SIPA Sentinel

April 2012

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.

The OSC Investor Advisory Panel wants Feedback from Investors

The OSC Investor Advisory Panel represents the interests of investors and provides comments to the Ontario Securities Commission on issues important to investors and on the OSC Statement of Priorities. The members on the panel work together under the chairmanship of Anita Anand who is an Associate Professor at the University of Toronto Faculty of Law. All the members are dedicated to representing investors' interests and want to get feedback from the public. They invite investors to visit their section on the OSC website and to submit comments. The IAP is initiating an outreach program to dialogue with investors so they will be better informed. As part of the outreach program a Webinar has been organized so the public can participate by asking questions or commenting on issues impact investors. The following notice is on the OSC website. SIPA members should consider participating, either by internet or telephone.

Invitation to Provide Advice on Commission Priorities

The OSC's Investor Advisory Panel will be hosting its first webinar, which is a presentation over the internet in which participants can communicate with the presenter, on Monday, May 7th from 12:00 – 2:00 p.m. and would like to hear from Ontarians.

The purpose of the webinar is to inform the Panel as it prepares its letter to the Commission providing advice about issues that are important to investors and that should be priorities for the Commission in the upcoming year. "Our explicit mandate is to represent the views of Ontario's investors in policy-making and this outreach is a first step in this process" said Professor Anita Anand, Chair of the Panel. "The webinar is a great opportunity for investors to present their views to the Panel about issues that are important to them. We look forward to hearing from individuals across Ontario."

Individuals can register to participate in the live webinar by sending an email to iap@osc.gov.on.ca. For those who are not able to attend the live session, the webinar will be recorded and available for on-demand viewing. Information on retrieving the webinar will be posted to the website at www.osc.gov.on.ca.
The Panel welcomes comments from investors which will be considered in the Panel's submission to the Commission. The Panel is particularly interested in receiving input about:

- *Advisers' duties to act in their clients' best interests*
- *Disclosure of information (e.g. performance reporting)*
- *Restitution for investors and improved enforcement*
- *Ombuds services and dispute resolution*
- *Enhancing investor protection*

The 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. Additional information about the Investor Advisory Panel is available on the OSC website atwww.osc.gov.on.ca.

FRAUD IS HAPPENING ACROSS CANADA - INVESTORS ARE LOSING THEIR SAVINGS

It seems we hear of a new fraud or industry wrongdoing every day, however the majority of cases do not reach the news. Many do not even reach the regulators. As a result there appears to be no detailed quantification of investor losses in Canada. SOPA estimates that Canadians are losing more than $20 billion per year due to investment fraud and wrongdoing. SIPA has suggested a Government inquiry to determine the extent of this problem that plagues Canadians and destroys their savings and retirement security. Did you ever notice how many people who seem well past retirement age are still working? Think about it.

SIPA continues to hear from small investors who do not know how their investment performance compares to an appropriate benchmark. It is small wonder because of the lack of disclosure from the investment industry. Many of the client statements do not provide sufficient information for investors to know what is happening. Many believe there is something wrong when they see their investments are not growing.

Recently the regulators took an initiative to require point of sale disclosure for mutual funds which would disclose essential information for investors before they decided to invest in a fund so they would have a better idea of the risks involved and the past performance of the fund. Over time the disclosure was watered down and a decision was made to implement this requirement in stages. Now they re-named the proposed disclosure Fund Facts. However they decided the industry would not be required to issue this document until after the sale. Does this make you think the regulators are not protecting investors?

The following article from the Halifax Chronicle Herald indicates that frauds are happening across Canada.

Pair Accused of Running Ponzi Scheme

The Chronicle-Herald, Tuesday, Apilr 17, 2012
Byline: Remo Zaccagna Business Reporter

A Halifax couple have a date with the Nova Scotia Securities Commission next month over allegations they ran a $650,000 Ponzi scheme.

