SIPA Sentinel

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Merry Christmas

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.

Ontario Securities Commission Investor Advisory Panel - Investor Advisory Panel Releases Annual Report

Canada NewsWire

TORONTO, Oct. 28, 2011 /CNW/ - The Ontario Securities Commission's (OSC) Investor Advisory Panel has submitted its first annual report to the OSC, which summarizes the ongoing work by the Panel in analyzing key issues of importance to investors in today's capital markets.

In its first year, the Panel has demonstrated a strong commitment to representing the interests of investors and has provided valuable input to the OSC on its statement of priorities as well as a variety of other issues, including OTC derivative regulation, point of sale, cost disclosure and performance reporting, credit rating agencies and shareholder democracy.

Additionally, the Panel has been active in building awareness of its activities within the broader community through contact with industry experts and retail investors and through a number of consultations and speaking engagements. As a result, the Panel has generated substantial feedback with respect to the regulation of the capital markets from investors' viewpoints which has, in turn, been fed into the OSC's policy making process.

"We are pleased with our success this year in tackling issues of great importance to investors and in relaying these concerns to the OSC," said Professor Anita Anand, Chair of the Investor Advisory Panel. "We look forward to extending our consultations with investors across Ontario and further understanding their views. It is only by hearing from investors directly that we can accurately represent them."

In addition to further outreach, the IAP has identified a number of priorities for the upcoming year, including support for: the implementation of a fiduciary duty on financial service professionals, a restitutionary remedy for wronged investors, transparency in information at point of sale and whistleblowing rights. The Panel supports these policy initiatives within the context of a national securities regime.

The seven member Investor Advisory Panel was created in 2010 as an independent body to contribute an investor perspective to the OSC's rule and policy making process. The Panel's annual report to the Commission and additional information are available on the OSC website at www.osc.gov.on.ca.

Leveraging strategies too risky for most retail investors

FAIR Canada has taken an initiative regarding leveraged investing. Most small investors who have suffered serious loss have been leveraged either with bank loans orchestrated by the investment dealer, home mortgages proposed by their advisor, or margin loans provided by the investment dealer. Some firms have established leverage plans that provide for 1 to 1, 2 to 1, 3 to 1 or sometimes even higher leverage. When markets go down, leveraged investors often lose everything when dealers are authorized to sell them out before the lender suffers loss, so there is no chance for recovery. The following is re-produced from the FAIR Canada website:

*FAIR Canada has written an **open letter** to the provincial Canadian securities regulators (CSA), calling for better investor protection from the risks associated with registrants who encourage retail investors to borrow funds to purchase mutual funds and similar products. The letter opens with the following request:*

"We are writing to you in your capacity as Chair of the CSA to recommend that the CSA enhance protection for investors who are persuaded to borrow money in order to invest in mutual funds and other investments. ***Leveraged investing is not suitable for most retail investors and current requirements do not provide adequate investor protection from unsuitable advice with respect to borrowing to invest. FAIR Canada believes that this is a systemic problem that regulators must address or investors will continue to be placed into unsuitable investments with resulting financial losses and an increasing number of investor complaints."***

In the letter, FAIR Canada stresses the importance of ensuring that individuals who recommend such strategies clearly and completely explain the risks of leverage to clients and that the risks are clearly understood by consumers.

In early October, FAIR Canada submitted ***comments*** *to the Mutual Fund Dealers Association of Canada (MFDA) regarding proposed changes to their leverage rules. Both the submission and the letter to the CSA call for a certification requirement, which would oblige registrants to certify, at the time of a leverage recommendation, that they have explained the risks associated with leverage to the client and certify their belief that the client understands the associated risks. The client would be required to acknowledge that the risks have been explained and are understood. We also suggest the imposition of a presumption that leverage is unsuitable for retail investors, thus placing the onus on the salesperson and firm recommending leverage to prove that leverage is suitable for the client and that if a home is to be used as security for leveraged investing, independent legal advice be obtained.*

Leverage is an Emerging Issue

A report by the New Brunswick Securities Commission ("NBSC") on leverage practices found that there was a high correlation between leveraged investing, unsuitable investments and losses to consumers. The NBSC found that 68 percent of cases where the use of leverage was aggressive were in a loss position.

