



**SIPA's mission: To aid public awareness of how the investment industry operates, to provide guidance to members with an investment complaint, and to pursue improved investment industry regulation and enforcement.**

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**Small Investor Protection Association - A voice for small investors**

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## **SIPA SENTINEL**

The SIPA Sentinel is issued bi-monthly. From time to time articles and re-prints are included 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.

### **THE DANGERS OF MARKET VOLATILITY**

Recent market volatility and especially the extreme volatility of May 6<sup>th</sup>, 2010, revealed some of the risks faced by ordinary investors when they invest in equities or equity based funds. Stop Loss orders are a mechanism that can be used to mitigate the risk of loss in equities, but care must be taken to also place limits to guard against extreme short term declines as happened on May 6<sup>th</sup>, 2010. If a Stop Loss order is placed without limits the price may temporarily plunge when buyers are not available to levels at which you would not want to sell. The Investment Industry Regulator of Canada (IIROC) which incorporates the former Market Regulation Services (MRS) has already investigated and has either reversed some trades or revised prices of the trades. This is one area that Canadian regulators can do a good job.

Unfortunately they seem to be deficient when it comes to investor protection and enforcement related to investor protection. The events of May 6<sup>th</sup> caused the market regulators in Canada to issue the following press release:

*For Immediate Release- Friday, May 14, 2010*

#### **Canadian Regulators Analyze Issues Arising from Recent Market Volatility**

*Toronto – The Canadian Securities Administrators (CSA) and the Investment Industry Regulatory Organization of Canada (IIROC) are conducting a comprehensive analysis of the events of May 6 in relation to the volatility that occurred on U.S. and Canadian marketplaces. The CSA and IIROC are engaged in active dialogue with other regulators, marketplaces and market participants to examine issues related to the market volatility as well as the increased reliance on electronic trading.*

*"In today's dynamic markets, where trading is increasing in speed and complexity, the CSA and IIROC are looking very closely at the risks involved in electronic trading," said Jean St-Gelais, CSA Chair and President and Chief Executive Officer of the Autorité des marchés financiers (Québec). "The events of May 6 indicate how rapidly market conditions can change. The CSA and IIROC are addressing the key risk factors and are committed to reviewing the existing market regulatory framework to ensure protection of investors and market integrity."*

*On May 6, Canada's marketplaces were impacted by events occurring in U.S. marketplaces. Although the volatility in Canada was not as extreme as in the U.S., IIROC quickly responded by re-pricing or canceling some unreasonably priced trades that were transacted between 2:40 p.m. and 3:10 p.m. EDT.*

*In Canada, there is one set of rules, the Universal Market Integrity Rules (UMIR), that apply to trading on all equity marketplaces. There are currently three equity exchanges and six equity*



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*Alternative Trading Systems (ATs) operating in Canada. UMIR rules allow IIROC to halt or suspend trading on a stock-by-stock basis or to impose a market-wide halt through the use of circuit breakers, which are applied consistently to all Canadian equity marketplaces. The CSA and IIROC are examining a number of electronic trading issues, such as the need to standardize parameters used by Canadian stock exchanges and ATs. Currently, some marketplaces use "freeze parameters" on their trading engines that allow them to freeze trading in specific securities where a significant price change occurs. This allows them to determine if a sudden price movement is due to potential erroneous trades. Currently, the use of these parameters is not consistent amongst the exchanges and ATs and the CSA and IIROC are addressing that inconsistency.*

*Susan Wolburgh Jenah, IIROC President and CEO, confirmed that "IIROC is continuing to closely monitor all trading on Canadian equity marketplaces to ensure market integrity. We are also conducting a review of trading that occurred during this period of extreme volatility to identify any potential regulatory issues."*

*In addition, the CSA and IIROC are examining the appropriateness of the existing circuit breaker policy. IIROC is also reviewing all relevant policies and practices under UMIR as they relate to these matters.*

*The CSA, the council of the securities regulators of Canada's provinces and territories, co-ordinates and harmonizes regulation for the Canadian capital markets.*

*IIROC is the national self-regulatory organization which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada.*

## **FINANCIAL LITERACY AND CANADIAN INVESTORS**

SIPA maintains that investors need to become aware of how the investment industry operates and the different types of products that are available. It is improbable that Canadians will all become astute investors as long as their lives are full with career and family responsibilities. In a trusting society Canadians will continue to place their trust in the financial services industry and for that reason Government must hold the financial services industry accountable.