In a statement of allegations filed in March, the commission says Robin States operated the Infinity Online Investors Group at the Halifax-area residence he shared with Bernadette Bowden.

"The respondents were not registered to trade or distribute securities in any capacity with the commission or elsewhere in Canada," the statement said.

In 2009, a Florida court found that the couple operated a Ponzi scheme and committed solicitation fraud and fraud by misappropriation, false statements and omissions.

According to that court's findings, States promoted Infinity Online to investors as a high-yield investment program in commodity futures, options, foreign exchange and precious metals through a website and personal telephone solicitations.

From October 2004 to October 2005, States solicited investments totalling $643,047 from at least 900 people in Canada, the U.S., and elsewhere. He guaranteed investors a fluctuating daily return ranging from 1.25 per cent to 2.5 per cent. States identified himself as Gregory Hampton when making telephone solicitations from a number "registered to States's wife, Bernadette Bowden, at an address in Halifax . . . that she shared with States," the Florida court found.

States failed to disclose any risk associated with the purported investments, the court said.

The securities commission hearing will be held in Halifax on May 14 at 9:30 a.m.

Reprinted from the Halifax Chronical Herald

Failure to Establish a National Securities Regulator

Although there have been calls for a national securities regulator for many years, it seems unlikely this will happen in Canada until the public arises to apply pressure to Government. The initiative by the Honourable James Flaherty, Minister of Finance, was welcome but the system entrenched in Canada is too lucrative to be abandoned without a major battle. Within the last couple of years developments could lead to an improvement in the investing environment for small investors. Since 1998 SIPA appeared to be one of the few organizations recognized as standing up for investors. However, in spite of submissions and presentations made to provincial and federal governments over the last decade very little has changed for the better.

In fact the reduction of limitation periods from six years to two years that occurred a few years ago is a major set-back for investors who have a dispute. Although SIPA made several submissions and presentations to Government this legislation was quietly passed in an Omnibus bill and now appears to be a forgotten issue.

On the bright side there is some reason for optimism. In the last few years two organizations have appeared on the scene. FAIR Canada is headed by Ermanno Pascutto and FAIR had received funding from IIROC that enabled them to take action that SIPA could only imagine. They have the resources to engage personnel able to carry out research and make comprehensive submissions. At the same time the Ontario Securities Commission established an Investor Advisory Panel (IAP) with seven members to represent the interests of investors. The Panel is chaired by Anita Anand who is doing a marvelous job of coordinating this group and making substantial submissions to the regulators. The IAP has a section on the OSC website that provides disclosure of panel meetings and invites investors to provide input. Their first Webinar is scheduled for early May (See above). The IAP is anticipated to work closely with the new OSC Office of the Investor.

Anita has recently written an article published in the National Post reprinted below.

Securities blanket; Ottawa should move now to enact securities regulations in areas that are clearly within federal jurisdiction

National Post, Friday, February 10, 2012
Byline: Anita Anand And Grant Bishop

In a recent decision, the Supreme Court nixed the federal proposal for a national securities regulator, finding that its proposed scheme was unconstitutional. Admittedly, the federal government's proposal largely (and intentionally) uploaded the current provincial model to a federal statute. The court held that, while aspects of the proposed legislation were within the federal wheelhouse, these could not justify a "wholesale takeover" of securities regulation in Canada.

Nonetheless, the court's decision should not be read as foreclosing a federal role in securities regulation. The judgment specifically observes that provinces would be incapable of enacting legislation to effectively address systemic risk and comprehensive data collection. Indeed, the court expressly stated that "the need to prevent

and respond to systemic risk may support federal legislation pertaining to the national problem raised by this phenomenon."

While the Court has barred one proposal, we note Minister Jim Flaherty's recent statements that the federal government remains committed to a presence in securities regulation to address a glaring regulatory gap with respect to systemic risk. But we seem to have moved from the specific notion that "systemic risk" is the interconnected financial breakdown where a triggering event causing default by one market participant in turn impacts others' ability to fulfill their legal obligations, causing a chain of negative economic consequences. As Governor Carney has suggested, "systemic risk" can be used more broadly to refer to the financial system's inability to support economic activity.

