption fees.

TAX FREE SAVINGS ACCOUNTS (TFSAs)

As we approach the end of the year it will soon be time to make another investment in your TFSA. Unfortunately not everyone is aware that this is really an investment account in which you can hold all types of investments that you can hold in registered or non-registered investment accounts. In January you will be able to invest another $5,000. There is no tax exemption for the money you invest, but there is no tax on any withdrawals. All of the gains, whether interest, dividends or capital gains will be tax free.

There may be advantages for some investors to first put their investments in a registered account, but it will depend upon your particular tax situation. Think dividend paying shares, ETFs and bonds. Be sure to diversify. Make each investment about $1,000 to start. Another advantage of the TFSA is that you can make withdrawals any time without paying tax and theses amounts can be replaced at a later date.

IT SOUNDS TOO GOOD TO BE TRUE

In these days when returns on fixed income investments are low there is a proliferation of offers that are enticing. In the Toronto Star Investment Market Place this morning the following are listed:
14% per annum – Fixed Rate paid monthly – NEWSTARTCANADA.COM
10% per annum – Fixed Rate paid monthly – Carter Securities Inc.
13% per annum – Fixed Rate paid monthly – Liquid Capital
12% per annum – Fixed Rate paid monthly – Nelson Investment Group
Most of these are for “Accredited Investors” and there is no mention of risk.

Investors should realize that high rates of return indicate high risk and that loss of your money is highly probable. Unfortunately many Canadians succumb to these offers and end up losing a major part of their investment. Always consider risk of loss.

Avoid becoming a victim of these offers that sound too good to be true.

FROM THE SIPA MAILBAG

The following e-mail received by SIPA vividly illustrates why Principal Protected Notes can be a poor investment even when the guarantee is honoured by a major bank.

"I am a small investor and, to my shame, only became aware of your organization when I got angry about a Principal Protected Note which I was sold by an RBC investment advisor ten years ago.

The PPN was paid out two months ago, and my principal of $80,000 was returned to me – without a nickel of profit after ten years.

This note represented half the money I had available in 1999 for the college education of my three then-young children. Receiving no return on that money for an entire decade is tantamount to losing about forty per cent of it through inflation. My first inkling of the dishonesty behind PPNs came in the form of one of Tom Bradley's columns in the Report on Business a year or so ago.

RBC's representative collected trailer fees from that money every year for ten years – a fee of which I was not informed when I purchased them.

My question is this: Should there not be a class action lawsuit against the financial institutions which sold these products? I am retired now, and will be compelled to dip into my retirement savings to pay for my kids' university education. Why should RBC and its overpaid 'advisers' walk away from this scot-free?"

CANADIAN SECURITIES TRANSITION OFFICE

The Government of Canada has established the Canadian Securities Transition Office (CSTO) to lead the transition to a single Canadian securities regulator. The CSTO will work with participating provinces and territories and consult with market participants to ensure an effective transition

A SIPA delegation is scheduled to meet with the CSTO on January 11, 2010. SIPA will also participate in a round table discussion with the CSTO on January 22, 2010. SIPA will also represent the Common Front for Retirement Security (CFRS) as Dan Braniff, the founder of the CFRS is out of the country.