The Government established a Task Force on Financial Literacy and SIPA made a submission on April 29, 2010, which concluded that:

*Government action is needed if Canada is to be perceived in future as a "just society" rather than the wild west of investing and a land where we live by the law of the jungle.*

*Let's call a spade a spade and deal with the issue. There are two options:*

- 1. Reveal the truth and warn all Canadians that it is INVESTOR BEWARE.*
- 2. Reveal the truth and take action to introduce legislation that places responsibility where it should be rather than place it on the shoulders of individual Canadians.*

*To take no action will result in even more Canadians losing their savings due to investment fraud and wrongdoing.*

*Financial literacy may be a part of the solution but what is needed is a total solution that will be effective to prevent the devastation currently caused by the failure of Government and regulators to protect the investments and savings of individuals.*

*We believe the investment industry should have a fiduciary responsibility and victims of investment fraud and wrongdoing should be exempted from current reduced limitation*



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*period. The devastating impact of losing life savings makes it impossible for most Canadians to react rationally and determine a course of action within two years.*

In his mid March Observer Ken Kivenko provides commentary as follows:

**Minister of Finance Welcomes Task Force Consultations on Financial Literacy**  
<http://www.fin.gc.ca/n10/10-012-eng.asp> *There are a number of issues and questions on which they would like your feedback. These are provided in their consultation document – We have provided feedback expressing concern that regulatory reforms could be stalled if too much value is placed on increased retail consumer financial literacy. What is missing from the 45-page report is any acknowledgment that Canada's financial institutions played a major role in the losses Canadians suffered in the recession. Seniors, retirees and pensioners blame bad financial advice, not their own lack of planning or willpower, for the loss of their nest eggs. Many citizens blame the financial institutions for creating such a blizzard of expensive, complex products that they need professional help to navigate the maze. Think mutual funds, ABCP ...Investor advocates assign a lot of the issues on regulators that just don't have a focus on retail investor protection. The OSC and FCAC are regarded as negligently weak regulators. You can provide your feedback to the Task Force via an on-line submission form*  
<http://www.financialliteracyincanada.com/eng/consulting-with-canadians/have-your-say.php>

*It should be clear that financial literacy is necessary but insufficient. Today's products are simply too complex for most people. The key is to educate people on how the financial industry works, how fees erode returns, the magic of compound interest and how to prevent having to make a complaint. People need to be taught to be less trusting and more inquisitive about financial products and services. For example, we have the highest mutual fund fees in the world because Canadians are too trusting and don't realize all the commissions built in and the impact these expenses have on returns over the long term. This is taking a very heavy toll on retiree and pensioner nest eggs*

## SENIORS SEMINARS EASTERN ONTARIO

Seniors' seminars are planned in eastern Ontario on Monday June 21 Millbrook, Tuesday June 22 Beaverton, Wednesday June 23 Apsley, Thursday June 24 Lindsay, Friday June 25 Haliburton.

These seminars are sponsored by local Members of Parliament and organized by Judy Muzzi, Past President of the United Senior Citizens of Ontario. These seminars bring together service suppliers for seniors including Government agencies and non Government organizations. Once again Judy has invited SIPA to participate and speak about investments and investor protection. Tax Free Savings Accounts and Reverse mortgages will be discussed along with other topics. If you live in these areas you should plan to attend as there is a great deal of information to help seniors and retirees. I will look forward to speaking with you.

## **Investors must increase scrutiny of boards**

**The new international accounting standards will make comparisons more difficult**

Al and Mark Rosen

June 2010



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*While it's true that corporate governance has always been a major concern in Canada because of clubby boardroom atmospheres, the problem has been brought into much sharper focus by unfolding events. The result is that board directors are now investors' last best hope for fair treatment in Canada.*

*A critical concern — starting now, and for years to come — will be Canada's switchover to a new brand of accounting rules, known as international financial reporting standards. Gauging how boards react to the turmoil will tell investors all they need to know about whether directors are falling short in maintaining their independence and carrying out their expanded duties to investors.*