The recent (and arguably ongoing) financial crisis underscores how financial contagion can spread from securities markets to financial institutions and back again, threatening the integrity of the entire economy. In Canada, our regulatory framework has not kept pace with the increasing integration of financial institutions and securities markets. In particular, banks are frequent counterparties in over-the-counter derivatives - products for which provincial securities regulators have yet to enact a coherent regime.

Many commentators rightly point to the efficacy of Canada's regulation of financial institutions in safeguarding against financial contagion. Certain commentators urge that what we have is good enough, arguing that the U.S. had a federal regulator (i.e. the Securities and Exchange Commission) but little good did this do. Such an inference is dangerously simplistic and conveniently forgetful.

Canada's own asset-backed commercial paper crisis highlights the gaps in our present regulatory structure. The solution hinged an arrangement fashioned under the thoughtful guidance of Purdy Crawford using a federal insolvency statute. Contagion from ABCP was forestalled but, had the $32-billion market collapsed, the default would have propagated throughout our financial system.

This weakness in our regulatory armour was underscored by former superintendent of financial institutions Nick Le Pan: "If anyone should have been on top of this, it was securities regulators. They expressed 'surprise' ex post at aspects of the issue, such as the extent of ABCP sales to individuals.... In Canada, we don't have one national securities regulator that could be a partner for federal authorities in financial stability monitoring and crisis management."

The Office of the Superintendent of Financial Institutions is ill placed to regulate such systemic risk emanating from securities markets (so-called "macro-prudential regulation"). Lumping prudential supervision of securities markets into OSFI's mandate would confuse its specialization and pose a worrisome conflict of interest: Would concern about keeping banks healthy lead to overcautious and hamfisted interventions in securities markets? Good regulation requires well-co-ordinated but specialized regulators that each have a clear mandate.

With its more ambitious scheme deemed unconstitutional, the federal government should now move to enact a federal regime in areas that are clearly within federal jurisdiction. Taking the lead from the Supreme Court, the federal government should create a financial markets regulatory agency and mandate such a national regulator specifically with the oversight of systemic risks in securities markets, investing it with powers to intervene where particular products or activities threaten financial stability.

So what specifically would the FMRA do? Notably, the Supreme Court's judgment sketches a statutory scheme that would form the backbone of such a body. This would involve the regulation of over-the-counter derivatives, credit rating agencies, record-keeping, short-selling and urgent regulation relating to "substantial risk of material harm to investors or to the integrity or stability of capital markets." As the Supreme Court

recognized, comprehensive data collection on potential risks in securities markets is similarly a function that only the federal government can accomplish. Provincial securities regulation, even under the opt-in umbrella of the Canadian Securities Administrators, cannot achieve a comprehensive and standardized regime for these systemically critical areas of law. There is provincial jurisdiction to protect investors and ensure companies can access capital markets. But with their admitted focus on local markets, provinces lack uniform incentives, not to mention constitutional ability to safeguard Canada's financial system as a whole. The Supreme Court was clear on this point.

The Canadian Securities Transition Office has already done a good deal of groundwork toward establishing such a national-level securities regulator. In addition, the Bank of Canada has been primarily responsible for the systemic risk oversight of clearing and settlement systems, is involved in international fora and is playing a leading role in the reform of derivatives markets. Revised federal legislation constituting the FMRA could leverage that foundation while conforming to the constitutional constraints articulated by the Supreme Court.

There is clear direction from the Supreme Court and a pressing rationale for the federal government to enact a national regime to address systemic risk in securities markets. The peace and order of Canada's economy demand no less.

- Anita Anand is associate professor and Grant Bishop is a JD candidate at the Faculty of Law, University of Toronto.