MFDA members and Approved Persons also are frequently found to have failed to establish, implement and maintain policies and procedures to supervise leveraging recommendations and ensure the suitability of leveraging recommendations leading to the issuance of an MFDA Compliance Bulletin dealing with, among other things, the Suitability of Leveraging. For the period from July 1, 2010 to July 30, 2011, 33 out of 453 MFDA enforcement cases dealt with problems with the suitability of leverage (7.28 percent of its total enforcement actions). The Ombudsman for Banking Services and Investments ("OBSI") data indicates that in the first ten months of 2011 there has been a 56 percent increase in complaints where the main issue was leverage.

Misleading marketing partly to blame

FAIR Canada believes that some intermediaries (approved persons, representatives, and registrants) push or encourage consumers to borrow money to invest (i.e. leverage) by presenting a misleading picture of the risks and benefits of leverage. FAIR Canada cautions that the industry must present the risks associated with borrowing to invest clearly, fully, and explicitly to investors in language the client can understand. Specifically, marketing materials should not be permitted to play down the associated risks.

Contractual Relationships Need to be Reviewed

Regulators should review the existing contractual relationships among the mutual fund companies, financing companies and registrants in order to address the systemic problem of investors being unsuitably placed in leveraged investment strategies. Some registrants actively promote the use of leveraged investing in order to generate increased commissions and assets under management. Registrants can recommend a leverage strategy to the client, process the loan application at their own office, and have the client invest in the mutual fund company's mutual funds, all within the same day. This is cause for concern and requires examination from a retail investor protection perspective.

Inherent conflicts of interest should be addressed with a best interest standard

In some cases, a misalignment of interests exists between the interests of the intermediaries and those of the investor; this is a result of commissions or other remuneration offered as an incentive for intermediaries to encourage investors to

borrow to invest. It is imperative that full disclosure is made to the client of any associated commissions and other remuneration that would be received by the intermediary if the investor were to borrow to invest. Further, and more importantly, intermediaries should have a duty to act in the client's best interest, and not recommend borrowing to invest unless it is in the best interest of the client.

Supervision by firms is essential

Leverage supervision by firms is vital in order to ensure it is recommended only where it is suitable. Criteria for leverage suitability should include investment knowledge; risk tolerance; age; time horizon; leverage as a percentage of net worth; debt as a percentage of gross income; employment status (including expected time to retirement); and ability to withstand loss.

Short term and long-term suggestions

FAIR Canada urges the CSA to consider our recommendations with a view to remedying these issues by revising section 13.13 ("Disclosure when recommending the use of borrowed money") of National Instrument 31-103. In the short term, we urged the CSA and its members to issue notices to registrants cautioning them: (1) on the use of leverage and the need for proper supervision of leveraged investments; and (2) that any advertising and marketing must be fair and balanced, and fully disclose the risks, including the statement that leveraged investing in mutual funds and similar products is only suitable for investors with a high risk tolerance.

Ombudsman for Banking Services and Investments (OBSI)

OBSI has been under pressure form the industry for some time. There are a number of cases where OBSI has been unable to satisfy the industry with their recommendations and so these disputes remain unsettled. Initially OBSI examined disputes with banks as well as investment dealers, however a couple of banks have now decided to engage another dispute resolution agency to deal with their banking disputes. The dealers are obligated by the regulators to use OBSI. Although we do not feel that victims really obtain fair and just treatment through any industry funded agency, OBSI is really the only game in town for small investors to seek dispute resolution. The courts may provide a more fair resolution but it is costly and time consuming. What is need is a Government funded investor protection agency that has the power to order restitution. In the interim the provincial securities commissions should be mandated the power to order restitution. The Consumer and Investor Advisory Committee issued a press release in October in support of OBSI. We agree.

Consumer and Investor Advisory Council to OBSI alarmed by TD Bank decision

TORONTO, Oct. 26, 2011 /CNW/ - The Consumer and Investor Advisory Council to the Ombudsman for Banking Service and Investments (OBSI) was established to bring the voice of the everyday Canadian consumer to this sector.