*IFRS was adopted in Canada by the Accounting Standards Board, which is financially controlled by the audit firms. The board decided it would no longer financially support separate accounting standards for Canada, so it chose to follow much weaker IFRS over U.S. generally accepted accounting principles. The AcSB initially argued that Canadian GAAP was more ideologically aligned with IFRS, a statement since retracted. Not to be ignored is the fact that the audit firms have received a massive fee windfall for switching corporate clients to IFRS. IFRS also embeds much more management choice, a characteristic that auditors can use to escape legal liability to investors by essentially downloading oversight responsibilities onto corporate directors.*

*Meanwhile, our closest trading partner and neighbour, the U.S., has easily grasped the significant deficiencies of IFRS. To quote one U.S. accounting journal: "IFRS adoption will usher in an era of financial statement manipulation that is historically unprecedented. Initially, the Big 4 and the [American Institute of Certified Public Accountants] were touting that IFRS would increase comparability. They seldom tout this today, as it has been convincingly shown that the flexibility and professional judgment embedded in IFRS will make fuzzy numbers a certainty and comparability an impossibility."*

*Canadian lawmakers and securities regulators are either unaware of the potential negative results for investors in adopting IFRS or simply do not feel any pressure to act. Many parts of the new accounting standards throw Canada backward by decades in terms of appropriate financial disclosure to investors. One example is not requiring financial services companies to disclose separately the amount of cash coming into the firm, a critical factor that can alert investors to potential bankruptcy. IFRS also introduces ideas that are completely foreign to Canadian investors, such as the ability to revalue assets on a quarterly basis, based on management estimates of their worth.*

*One company might use pie-in-the-sky estimates of value, while another might stick to using outdated historical cost figures. Take real estate companies as just one example. The ability to increase and decrease property values on a quarterly basis can have an impact on all kinds of key financial ratios, such as debt/market value.*

*There are so many choices surrounding similar critical areas within IFRS that companies are almost destined to become completely incomparable in the eyes of investors, thus severely hampering investors' ability to value stocks. Most concerning is that IFRS gives considerable freedom to corporate executives to report the financial figures they want, especially in order to make their own managerial performance look good.*

*Many wonder why IFRS was adopted in Europe and is spreading elsewhere in the world, given that the standards can be manipulated by management so easily. Europe was essentially forced by the European Commission to adopt a single accounting language to unify the disparate financial reporting on the Continent. The creators of IFRS were given a very tight deadline,*



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*which led to some significant holes being left in IFRS. Given those weaknesses, adoption of IFRS for Canada is actually a step backward for investors and directors. Canadian accounting, although far from perfect, includes many more investor-friendly attributes. It was developed over decades — not mere years, like IFRS — and is the product of many costly lessons learned. As a result, Canadian corporate directors must now become the “real” auditors, acting on behalf of shareholders. In turn, investors have to recognize this fact and step up their scrutiny of a board’s actions.*

*Investors have to look for tangible signs that a board of directors is carrying out its duties with vigour. This includes having their own budget to hire independent specialists to check the appropriateness of key executive decisions. Investigating management’s choice of accounting rules (from among the numerous alternatives now allowed by IFRS) has now become a major part of the fiduciary responsibilities of directors.*

*A disturbing sign for investors is evident when auditors also advise the audit committee and board on the acceptability of certain IFRS choices made by management. Directors should be seeking counsel from independent, non-auditing advisors.*

*Above all, specific answers must be sought on whether the board and audit committee have the ability and financial budget to act, independent of the strong influences of management and the company’s auditors.*

***Al and Mark Rosen are forensic accountants with Accountability Research Corp.***

## INVESTOR ADVISORY PANELS

Investor Advisory Panels are now a hot topic.

Several years ago the OSC engaged a consultant to prepare terms of reference for an investor advisory committee and I spent several hours with the consultant discussing issues. The OSC invited SIPA to participate, but when I learned that the OSC was not providing a copy of the terms of reference to candidates and would not be providing a public report I declined to participate. The committee was formed and operated for two years under the Chairmanship of Eric Kirzner. It did not issue any reports and was disbanded after two years.

This year the Ontario Securities Commission (OSC) announced it will form an Investor Advisory Panel, provided terms of reference on the OSC website and invited applications. The investor advocate community, at least in the Toronto area, is strongly against participation on the panel feeling the terms of reference are restrictive, and far from the recommendations made by investor advocates. It also feels that the committee should be limited to retail investors and exclude institutional investors as their issues are quite different from those of small investors. Peter Smith of the Financial Services Authority said at the recent Fiduciary Standards conference in Toronto that *“a solution will not come from the industry”*, with which I agree. The proposed OSC Investor Advisory Panel was discussed at length by SIPA’s Advisory Committee.