Can the Investment Industry or the Regulators Resolve Disputes?

Resolving an investment dispute is never easy. Although the investment industry offers management and ombudsmen to resolve disputes it is not unusual that the resolutions offered seem unfair to investors. The regulators offer arbitration but feedback suggests this is also unfair to investors. The Ombudsman for Banking Services and Investments is considered by many to be the best approach to dispute resolution. Certainly it is less costly and less time consuming than civil litigation, but it is concerning that the recommendations are regularly discussed with the industry prior to being released. The practice of using "notional accounts" is also a concern. A notional account is simply an account set up on the basis of the victim's KYC (Know Your Client Form) to determine if the investment outcome would have been different with a revised account.

The concern with this approach is that feedback suggests there are systemic issues with KYCs in that they do not always reflect the facts. There are cases where the KYC has been newly established to be consistent with the holdings in the account. Many investors had not seen their KYC until after a problem developed and they investigated. In some cases the client signatures on the KYC were not those of the client. The weakness in the system is that there appears to be no requirement that the KYC is to be filled out and signed by the investor and a copy provided upon the opening of an account.

Civil litigation is long and costly and for many seniors it may not be practical. The need for a national ombudsman was recognized many years ago when the Federal Government saw the need to create a national Ombudsman for Banking and Investment. The industry was quite helpful and offered to expand the Banking Ombudsman (provided by the industry) to fulfill this role, and offered to do this at no cost to Government thus saving taxpayers' money. This resulted in the OBSI being born. The first Ombudsman, Michael Lauber, stated publicly that it was his objective "to make victims whole again" after they suffered loss due to wrongdoing. Sadly this seemed not to be possible. However since "half a loaf is better than none" many victims choose the OBSI process with the hope of a quick settlement at low cost rather than opt for civil litigation that can be costly and filled with delaying tactics and appeals of lower court decisions.

The case of Armand Laflamme stands out. Laflamme unfairly lost his life savings. At age 61 he started civil litigation. He received favorable decisions at two levels of court but the decision was appealed to the Supreme Court of Canada. At age 71 The Supreme Court awarded Laflamme restitution. He spent ten years in a court battle that no doubt was stressful. He died within four years. This is not a fair and just system.

The following article By Jennifer Imrie on Mondaq states *"the OSC's regulatory proceedings may not be the preferable procedure for resolving the issues of investors."*

Court Of Appeal For Ontario Says Securities Commission Proceeding Not Preferable To Class Action For Resolution Of Investor Issues In Market Timing Case

Mondaq, Friday, February 10, 2012
Byline: Ms Jennifer Imrie

In its decision in Fisher v. IG Investment Management Ltd.((www.canlii.org»)) (released January 27, 2012), the Court of Appeal for Ontario held that capital-markets participants that settle complaints with the Ontario Securities Commission (OSC) may still be subject to class action lawsuits, as the OSC's regulatory proceedings may not be the preferable procedure for resolving the issues of investors.

The defendants in the proceeding are five mutual fund managers accused of participating in improper mutual fund market-timing. Prior to the commencement of the class action, the defendants entered into settlement agreements with the OSC pursuant to which they paid $205.6 million in compensation directly to the aggrieved investors. The settlement agreements were without prejudice to the rights of any person to bring civil or other proceedings against the defendants with respect to the same subject matter. Shortly after the settlements were approved by the OSC, the plaintiffs commenced a putative class action seeking to recover the difference between the OSC settlements and the additional monies the plaintiffs allege are necessary to fully compensate them for their losses.

The central issue on the certification motion, and on appeal, was whether the proposed class action met the preferable procedure criterion in s. 5(1)(d) of the Class Proceedings Act, 1992((www.canlii.org»)) (CPA). The motion judge denied certification because, in his view, the completed OSC proceedings and settlement agreements fulfilled the purposes of the CPA, namely judicial economy, access to justice and behaviour modification. The Divisional Court disagreed and held the OSC proceedings could not have been the preferable procedure for recovering damages because the investors' action was for significant monetary damages beyond the amount that had been recovered through the OSC proceedings. The mutual fund managers appealed the Divisional Court's decision.

