SIPA Sentinel

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Small Investor Protection Association - A voice for small investors

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.

INVESTOR BEWARE

In 1999 Robert Goldin wrote a book entitled *"INVESTOR BEWARE"*. His book exposed how the public is being deceived by the investment industry regulator complex (IIRC). Every Canadian should read this book. You can view a PDF version of Robert's bestselling book *"INVESTOR BEWARE! – Protect Your Investments From Broker Misconduct - Second Edition"*. It is available FREE on the web at
http://www.macgold.ca/_/rsrc/1271014517090/investorbeware/InvestorBewareCoverMini.jpg?
For those without computers INVEST BEWARE is available at Chapters/Indigo.

In the United States lawyer John Lawrence Allen also published a book entitled *"INVESTOR BEWARE"*. His website provides additional information at *http://www.investorbeware.org/*. John Lawrence Allen has been prosecuting claims on behalf of investors against fraudulent stock brokers, investment advisors and wealth management companies for over 15 years.

Investors need to be aware that it is not only unregulated fraudsters like Earl Jones in Canada, Bernie Madoff in the United States, and many others in both countries that cause investors to lose their savings. There are systemic practices in the investment industry that cause investor loss. Toxic products are sold to investors that cause loss. It seems there are no restrictions.

Most Canadians invest in mutual funds because they 1. trust their "Advisors", 2. feel the industry regulators protect investors, and 3. believe that mutual funds are safe.

The reality is:

1. "Advisors" are often simply *"dealers representatives"*. Until recently they were registered as "sales representatives" yet these sales persons are allowed to call themselves "Investment Advisors", "Financial Consultants", or some other fancy title to enable them to gain clients' trust. Those who are the best sales people earn the title "Vice President" to recognize their sales volume. Although this practice seems like fraud to investor advocates the regulators allow these practices.
2. Investors believe the regulators protect investors. Taking the Ontario Securities Commission as an example, their website indicates: *"The OSC mandate is set by statute: To provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets."* One of their stated goals is to "Champion investor protection, especially for retail investors." However their preventative approach to investor protection does not prevent fraud and wrongdoing and they offer no remedial protection. Most provincial regulators are similar except Quebec which seems miles ahead of The Rest of Canada (TROC) when it comes to investor protection.
3. Investors believe mutual funds are safe because they are diversified and managed. The facts are that mutual funds are created by the industry. There is great variety and there are high fees to pay the dealers and the sales people as well as the management fees or MER. These fees are often not disclosed to the investor. Keith Ambachtsheer published a report on mutual funds that estimated Canadians are losing $25 billion a year due to excessive fund fees. These excessive fees could mean that your savings will be 50% less than if you had not paid excessive fees.

The public is being misled with creative marketing, misleading marketing material and sales pitches. As a result many are either losing their savings or their investment are stagnant although earning money for their "Advisor". Investors need to be more aware.

So what can you do?

For a start compare the performance of your account to the performance of the Toronto Stock Market. If your account performance is not better than the Toronto Stock market you should consider changing your "ADVISOR" or become a DIY Investor (Do It Yourself Investor) and invest in an ETF that tracks the Toronto Stock Exchange closely. The iShare ETF XIU tracks the market closely and is up by about 5% this year. You can learn more about iShares *at http://ca.ishares.com/home.htm* .

SIPA is introducing on-line chats to enable members across Canada to better communicate and participate. See article below for details.

THE REGULATORS KNOW

One of the most disturbing aspects of working as an investor advocate is the fact that the investment industry regulator complex knows what is going down. It is difficult to believe and impossible to accept that people can allow the tragedies that are happening to continue to happen. In 1999 SIPA recommended to the Ontario Securities Commission that they seek legislation revision to enable them to order restitution to victims of industry fraud and wrongdoing when they have found the perpetrators guilty of misconduct resulting in investor loss. Their response was they were considering it. Are they still? At the recent Fiduciary Roundtable in Toronto February 23 the regulators admitted that it is a BUYER BEWARE regime.