On the other hand there are some opinions that SIPA should participate to represent the interests of members and small investors generally, in part because SIPA is recognized as a voice for small investors.

At the same time the Canadian Securities Transition Office (CSTO) is incorporating an Investor Advisory Panel in the proposed legislation for a national securities regulator.

SIPA has long said that SIPA is prepared to work with industry, regulators and government towards a better investing environment for investors. After due consideration I decided it would be appropriate to demonstrate SIPA’s willingness to work with industry by applying to the OSC.



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At the time of my departure for Italy on May 22<sup>nd</sup> I had received no response from the OSC but heard they had received some 80 applications.

### THE IMPORTANCE OF FIDUCIARY DUTY

In Canada the responsibilities imposed by "fiduciary duty" and "duty of care" are vastly different. Although most investors believe their "Advisor" has a fiduciary duty to them, and we absolutely agree, the industry has the opinion that fiduciary duty applies only to managed or discretionary accounts.

On March 25, FAIR Canada and the Hennick Centre for Business and Law hosted the first Canadian conference focused on the fiduciary standard in the context of the financial advisor-client relationship. At the conference, the question of whether investment advisors should be required to put their clients' best interests first was considered in the context of the US proposal to implement a uniform fiduciary standard for all advisors and broker-dealers. We attended the conference and had the opportunity to speak with other participants. While many feel there should be a fiduciary standard, not surprisingly the law tends to support the industry's attitude and interpretation.

Unfortunately there is widespread industry practice of "Advisors" telling their clients that the "Advisor" will look after their account and manage it for them so they "don't have to worry about it." However, to create a managed or discretionary account there are forms that must be completed as there is added responsibility for the firm and only certain individuals are qualified to manage a discretionary account. Most "advisors" are not qualified to do so and so if they were to complete the necessary paperwork they would lose this client's commissions. As the industry "advisors" are commission driven, this is a powerful incentive for them to not complete the paperwork.

As a result many investors who believe they have a discretionary account find out when things go terribly wrong that the firm will not accept responsibility because there is not sufficient evidence (no completed forms) of a discretionary account. If you think you have a discretionary account ask for a copy of the necessary forms.

### SOME INFORMATION ON IIROC FROM THEIR WEBSITE

Many small investors are not aware of the roles of regulators. The investment industry is self regulated and this can result in issues for small investors. The following is an excellent outline of the role of SROs and their limitations. From the IIROC website:

**The Investment Industry Regulator of Canada (IIROC) regulates all investment dealers in Canada. That's why choosing an IIROC-regulated firm and advisor for your investment needs matters.**

*IIROC regulates firms*

*IIROC-regulated firms must comply with rules that minimize the possibility of financial failure and protect client assets if a firm becomes insolvent.*

*IIROC sets minimum capital requirements that require firms to have enough capital for the type and scope of their business activities. This reduces the possibility of firms failing by preventing excessive leverage and risky business practices.*



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*IIROC monitors firms' financial condition, conducts surprise on-site audits, and requires comprehensive financial reporting. We review each firm's books to verify they are current, accurate and compliant with our regulations. Firms must have their financial statements audited annually by independent IIROC-approved accounting firms.*

*IIROC requires firms to keep their clients' securities separate – or segregated – from the firm's assets. Firms must hold segregated assets in trust to minimize the risk of client assets being lost if the firm suffers failure or insolvency.*

*All IIROC-regulated firms are members of the Canadian Investor Protection Fund. Coverage is automatic when a client opens an account.*

*Accounts held at IIROC-regulated firms have additional protection through the Canadian Investor Protection Fund (CIPF). CIPF was created so client assets (including cash, securities and certain other property such as segregated insurance funds) within defined limits are protected.*

*If a client's assets are missing because of an investment dealer's insolvency, CIPF covers the shortfall to a maximum of \$1million per account. Many investors have a general account and a retirement account. In such cases, each account is eligible for \$1 million in coverage. If an investor has several general accounts, such as cash, margin and US dollar accounts, they are combined into one general account for coverage purposes.*

*Similarly, retirement accounts such as RRSP, RIF, LIF and LIRA accounts are combined into one retirement account for coverage purposes.*

