SIPA Sentinel

September 2014

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.

Video voicing experience with financial loss recovery

The following message was sent to SIPA members during August 2014:

Larry Elford has just posted a video prepared by one of our members whose family has recently experienced financial loss and the ensuing gauntlet of pursuing restitution. You must view this video by this courageous lady originally prepared for CBC Marketplace. It is concise and describes the main issues, however it was never aired by the CBC.
https://www.youtube.com/watch?v=TYu_td_bvs8&list=UUy8dpTRZHEz-0JBa_l0w7AQ

This story is similar to most of the experiences I have heard over the last 15 years. The difference is this lady is courageous enough to speak out to try to help her fellow Canadians from facing the same fate.
I have talked with many hundreds of people over the years who have experienced financial loss when they placed their trust in a "Financial Advisor". It is not surprising because most "Financial Advisors" are registered as a "Dealing Representative - A sales person" who does not have a responsibility to look after his client's best interests.
I think the industry and regulators are deceiving Canadians when they allow sales persons to be called "Financial Advisors" and claim that "Advisors" are not the same as "Advisers".
At the same time most people and many financial journalists believe "Advisor" and "Adviser" are simply spelling variations of the same word.
If that is so then shouldn't "Financial Advisors" be required to be registered as an "Advising Representative" rather than a "Dealing Representative - A sales person"?
The point is many Canadians are losing their savings when they place their trust in a sales person and wrongly believe their "Financial Advisor" has a fiduciary duty. After all he is looking after their life savings. Any rational person would believe he should have a fiduciary obligation.
The industry believes otherwise. The fact is the industry and IIROC consider "Financial Advisor" and "Vice President" simply a business title and there is no regulation of business titles. The regulators allow this to happen.
In my book this is just plain wrong to deceive people by allowing sales persons to be called "Financial Advisor" and "Vice President" without having the legal obligations one would expect. Government and regulators should not allow this practice to continue.
The magnitude of losses due to this deception is difficult to quantify because:
Victims are reluctant to admit their losses
The regulators will not make information on losses, claims or settlements available.
The Government relies upon regulators for the financial services industry and the regulators delegate to self regulatory organizations so information will not be released that would paint a negative picture of the industry.
When victims do file a civil claim and receive an out of court settlement it includes a confidentiality clause (or "Gag" order) that discourages victims from speaking out at all. Certainly they can't reveal the amount of loss or settlement. They can say they had an issue which has been satisfactorily resolved, but most just will not speak out.
This lady has the courage to speak out. I feel she has an important message for all Canadians.

The fundamental reason for most victim's loss in my opinion is that they place their trust in a Financial Advisor because they do not know he is a sales person without a legislated requirement to look after his client's best interests.
This is a short video. Please take the time to view it. It will help you to understand how the industry operates. Most Canadians do not learn until they themselves have lost their savings.

SIPA is one Voice for small investors. We need other Voices to speak out. SIPA's website (www.sipa.ca) will provide a special section for videos of victims of the investment industry who are prepared to speak out. It is not necessary to publish your name of your location. If you are prepared to help please contact SIPA for guidance. You may wish to read what victims say on our website at http://www.sipa.ca/library/voices.htm

How widespread is investment fraud and wrongdoing?

In spite of claims that the investment industry is well regulated and that regulators protect investors, the fact is Canadians are losing an estimated amount in excess of $25 billion each and every year due to fraud and wrongdoing by the regulated investment industry. The following several articles outline some particular cases this summer.