THE BANKS KNOW

from **Madoff Says From Prison That Banks 'Had to Know' - New York Times**

The New York Times (NYT) has dispelled any doubt that the banks know what is going down and are complicit as long as they get a piece of the action. The systemic practices in the regulated industry often depend upon co-operation from the banks to make these schemes operate ... facilitated bank loans and mortgages for investments, schemes using registered plans as sources of loot, and various innovative schemes.
The recent market meltdown exposed many frauds outside the regulated industry that also depended upon co-operation of the banks. It seems money talks. A piece of the action can provide a blind eye or a failure to exercise good governance and allow actions that a prudent banker should not without investigation

The NYT states that Bernard L. Madoff *"during a private two-hour interview in a visitor room here on Tuesday, and in earlier e-mail exchanges, he asserted that unidentified banks and hedge funds were somehow "complicit" in his elaborate fraud, an about-face from earlier claims that he was the only person involved. Mr. Madoff, who is serving a 150-year sentence, seemed frail and a bit agitated compared with the stoic calm he maintained before his incarceration in 2009, perhaps burdened by sadness over the suicide of his son Mark in December.*
Besides that loss, his family also has faced stacks of lawsuits, the potential forfeiture of most of their assets, and relentless public suspicion and enmity that cut Mr. Madoff and his wife Ruth off from their children.

In many ways, however, Mr. Madoff seemed unchanged. He spoke with great intensity and fluency about his dealings with various banks and hedge funds, pointing to their "willful blindness" and their failure to examine discrepancies between his regulatory filings and other information available to them.
"They had to know," Mr. Madoff said. "But the attitude was sort of, 'If you're doing something wrong, we don't want to know.' "
While he acknowledged his guilt in the interview and said nothing could excuse his crimes, he focused his comments laserlike on the big investors and giant institutions he dealt with, not on the financial pain he caused thousands of his more modest investors. In an e-mail written on Jan. 13, he observed that many long-term clients made more in legitimate profits from him in the years before the fraud than they could have elsewhere. "I would have loved for them to not lose anything, but that was a risk they were well aware of by investing in the market," he wrote. Mr. Madoff said he was startled to learn about some of the e-mails and messages raising doubts about his results -- now emerging in lawsuits -- that bankers were passing around before his scheme collapsed.
"I'm reading more now about how suspicious they were than I ever realized at the time," he said with a faint smile. He did not assert that any specific bank or fund knew about or was an accomplice in his Ponzi scheme, which lasted at least 16 years and consumed about $20 billion in lost cash and almost $65 billion in paper wealth. Rather, he cited a failure to conduct normal scrutiny.
Both the interview and the e-mail correspondence were conducted as part of this reporter's research for a coming book on the Madoff scandal, "The Wizard of Lies: Bernie Madoff and the Death of Trust," for publication this spring by Times Books, a division of Henry Holt & Company.

It is not unusual for the perpetrators of fraud to claim that the firms were aware of their actions. In this age of computer sophistication and management tools available it is hard to imagine that a single individual can escape detection when they are involved in a major fraud. It is no surprise to read Madoff's revelations in the New York Times and that the investment industry will question Madoff's credibility, as they also do with all of their victims. Anyone who has gone up against the industry has learned these truths.

The NYT states further: *"In the interview and e-mails, he also claimed he had been helping the court-appointed trustee who is seeking to recover lost billions on behalf of his swindled clients. In e-mails, Mr. Madoff said repeatedly that he provided useful information to Irving H. Picard, the trustee trying to recover assets for the fraud victims. He met with Mr. Picard's team over four days last summer, he said. The e-mails were written in December and January, but he only recently agreed that they could be made public.*
...
Mr. Madoff asserted in an e-mail written on Dec. 19 that he had given Mr. Picard's legal team "information I knew would be instrumental in recovering assets from those people complicit in the mess I put myself into."
In a message 10 days later, he was even more explicit about what he told the trustee: "I am saying that the banks and funds were complicit in one form or another and my information to Picard when he was here established this."
Mr. Madoff's claims must be weighed against his tenuous credibility. After deceiving federal regulators and supposedly sophisticated investors for at least 16 years, he would certainly be branded as a liar by defense lawyers if he appeared as a witness against any defendant in a courtroom -- a fact he acknowledged somewhat ruefully during the interview on Tuesday.
…
To date, none of the major banks or hedge funds that did business with Mr. Madoff have been accused by federal prosecutors of knowingly investing in his Ponzi scheme. However, Mr. Picard in civil lawsuits has asserted that executives at some banks expressed suspicions for years, yet continued to do business with Mr. Madoff and steer their clients' money into his hands. All the financial entities facing civil lawsuits by Madoff victims and Mr. Picard have denied they had any knowledge of the fraud."

Madoff's confessions ring true with what I have learned about the investment industry regulator complex over the last decade. This includes fighting a legal battle, reviewing numerous Court Decisions that provide details of cases, and speaking with thousands of small investors and industry participants.