The Council reacted with alarm and disappointment to TD Bank's decision to withdraw from the services of OBSI for its banking clients, a neutral, impartial ombudsman scheme that has been recently reviewed and assessed to be a 'gold standard' in the financial ombudsman sector.

"OBSI provides a free, fair and effective way for Canadians to resolve disputes with banks and financial institutions. Many Canadians would be unable to resolve their disputes effectively without a neutral third party dispute resolution body - one that consumers know that they can have confidence in" says Laura Watts, Chair of the Council. TD has announced that it will retain a private profit-based mediation company for banking complaints instead of OBSI. TD will continue to use OBSI for investment complaints.

The Council is very concerned that using for-profit private mediation companies, hired by the financial institution itself, is not only confusing for consumers, it also could lead to the perception of a severe conflict of interest. "It can look to

everyday Canadians that the financial institutions are buying their own judge", says Watts, "if banks can choose to whom the dispute goes to. An independent body with statutory binding powers can provide a better way."

Despite the move, TD representatives appear to agree that a reformed OBSI may be the answer. "We agree with the regulators that one single, independent dispute service is preferable and that should be OBSI," TD's internal ombudsman Paul Huyer was quoted in the Financial Post on October 26, 2011 as saying. "We're committed to work with regulators and OBSI to improve the service and reform it."

TD's withdrawal could be seen as putting pressure on the Canadian financial regulators to move quickly to designate OBSI as the single provider of consumer dispute resolution services and to make its recommendations binding - which has long been the call of the Consumer and Investor Advisory Council of OBSI.

There has been a high level of tension between some of the Canadian financial institutions and OBSI since RBC pulled out of OBSI's current non-binding, non-statutory dispute resolution scheme for banking matters.

Council member Julia Dublin notes that the challenges faced are largely attributable to the original design of OBSI as an institution, and if not addressed will continue to hamper OBSI's operations. "I do not believe that consumers benefit at all from a system that delivers them to a confusing array of competing private financial dispute resolution services. The experience in jurisdictions such as New Zealand that have experimented with this approach demonstrates that a single mandatory system is the way to go."

In these uncertain economic times, the need for a single-access point, easy-to-understand and neutral process is more important than ever. The Council is committed to working with consumer advocates, the financial sector and government to support a transition to a binding judgment process that works for Canadians. Changes will have to be made in the governance of OBSI to allow this to happen. This point was emphasized in a recent external review of OBSI which, while giving OBSI high marks, the report noted the severe limitations on the organization itself. OBSI must be given the powers and resources it needs to work on the scale this challenging economy will require. The Council also urges that resources be made available to help lead the implementation of the changes suggested in the external reviewer's report. Without leadership and resources to smooth these troubled waters, all parties will continue to be negatively affected.

The Council also urges that the financial regulators act quickly to reform OBSI's governance, to designate OBSI as the single provider of consumer dispute resolution services in the banking and investment sectors, and to make its recommendations binding. The Council also supports working with all parties to create solutions to overcome the current impasse. "In the end, it is the consumer who loses when OBSI does not have the power and resources it needs to work effectively. Canadians want a system that works, that all stakeholders including the financial industry, can feel comfortable with. The Council is committed to working to achieve these solutions together" says Watts.

Council members sit in their individual private capacities and do not represent organizations to whom their members may belong.

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Investor Protection in Canada

In 1998 SIPA proposed that the OSC seek a mandate to provide remedial investor protection. We received a response that they would consider it. They may be considering it but meanwhile several years ago the Quebec Authority implemented a system to investigate complaints and to pay restitution in some cases.
It was obvious in the mid nineties that the Quebec approach to regulation was years ahead of TROC (the rest of Canada) with regard to investor protection. When SIPA appeared before the Senate Committee in 2004 we

stated that Quebec was more socially responsible in its approach to securities regulation and investor protection. We also recommended a national regulator based upon the Quebec model.

Sadly it seems that the proposals for a national regulator will be more in line with the Ontario Securities Commission than the FMA. Of course the FMA regulates the banks and insurance companies as well as the securities dealers and the fund companies so investors have one source to go to if they have a complaint.