The Divisional Court's order granting certification was upheld by the Court of Appeal, but for different reasons. Writing for a unanimous court, Winkler C.J.O., held that in considering whether an alternative proceeding is preferable to a class proceeding, the court must examine the fundamental characteristics of the alternative proceeding and compare those characteristics to those of a class proceeding in order to determine which is the preferable means of fulfilling the purposes of the CPA.

In its analysis, the Court of Appeal considered the following characteristics: the impartiality and independence of the forum; the scope and nature of the alternative forum's jurisdiction and remedial powers; the procedural safeguards that apply in the alternative proceeding, including the right to participate either in person or through counsel and the transparency of the decision making process; and the accessibility of the alternative proceeding, including such factors as the costs associated with accessing the process and the convenience of doing so. The Court noted that not all these characteristics will be material in a given case and that each case will turn on its own facts.

The Court of Appeal found two important differences between the OSC proceedings and the class action, which made a class proceeding preferable. The court noted that the scope and nature of the OSC's jurisdiction and remedial powers, and the lack of participatory rights provided to investors in the OSC proceedings were found to favour a class proceeding.

After reviewing the Supreme Court of Canada's decision in Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)((www.canlii.org»)) the Court of Appeal held that section 127 of the Securities Act((www.canlii.org»)), "Orders in the Public Interest", is not intended to serve as a compensatory or remedial provision with respect to harm done to individual investors. Rather, the provision empowers the OSC to regulate capital markets in a way that protects both investors and efficiency. In contrast, the purpose of a class action is to assess civil liability issues such as breaches of a fiduciary duty, a duty of care owed to investors or to quantify the harm allegedly caused by such breaches. In other words, to obtain relief for investors (monetary or otherwise) who have suffered losses as a result of the defendants' alleged conduct.

As well, the Court of Appeal found that the OSC proceedings did not provide comparable procedural rights to that of a class action. In particular, there was no attempt to notify the affected investors of the OSC settlement hearings and neither the investors nor their counsel attended or made submissions. Moreover, the substantive portions of the hearing took place in camera and the amount of compensation the defendants agreed to pay as part of the OSC settlements was calculated without any opportunity for the investors to participate and without any details in the record of the OSC proceedings as to how the amount was calculated. The investors were not intended to be parties to the OSC proceedings nor were the proceedings intended or designed to provide the investors with access to justice for purposes of adjudicating the claims advanced in the class action.

The Court of Appeal held that the motion judge incorrectly viewed the OSC proceedings as if they were a reasonable alternative to a class proceeding, by ignoring the essential differences between the scope of the OSC's jurisdiction and remedial powers and a class proceeding and by failing to consider the participation of the investors in the OSC proceedings. As the issue of whether a class proceeding was the preferable procedure was the only bar to certification in the court below, the Court of Appeal dismissed the mutual fund managers' appeal and upheld the Divisional Court's decision to certify the proceeding.

In this decision, the Court of Appeal makes it clear that the analysis of whether an alternative proceeding is preferable to a class proceeding requires a thorough consideration of the central characteristics of the alternative proceeding as compared to the class proceeding, and provides an analytical framework for that determination.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Ms Jennifer Imrie, Stikeman Elliott LLP

Mutual fund salesman banned for life after shunning investigators - Michael Harvey didn't want to discuss risky leveraging strategies he recommended to clients

BY DAVID BAINES, VANCOUVER SUN JANUARY 7, 2012

Michael Labrick Harvey, a former mutual fund salesman with Investors Group and Canac-cord Capital, has been booted from the mutual fund industry for life after he failed to answer charges of serious and repeated misconduct. A hearing panel struck by the Mutual Fund Dealers Association of Canada imposed the permanent ban on Wednesday after Harvey failed to cooperate with MFDA investigators. The panel also assessed a $100,000 fine and $10,000 in costs.