IS THE INVESTMENT INDUSTRY PRACTRICING FRAUD?

from **Cracking Down on Commissions -** Financial Post Comment Feb 15, 2011

In mid February 2011 the Financial Post published an article by Ed Waitzer, a professor and director of the Hennick Centre for Business and Law at York University, and a former chair of the Ontario Securities Commission. He writes of how the investment industry regulator complex is able to modify any attempt to improve the situation for investors by downgrading it to perpetuate the status quo. If you read this article and still believe investing is not BUYER BEWARE, read it again.

"In January 2004, the Ontario Securities Commission released a concept paper advocating a "fair dealing model." The paper acknowledged that the regulatory regime -- regulating dealers and their representatives through the products they sell -- was based on the outdated assumption that transaction execution is the primary reason people seek financial services. Recognizing that most customers are seeking advice, the concept paper proposed changing the regulatory framework to focus on the advisory relationship.

Financial professionals and salespersons in Canada are allowed to call themselves advisors, irrespective of their professional designation. Few, however, are compensated directly for their advice. Instead, they are paid commissions to sell specific products. Addressing the conflicts of interest that result from commission-based compensation, the paper proposed that retail clients should be entitled to rely on objective advice that is in their best interest and, when there are conflicts of interest, they should be clearly disclosed so that the client can understand the conflicts and how they may affect the advice given.

In September 2004, the proposal was swept into a broader project of the Canadian Securities Administrators (CSA) and rebranded as the "client relationship model." Last month, the Investment Industry Regulatory Organization of Canada (IIROC) published its proposed reforms to establish requirements for the client relationship model. They specifically avoid imposing a duty on firms and their representatives to act in the best interest of clients, focussing instead on improving compliance with the existing "suitability" standard and improving disclosure with respect to conflicts of interest and performance reporting. IIROC noted that part of what influenced its thinking was an effort to harmonize with existing and proposed CSA standards (and other standards applicable to firms not under its jurisdiction).

To understand the difference between a "suitability" and "best-interest" standard, think of a student seeking advice at an electronics store about her need for a laptop. The salesperson recommends a highly priced unit with an expensive extended warranty -- all designed to generate the highest commission. The laptop is suitable--it will satisfy the student's needs. It clearly isn't the best solution and a disclosure obligation isn't likely to stand in the way of a motivated salesperson. If the salesperson had been bound by a "best-interest" standard, he would recommend a simpler, more reliable and affordable unit.

In the U.S., brokers and investment advisors are subject to different standards when providing investment advice. Many investors are unaware of these differences or their legal implications or find them confusing. In the wake of the global financial crisis, the Dodd-Frank Act required the Securities and Exchange Commission (SEC) to evaluate the effectiveness of existing legal or regulatory standards of care for providing personalized investment advice to retail customers. Five months later and with the benefit of over 3,500 comment letters as *well as a survey conducted by the CFA Institute (which already requires both a suitability and best-interest standard of its members in order to use the Chartered Financial Analyst professional designation) SEC staff released its analysis and recommendations. It has proposed a uniform standard of conduct for all brokers, dealers and investment advisors providing personalized investment advice about securities to retail customers to act in the best interest of the customer.*

The SEC staff study acknowledges that working through the details of such a standard so as to ensure it is practicable and cost effective will be complex. It does not propose a strict fiduciary duty, nor does it suggest rules to try to eliminate conflicts.

The U.K. Financial Services Authority (FSA) recently banned commissions for advised sales of retail investments and released proposals which would require advisors to explain why a product is better than a cheaper alternative. This and other more intrusive proposals are based on the FSA's realization that there are "fundamental reasons why financial services markets do not always work well for consumers."
...

*Why is it that Canadian regulators have shied away from proposing a "best-interest" standard? As one commentator to the SEC staff's study noted, **"If the product sold is that of advice, then that advice should be in the best interest of the client. Anything else is fraud, because the seller is delivering a service different from what the consumer thinks he or she is buying."** Many argue that it's the buyer's responsibility to do due diligence and shop around for the best price. But should caveat emptor apply when buyers think they are hiring a professional to do the shopping?*

DO OSC RULES IMPOSE FIDUCIARY OBLIGATION ON REGISTRANTS?

from **Existing Rule Requires Good Faith** - Financial Post Letter Feb 16, 2011

Dr. Philip Anisman is one of Canada's leading securities lawyers and commentators. He was a professor of law at Osgoode Hall Law School and the Director of the Corporate Research Branch in the Department of Consumer and Corporate Affairs (Canada), and was a member of the Legal Advisory Committee for the Expert Panel on Securities. He offered additional comments subsequent to those of Ed Waitzer.