MFDA fines former advisor $50,000

Ex Armstrong & Quaile advisor sold unauthorized products, engaged in personal financial dealings with clients

By Fiona Collie | July 23, 2014 10:25

A former financial advisor in Ontario must pay a $50,000 fine to the Mutual Fund Dealers Association of Canada (MFDA) for recommending and selling unauthorized investment products and engaging in personal financial dealings with clients.
According to MFDA documents, between September 2007 and June 2011, Barry Hunt recommended a client invest in two real estate properties, the Brockville Real Estate Investment and Marsden Renovations. Neither of these investments were approved by Waterloo, Ont.-based Armstrong & Quaile Associates Inc., Hunt's employer at the time, nor did the ex-advisor seek approval of the investments from the firm.
Furthermore, the same client personally loaned Hunt $120,000 in order for him to finance the operation of a property he owned. Hunt verbally agreed to pay interest payments of $800 per month for the loan.
Finally, in 2008, Hunt sold interest in another property he personally owned to three clients – including the individual mentioned above – and 11 other individuals. At no time did Armstrong & Quaile give approval for such an investment.
The investigation into Hunt's activities originated with a complaint from the brother and sister-in-law of the client invested in the Brockville and Marsden projects. The brother and sister-in-law were the client's powers-of-attorney. Hunt repaid the loan and reimbursed the client for her investments. In regards to Hunt's property, everyone except that client continues to hold their interest in the investment.
In addition to the fine, Hunt is banned from acting as a mutual fund salesperson for seven years and must pay $5,000 in costs.

Former B.C. advisor fined $80,000

Rep purchased unsuitable stocks for client's registered retirement savings plan

By Fiona Collie | July 24, 2014 14:30

The Investment Industry Regulatory Organization of Canada (IIROC) has fined a former financial advisor in British Columbia $80,000 for purchasing unsuitable investments in a client's account and for failing to cooperate with an investigation.
Between 2008 and 2009, Simon Jaques, who was working at the Vancouver branch of Mackie Research Capital Corp., purchased high-risk stocks in a client's registered retirement savings plan (RRSP). According to IIROC documents, the orders consisted of the purchase and sale of a silver exploration company called Orko Silver Corp., the purchase of stock in KCC Capital Corp., a capital pool corporation.
At the time, the client was 56 years old and retired. She was unable to work due to an illness and so depended on the investments for income. The client's New Client Application Form (NCAF) stated her risk tolerance as follows: 25% low risk, 50% medium risk and 25% high risk.
Despite the high-risk allocation in the NCAF file, an IIROC hearing panel ruled that the purchase of these investments were unsuitable for the client given her overall risk tolerance, investment objectives and financial situation.
IIROC ordered Jaques to pay $30,000 for failing to use due diligence when placing orders for the client's accounts. The remaining $50,000 of the total fine was levied against Jaques for his failure to cooperate with IIROC's investigation into this matter.
In addition to the fine, Jaques is permanently banned from IIROC registration in any capacity and must pay $20,000 in costs.
Jaques is no longer a registrant with an IIROC-regulated firm.

Former fund salesman fined $1.5 million

Jacques Scribnock facing criminal charges

By Fiona Collie | August 27, 2014 17:10

The Mutual Fund Dealers Association of Canada (MFDA) has fined Jacques Scribnock, of Kinburn, Ont. $1.5 million for misappropriating client funds and failing to cooperate with the regulator's investigation.
According to MFDA documents, Scribnock, while a mutual fund salesman with Investia Financial Services Inc., headquartered in Quebec City, incorporated a separate company, called Stone Securities, in 2009 without the knowledge of his dealer firm.
Scribnock then lead four clients to believe this company was related to Stone & Co. Ltd., a mutual fund company which some of the individuals had already invested in. However, no such relationship existed. Scribnock also told clients that Stone Securites was an investment product offered by Investia and was affiliated with Manulife Financial.
In total, four clients invested $859,723 in Stone Securities between March 2009 and March 2011. According to the MFDA, Scribnock did not invest any of the funds but rather deposited them into a personal bank account. Scribnock has not returned or in any way accounted for the funds, says the MFDA. Three of the clients were retired and at the time one individual was about 80 years old and showing early signs of dementia.
In March 2011, Investia terminated Scribnock's employment primarily for recommending unsuitable leveraged investments to clients, according the self-regulatory organization. At that time, the firm was not aware of Stone Securities. During an interview with the MFDA following the termination, Scribnock denied entering into any outside business activity that was not disclosed to Investia. It was during the course of this investigation that the MFDA became aware of allegations that Scribnock had misappropriated funds.
Scribnock continued to solicit funds from clients after he had left Investia, however, the MFDA did not include these funds in its investigation because it does not have jurisdiction over those transactions. The Ottawa Police Service also investigated Scribnock and have charged him under the Criminal Code, according to the MFDA. The charges are still pending. The police place the total of funds deposited with Stone Securities at $2.6 million.