So what has been achieved since SIPA was founded in 1998? We spent several years dialoging with provincial regulators and provincial Governments. We made submissions to regulators and Government agencies but nothing seemed to change.

In 2004 SIPA issued a report "The Small Investors' Perspective of Investor Protection in Canada". The document is more than 100 pages and includes comments from dozens of small investors to illustrate the issues investors face. This report resulted in SIPA appearing before the Senate Committee on Banking Trade and Commerce, and according to David Brown, then Chair of the OSC, precipitated the OSC organizing the Town Hall Event in 2005. This was the first time the public had the opportunity to meet with the regulators and ask questions openly. It was an unqualified success with over 500 people attending. The meeting went overtime and still individuals were lined up to present their questions and comments. Why were there no similar events in subsequent years? Was it embarassing for the investment industry and regulators?

The Senate Committee was quite interested in the SIPA report and decided they would like to interview the Chair of the OSC because they had been led to believe that the industry was well regulated and investors were protected.

Since then an Expert Panel was established to consider a national securities regulator, and a couple years ago the Canadian Securities Transition Office was established to devise implementation. Although SIPA had recommended a national financial services regulator based on the Quebec model it seems that the national regulator proposed will be limited to securities regulation in the same way that most provincial regulators are limited. It is improbable that TROC will follow the Quebec lead, and also improbable that Quebec will participate in a national regulator that appears to be three steps back from the regulator in place in Quebec.

Although for many years SIPA was one of few organizations representing small investors two years ago the industry regulators decided to finance FAIR Canada which bills itself as The Voice for Investors. Three million dollars enable FAIR to prepare excellent reports on issues impacting investors and they have become influential in the short time they have been on the scene. Ermanno Pascutto is an accomplished lawyer with regulatory experience and commands an excellent knowledge of the issues.

At the same time the OSC has established the Investor Advisory Panel comprising seven individuals under the Chair Anita Anand, a lawyer and professor at York University. This small group with limited funding of about $50,000 a year has carried out surveys and written reports that seem to carry weight. One of the most significant actions taken by the IAP is they have established five initiatives including fiduciary duty. This is one of SIPA's priorities as we feel financial advisors should have a fiduciary responsibility. Unfortunately the so-called "Advisors" are more often than not simply sales people who legally have no fiduciary responsibility contrary to what most investors believe.

The industry/regulator complex has a registered category of "Adviser" (spelled with an 'e') that is qualified and registered to give advice. However the regulators allow dealers' representatives, or sales people, to use the title "Advisor"(spelled with an 'o') which misleads the public.

Over the last ten years more individuals have come forward as investor advocates operating on an individual basis. Some of them are industry representatives or former industry representatives. Few have experienced loss at the hands of the industry. Most victims of loss simply disappear from public sight once they have resolved their dispute. This is a great pity because they have experienced first hand the issues which need to be revised to provide better investor protection.

As Glorianne Stromberg said a decade ago when she addressed a SIPA public forum. nothing will change until the public becomes enraged.

A few voices raised in protest is not enough to change an industry that grows rich by pilfering the savings of unsuspecting investors.
It is most important that investors become aware of the need to check their investment performance. It not enough to depend upon your "Advisor" telling you that you are making money. Unfortunately many investors, particularly those investing in funds will have about half the amount of savings they should have when they reach retirement. That is still better than those who will lose all of their savings depending upon their "Advisor".

Task Force on Financial Literacy

It is improbable that financial literacy will help protect small investors as long as the investment industry is not held accountable with a fiduciary responsibility, and the industry/regulatory complex continues to mislead the public with information and marketing suggesting that investors are protected by the regulators. Here is some of what Jonathan Chevreau writes in the Financial Post:

> *Here we are midway through the newly designated Financial Literacy Month when skeptics on both sides of the border are questioning whether the financial industry sincerely wants informed consumers.*
> *I have posed this question myself but not so harshly as Marketwatch. com columnist Paul Farrell did this week. He damned the whole financial literacy movement as a "big, fat Wall Street hoax."*
> *Banks, brokerage firms, fund companies and insurance companies make their billions off investors who are "clueless financial illiterates," Farrell said, listing seven reasons Wall Street doesn't want savvy customers. "Revenues would drop substantially if financial literacy really did work."*
> *He attributed to University of Chicago professor Richard Thaler the quip Wall Street "needs investors who are irrational" and "woefully uninformed."*
> *In Canada, can we substitute Bay Street for Wall Street and come to a similar conclusion? Carleton University public policy professor Saul Schwartz thinks so but even he was taken aback by the ferocity of Farrell's attack. Schwartz is, however, concerned about the dominance of financial executives making up the federal Task Force for Financial Literacy*
> *Likening them to the proverbial "foxes in charge of the chicken coop," he points out the Task Force is headed by an insurance company chief executive (Don Stewart of Sun Life Financial Inc.) and co-chaired by BMO Nesbitt Burns chairman Jacques Menard.*
> *Schwartz criticized the Task Force in the September issue of Canadian Business Law Journal. Subtitled "Consulting without listening," he said the goal was "driven by the twin desires to avoid any increased regulation of the financial service industry and to avoid the debate that surrounds the efficacy of financial education ... It knew what it wanted to say before it even began."*

Charges laid in fraud investigation

TRURO - The Truro Police Services Criminal Investigation Division has laid charges in a multi-year investigation of fraud, forgery and breach of trust. Facing charges is John Alexander Allen, a former employee of Keybase Financial in Truro. Allen is due to appear in Truro provincial court next month. Truro solicitor Robert Pineo filed the action against Allen in Nova Scotia Supreme Court last December.

The Nova Scotia Securities Commission fined Allen more than $1 million for bilking dozens of clients out of an estimated $14 million. Allen was ordered to pay $1.05 million to the commission and $7,000 in investigation and proceedings costs after he admitted in an agreed statement of facts to violating the Securities Act and engaging in unfair practices. The Supreme Court claim alleged Allen advised clients to participate in inappropriate investment schemes beyond their risk tolerances, including leveraged investment schemes and that he obtained loans for the applicants from financial institutions by mis-representing their factual circumstances.

Tony investment firm flirts with bankruptcy;

The Toronto Star reports on yet another investment firm issue where investors could lose millions of dollars. It seems there are almost daily reports of industry fraud and wrongdoing and still there is no move to establish a Government agency to protect investors. Many of the frauds operate outside of the regulatory system, however within the system there are unregulated products and exemptions from regulations. Many products created by banks and insurance companies are not considered securities and so do not come under securities regulators. The public does not realize these products being sold to them are not regulated by the securities administrators. That is why it is important for investors that Canada has a national financial services regulator so that banks and insurance companies would be regulated by the one regulator similar to the Quebec model. The Star report states:

Toronto man who has served time in prison for fraud is at the centre of a new bankruptcy filing that could leave investors out of millions.

Seaquest Corp. and Seaquest Capital Corp., headed by David Burns Holden and Rosa Holden, have posh Bay St. offices overlooking Harbour St., a $1.4 million condo on the Humber Bay and an executive aircraft.

The companies filed a notice of intent to file a proposal under the Bankruptcy and Insolvency Act on Oct. 24. That gives the companies 30 days to come up with a plan to settle its liabilities.

According to court documents, an investigation revealed "a number of the companies in which the investments were to have been made by Seaquest did not appear to exist, nor did the required general security agreements for individual investments."

An interim report to creditors by chief restructuring officer Greg MacLeod dated Wednesday said an investigation of the company's books and interviews found questionable investments, few assets and no recurring revenues.

It reported there is little or no prospect of meaningful recovery in the short term or the long term of the investment portfolio, without additional funding.

The interim report said Seaquest appears to have incurred substantial operating losses that have been funded, at least in part, by portfolio investors. It isn't clear how many investors are involved and how much money is at stake.

However, at least one family invested $6.2 million and has sued for recovery of the funds.

In 1995, David Holden was sentenced to 90 days in jail for violations of the Ontario Securities Act. He was sentenced to a further six years in prison in 2000, concerning an investment fraud, according to court documents.