Edward Waitzer's column, while laudably advocating an obligation on the part of securities registrants, both dealers and advisors, to provide advice that is in the best interests of their clients, fails to mention an existing requirement in Ontario that may impose this obligation.

OSC Rule 31-505 requires all dealers and advisors registered in Ontario and their registered representatives to "deal fairly, honestly and in good faith with [their] clients." Although our courts have not yet recognized that it does so, this rule arguably imposes a fiduciary obligation on Ontario registrants with respect to their clients.
...
a salesman who sells an expensive high-end laptop to a customer whose needs would be satisfied by a less-expensive product cannot be fulfilling the obligation to act fairly and in good faith that is imposed by OSC Rule 31-505.
It is also difficult to understand how an advisor who fails to provide advice that is in the best interests of its client would be acting fairly
The suitability obligations of Canadian dealers and advisors are an element of fair dealing. So are the requirements in Canadian rules that registrants identify potential conflicts of interest and manage them appropriately, either by disclosure or by total avoidance.

In light of OSC Rule 31-505, one might wonder whether the debate in Canada is as much about labels and attitudes as it is about legal obligations. Our regulators may be better advised to adopt the Ontario rule nationally and enforce it rigorously.

This commentary by Dr. Anisman illustrates the difficulty investors face in dealing with an industry that flaunts the rules, has a cavalier attitude towards investors' savings and employs legal brigades to argue against their victims who often can not afford the securities specialists retained by the industry. The key word in Anisman's opinion piece is *"arguably"*. In court the judges will say whether fiduciary duty applies depends upon *"a finding of fact."* There is no doubt that the best legal team will win. Unless and until our legislation clearly states the industry has fiduciary responsibility Canadians will fall victim to a predatory industry.

ARE YOUR INVESTMENTS PROTECTED BY CDIC?

Many investors think their investments are protected by the Canada Deposit Insurance Corporation (CDIC) although they cover cash, they do **NOT** cover stocks or funds. The following is from the CDIC website.

Mutual Funds and Stocks
CDIC does NOT insure mutual funds or stocks.
For example…
If you have the following in your name at a CDIC member:

- *$1,000 in a chequing account*
- *$3,000 in a savings account*
- *$20,000 in mutual funds*
- *$10,000 in stocks*

You have $4,000 insured by CDIC in case your bank fails, because the mutual funds and stocks above are NOT insured by CDIC.
CDIC also insures other types of deposits from $1 to $100,000.
CDIC covers: savings held in trust*,* savings held in an RRSP*,* savings held in a RRIF*,* savings held for paying realty taxes on mortgage payments*. CDIC also insures* savings held in more than one name (joint deposits)*.*

Many investment firms have insurance coverage to cover your investments in case of bankruptcy but these insurances will not cover market losses. Check with your "Advisor".

WHAT ARE EXCHANGE TRADED FUNDS (ETFs)?

Rob Carrick provides an excellent guide to choosing and buying exchange trade funds. The complete guide is available on the Globe and Mail website at:
http://www.theglobeandmail.com/globe-investor/personal-finance/rrsp/how-to-use-etfs-for-your-rrsp/article1881114/

Rob Carrick's step-by-step guide to choosing and buying exchange-traded funds --

- *1. The lowdown on ETFs*
  Exchange-traded funds are like mutual funds that mimic the returns of major stock and bond indexes. They trade like stocks, so you'll need a brokerage account to buy them. There are roughly 200 ETFs listed on the Toronto Stock Exchange from four companies. You need only about half a dozen or so for a well-constructed RRSP.

- *2. The ETF cost advantage*
  ETFs cost very little to own, which means less of your investment gains will be eaten up by fees. Higher fees for mutual funds prevent many of them from producing the same returns as ETFs. Note: You must pay brokerage commissions to buy and sell ETFs, whereas you can sometimes buy mutual funds without any upfront costs.

- *7. Zeroing in on Canadian stocks*
  Here's a list of ETFs that track the big Canadian stock indexes:
  iShares S&P/TSX 60 Index Fund (XIU-T 19.88-0.10-0.50%)
  Fee: 0.17%
  Size (million): $10,960
  iShares S&P/TSX Capped Composite Index Fund (XIC-T 21.72-0.10-0.46%)
  Fee: 0.25%
  Size (million): $1,256
  BMO Dow Jones Cda Titans 60 ETF (ZCN-T 18.82-0.04-0.21%)
  Fee: 0.15%
  Size (million): $582-million
  Claymore Cdn Fundamental Index ETF (CRQ-T 12.74-0.05-0.39%)
  Fee: 0.65%
  Size: $168-million
  HBP S&P/TSX 60 Index ETF (HXT-T 11.27-0.06-0.53%)
  Fee: 0.07%
  Size: $249-million