*It is important to keep in mind that investment dealer failures are relatively rare occurrences in Canada. To learn more about CIPF, please visit [www.cipf.ca](http://www.cipf.ca).*

*IIROC requires that firms have procedures in place to supervise client accounts and advice and transactions reflect clients' needs and instructions. IIROC also monitors firms' trading activities so trading compliance and client needs are addressed.*

*Here are some of the tools used to achieve these outcomes:*

*Suitability and Know Your Client – IIROC-approved advisors must follow suitability and "know your client" rules. Advisors must be familiar with a client's financial situation, investment knowledge and objectives, and tolerance for risk.*

*Product Knowledge – Advisors must understand the products they sell. They must be aware of the risk/return of all securities before proceeding with a transaction, and know the relevant information about the client.*

*Supervision – Firms must have systems to supervise the activities of their advisors and client activity.*

*Marketing Materials – Firms must monitor and approve product marketing materials.*

*IIROC is here for you, the investor*

*When you choose an IIROC-regulated firm or advisor, you have access to IIROC's resources and knowledge about your firm and the marketplace.*

*Our Firm/Registrant Info Service – available on our website at [www.iroc.ca](http://www.iroc.ca) – will tell you:*

*Whether a firm is regulated by IIROC;*

*If an advisor works for an IIROC-regulated firm;*

*About an advisor's training; and*

*Whether an advisor has a regulatory disciplinary record.*

*Our website provides other information, including:*

*A Glossary of Terms to help you better understand advisors' titles and industry terminology;*



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*Recent regulatory developments, such as new policies and rule proposals; and Links to other regulators, organizations, governments and investor education sites.*

*IIROC investigates possible misconduct by firms or individual advisors and can bring disciplinary proceedings.*

*This may result in penalties such as fines, suspensions, permanent bars for individuals, or termination of membership for our regulated firms.*

*If you are making a complaint directly to a firm, they are required to comply with our standards for handling client complaints.*

*Clients of IIROC-regulated firms who wish to seek compensation also have access to an independent arbitration program made available by IIROC and the Ombudsman for Banking Services and Investments (OBSI). Residents in Québec can also access a voluntary mediation service through the Autorité des marchés financiers (AMF).*

*These options may not be available if you deal with a firm that isn't regulated by IIROC.*

### *IIROC matters*

*IIROC matters because we're committed to protecting investors and promoting fair and efficient capital markets. We are committed to sharing our knowledge and resources with our stakeholders. Don't forget to ask if your firm or advisor is regulated by IIROC.*

It should be noted that regulators will not get your money back. While they talk of protecting investors, that protection is very indirect as it is supposedly preventative. However they fail to prevent the wrongdoing. What investors need is remedial investor protection so regulators can re-instate the victims of wrongdoing. The proposed national securities regulator is to have the power to order restitution and a fund to pay restitution if Expert Panel recommendations prevail.

## **SIPA'S CHAT ROOM**

As part of SIPA's new communications we are initiating a regular members' chat room. Membership secretary Steven Johnson will be pleased to provide assistance on how it works to members wanting to participate. It is quite simple to use ... if I can learn, anyone can. I will also participate and respond to any questions. Initially it will be to provide general information for all investors. As the chat room develops and interest grows we may initiate additional chat rooms. E-mail [sipa@sipa.ca](mailto:sipa@sipa.ca) with subject "CHAT ROOM". Suitable times will be established based upon response, so please indicate your time zone in your response and preferred timing.

## **FROM THE SIPA MAILBAG**

We continue to hear from people who have lost their savings. It is tragic that so many are losing their life savings and it is so difficult to get a timely resolution. With reduced limitation periods the chances of achieving a settlement are much reduced. The following is a typical story:

*"I'm trying to help my dad, who is going through a tough time right now since his investment and retirement accounts were wiped out a couple years ago by an incompetent investment advisor at one of the large investment firms. In my opinion, the case involves misrepresentation by the advisor, along with neglect and inadequate supervision by the firm. The advisor left shortly after the loss (surprise?) and the firm is offering a meager settlement – slightly more than fees paid. They are willing to negotiate, however, I'm not sure how to best go about it, given the large gap between their offer and my father's loss."*



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Anyone who has experienced unacceptable loss needs to seek competent legal advice as soon as possible to avoid being statute barred from taking legal action. Keep in mind the two year limitation period. Members should contact SIPA for guidance.