According to Ontario corporation filings, only David and Rosa Holden are named as officers or directors of the companies.

On Seaquest's website, the company is described as a privately owned corporate and commercial lender that specializes in providing short-term funding for companies that cannot access temporary financing from banks and other financial institutions. As recently as Oct. 31, the company was soliciting investors in a Toronto newspaper.

In Ontario, anyone selling securities or offering investment advice must register with the Ontario Securities Commission unless there is an exemption. In court documents, a judge said contrary to Holden's representation, neither Holden nor Seaquest is registered with the OSC. That was confirmed by the Star in a check of the OSC website Thursday.

Seaquest has until Nov. 23 to come up with a proposal to settle its liabilities, or seek an extension to bring in a restructuring plan. MacLeod said "a significant funding commitment" would be needed to carry out a restructuring plan because "Seaquest has no ability to self-fund."

If Seaquest does not file such a request, or if it's denied, then it will be deemed bankrupt on Nov. 24.

The MacLeod report also says:

The investment portfolio is composed of a large number of highly speculative and illiquid loans and shareholdings, the majority of which consist of loans and advances to non-arm's-length companies, indirect subsidiaries and affiliated companies.

More loans are unsecured. The few secured loans are to companies that are themselves underperforming, inactive or insolvent.

A condo on Lake Shore Blvd. and an executive aircraft are registered to Seaquest. But according to BDO, there is very little realizable value in either assets after considering mortgages and encumbrances.

Books and records have been poorly maintained and are inadequate for an enterprise of this kind.

Seaquest is not operational and has no recurring revenue or cash-flow streams at present.

When asked if a restructuring was in the works, company lawyer Lisa Corne said: "I'm really not in a position to discuss this."
The Star visited Seaquest's tony offices on Thursday, and by all appearances, it was business as usual. A receptionist said Holden was out and promised to deliver a message. Holden did not call back.
When reached by telephone at the number of the Lake Shore Blvd. penthouse condo, Rosa Holden said she knew nothing about Seaquest's restructuring.
"You'd have to speak to Greg MacLeod about that," she said. "I have no idea what you're talking about."

SIPA's Priority Issues

It seems some of the issues that were apparent in 1999 still remain unresolved. However with the addition of FAIR Canada and the OSC Investor Advisory Panel we are confident that the situation will gradually improve. While the regulators may fiddle with refining rules and regulations, without aggressive enforcement and improved legislation there will be little improvement in investor protection.

There is no doubt that preventative investor protection has failed to protect investors and what is needed is fiduciary accountability and remedial investor protection. Therefore SIPA's priority issues remain:

- Fiduciary responsibility for the financial services industry
- A legislated authority with a sole mandate for investor protection
- A national financial services regulator with the power to order restitution
- Whistleblower legislation to protect all Canadians

There are many other issues that can impact on investors and should be more easily resolved than the fundamental issues:

- Point of Sale disclosure for all financial products prior to commitment
- Better regulation and enforcement on the use of leverage
- Implementation of regulatory power for Securities Commissions to order restitution

In 1999 SIPA wrote the OSC requesting they get the power to order restitution. The written response said they would consider it. I hear they are still considering it.

National Regulator Nixed by Supreme Court

It's not really surprising that the Supreme Court found that a national regulator would be against our constitution. Contrary to the fact that it would seem that wise judges should make wise decisions, the decision is against a national regulator. This discussion has continued for decades. The "Wise Persons Committee" decided "It's Time" for a national regulator years ago. Subsequently the "Expert Panel" said we should have a national regulator. The reasons are many and Canada is almost the only civilized country that does not have a national regulator.

However our legal system often does not provide justice. It would seem too much to expect that judges would have the wisdom to make decisions that are good for Canadians and the right thing to do. Rather they debate and argue and use obsolete legislation to arrive at decisions that seem unrealistic to the ordinary citizen. But then as one wise person once said "The court system is just a game that lawyers play". So how could we expect justice to prevail.

It seems that we will continue to have an investment environment that is "Caveat Emptor" or Buyer Beware.