DO YOUR STATEMENTS SHOW YOUR PORTFOLIO PERFORMANCE? - Calculate your portfolio's return

Regularly I talk about the importance of knowing the performance (return) of your investment account (portfolio) and the importance of comparing your return to a benchmark. Your "Advisor" should provide this information to you. Keep in mind that most so-called "Advisors" are in fact sales persons selling products. This is why "Advisors" selling mutual funds do not recommend buying bonds but instead will sell you a bond fund. Recently I met with Warren MacKenzie of Weighhouse Investor Services (WIS). I learned that WIS provide a tool on their website that will calculate your return and also calculate an appropriate benchmark for comparison of your return. This is a tool WIS uses when they review accounts but they also make it available to the public on their website. *(http://www.weighhouse.com/resources/portfolio_return.aspx)*

ARE YOUR MUTUAL FUNDS PERFORMING WELL? - Check your funds' return

It is most important that you know how each of your mutual funds is performing. Now you can refer to a list of funds on the web. Simply visit *www.globefund.com* and on the third top menu left click on Fund Lookup. This provides an alphabetical listing of funds and provides for each fund: *service code, latest price, net assets, MER (management expense as %), YTD (year to date) return, 1yr, 3yr, and star rating.*
This website also provides additional tools for the DIY (Do It Yourself) investor including a Watchlist, Stocklist, Fundlist, FundSearch, Stock Filter, Fund Filter, and Portfolio.

SIPA COMMUNICATIONS

This year SIPA has introduced online chat to improve communication. We have a regular weekly meeting for administration and will start chats for members in March 2010.

- **SIPA's First Chat is scheduled for March 12, 2:00 pm Toronto time until 3:00 pm.** Topics for discussion are understanding statements, investment performance, and Tax Free Savings Accounts.
- **SIPA's Second Chat is scheduled for March 26, 2:00 pm Toronto time until 3:00 pm.** Topic for discussion is Do It Yourself Investing. What are the advantages and disadvantages.
- **SIPA's Third Chat is scheduled for April 9, 2:00 pm Toronto time until 3:00 pm.** Topics will include volunteers, disputes, using the internet, & investment tools.
- **SIPA's Fourth Chat is scheduled for April 23, 2:00 pm Toronto time until 3:00 pm.** Topics to be determined.

Bi-weekly chats will be continued depending upon member interest. You can also participate by telephone if you don't have voice capability on your computer. Just let us know your interest and your telephone number. Call SIPA at 416-614-9128.

COMPULSORY INDEMNITY FUND TO PROTECT QUEBEC INVESTORS

from **Fraud Bailout Fund Hits the Wall** - Financial Post Feb 16, 2011

An investor protection fund has been discussed and recommend in the CARP-SIPA Report in 2004 and subsequent SIPA submissions. The Expert Panel On Securities Panel included the recommendation in its Final Report in 2008. It remains to be seen if the CSTO will implement this recommendation of the Expert Panel. Meanwhile in Quebec, the province that leads the rest of Canada in regulatory innovation, the Coalition for the Protection of Investors (CPI) is actively promoting a compulsory indemnity fund to protect investors. *"Fraud Bailout Fund Hits the Wall"* states the following:

> *The Coalition for the Protection of Investors (CPI), an organization comprised of academics and financial industry representatives, says a compulsory indemnity fund to protect against fraud for Quebec, which has suffered numerous high-profile investor scandals in recent years, is running into resistance from the major chartered banks.*
>
> *... Mr. Pouliot and the Quebec based investor coalition asked the provincial government and the province's Autorité des marches financiers last month to consider creating a mandatory indemnity fund. Investors would fund it through premiums and financial advisors covered by the fund would make contributions.*
>
> *If Quebec formally adopts the indemnity fund as mandatory, the banks will be forced to participate -- and the coalition expects that to create momentum elsewhere in the country.*
>
> *"If Quebec could launch it, the rest of Canada will buy into it because consumers across the country will want the protection," Mr. Pouliot says.*

Let's hope that Robert Pouliot and the CPI achieve success in getting Quebec to adopt their proposal.

CONFERENCE ON CANADIAN JUSTICE

A national conference is being planned in Ottawa by the Canadian Justice Review Board and the Canadian Police Chiefs. SIPA will participate and they are looking for investment victims to participate and speak out. If you are interested please call 416-614-9128 of e-mail SIPA at sipa.toronto@gmail for additional information.