MFDA enforcement staff began investigating Harvey's activities after 19 clients filed a total of 12 complaints relating to leveraging strategies that he had recommended to them before the 2008 market meltdown. Leveraging involves borrowing money to invest in assets (in this case, mutual funds). It's a risky strategy: with more money in play, returns can be enhanced, but if the market goes the wrong way, losses can be exacerbated. Unfortunately for all concerned, the

market collapsed. Harvey's clients complained that, given their financial circumstances and risk tolerances, he should never have rendered this advice in the first place.

Let's pause here. There are many securities sales people who will argue that clients want it both ways: if the market goes up, they happily accept their returns, but if the market goes down, they squeal like little pigs. This is quite true, but it is no defence. Down markets are a fact of life. The sales person must be able to defend the strategy, not only in good times, but also in bad. If he can't, he must be prepared to accept the consequences. That is the way it is, and the way it should be. In this case, MFDA enforcement staff found reasonable grounds to believe that, between December 2006 and September 2008 (while working at Investors Group), Harvey got his clients into leveraging strategies that were not suitable for them.

MFDA staff further alleged that, to ensure that his employer approved his strategies, Harvey falsified information on account documents for at least 13 clients, and forged signatures on at least 67 client account documents. In a notice of hearing issued in August 2011, MFDA enforcement staff outlined three client complaints. In one case, a client was approved for a $200,000 loan (provided by the National Bank of Canada under a distribution agreement with Investors Group). He used the proceeds to buy mutual funds.

When Harvey moved to Canaccord in September 2008, Investors Group assigned another mutual fund sales-person to the account. By that time, the market was in a serious downturn and the client inquired about selling his mutual funds. The new account rep told the client that if he liquidated them, he would have to pay deferred service charges (a form of early redemption fee). The client claimed he had instructed Harvey not to buy any funds with deferred service charges. Investors Group reviewed the matter and found signed documents indicating the client had, in fact, been apprised of all fees. The client protested that these and other documents had been falsified. Among other things, he alleged that his income had been listed at $93,911 when it was actually $75,000, and his risk tolerance was listed as "high" when it should have been "medium."

In another case, Harvey recommended a client borrow $300,000 and used the proceeds to buy mutual funds, once again on a deferred ser-vice charge basis. By the time Harvey left Investors Group, the value of the client's mutual funds had dropped by $105,000. The client complained that Harvey had recommended unsuitable leveraging strategies; failed to adequately explain the risks; and misrepresented the fees associated with their investments.

When Investors Group reviewed the matter, it discovered 16 more client documents that had been allegedly falsified. Among other things, the client's income had been listed as $50,000 to $75,000, when it was really $25,000 to $50,000; his net worth had been inflated; his investment knowledge was listed as "good" when it was clearly minimal; and his risk tolerance was listed as "high" when it was obviously lower. In several cases, Investors Group found sufficient evidence to conclude that the leveraging strategies Harvey had recommended were not suitable. As a result, the firm unwound those investments at its own expense.

MFDA investigators told Harvey about the client complaints in early 2009, by which time he was working at Canaccord. Harvey dismissed them as "a calculated and malicious attack on my professional reputation and a manipulation of my clients by Investors Group in response to my decision to move to Canaccord." However, when MFDA investigators sent Harvey a registered letter requesting a meeting, it was returned "unclaimed." Other letters and phone calls were similarly unanswered. He resigned from Canaccord in February 2010 and is no longer registered in the securities industry in any capacity. Nor will he ever be. On Wednesday, the MFDA held a hearing in downtown Vancouver. Harvey didn't attend. In his absence, the panel banned him for life. I have been unable to determine Harvey's current location or employment. If any readers know what he's up to, I would be most interested in hearing from them.

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