In addition to the fine, Scribnock is permanently banned from conducting securities-related business in any capacity with an MFDA member and must pay costs of $7,500.

Ex fund salesman fined $250,000
Off-book exempt market transactions concealed from dealer

By Fiona Collie | August 15, 2014 10:15

The Mutual Fund Dealers Association of Canada (MFDA) has fined another Alberta fund salesman, Stuart Henschel of Alberta, $250,000 for off-book transactions.

According to MFDA documents, between 2007 and 2010, Stuart Henschel worked as a mutual fund salesman in the Calgary area for Vaughan, Ont.-based FundEx Investments Inc. During that time, Henschel sold, recommend, facilitated the sale or referred exempt market investment products to more than 25 clients. FundEx did not approve these exempt securities and was not aware of Henschel's actions as he took steps to conceal his activities.

In total, clients invested at least $6,346,000 in the exempt securities over the three-year period, according to the MFDA, creating $224,375 in commissions for Henschel.

In addition to the fine, the MFDA permanently banned Henschel from conducting securities related business as an employ of an MFDA member and order him to pay costs of $7,500.

Off-book transactions used to purchase real estate

By Fiona Collie | August 19, 2014 10:30

Bruce Mawer, a former mutual fund salesman in Alberta, must pay the Mutual Fund Dealers Association of Canada (MFDA) a fine of $50,000 for engaging in personal financial dealings with clients and off-book transactions.

Between 2006 and 2007, Mawer was working as a mutual fund salesman in the Edmonton-branch of Worldsource Financial Management Inc. During that time, he accepted $103,000 from four clients (two couples), according to MFDA documents. As well, Mawer solicited another $137,316 from four insurance-only clients of his but who were not connected to Worldsource.

Mawer used the money to pool with his own funds and that of a business partner – a real estate agent – to purchase investment properties in Alberta and British Columbia.

In 2007, due to the downturn in the real estate market, some of the properties had to be rented rather than sold while other properties under construction were never completed. Finally, in 2012, all of the properties were in foreclosure, according to the MFDA, and there was no longer any reasonable possibility of the clients' receiving their principle back.

According to the MFDA, Mawer did not keep proper records of the money he received from clients and Worldsource was never aware of his dealings. Mawer was let go from Worldsource in 2008.

In addition to the fine, Mawer is permanently banned from conducting securities related business with an MFDA member and must pay $7,500 in costs.

E-mail to a journalist February 2014
Subject: Adviser/Advisor and the Investor Advisory Panel Report

The report "Strengthening Investor Protection in Ontario - Speaking with Ontarians" by Ascentum carried out for the Investor Advisory Panel is most revealing in the quoted comments received from investors.

It is also interesting that the word "adviser" is used throughout when it is obvious in most cases the individual was a sales person, registered as a dealer's representative that likely used the industry conspired title of "Advisor".

Not much new or surprising in the report, but a good professional study that re-confirms what was said in many previous reports including the SIPA Report a decade ago which was based upon interviews with hundreds of investors.

And yes, most investors trust their financial representative, but the investors are not aware of what they do not know. They trust their representative. As SIPA did in our report they quoted many small investors, and once again what the investors say is most revealing. However no clarification of the Adviser/Advisor deception is offered. A few of the investor comments follow.

> *"We are not all financially trained...but it is more essential now than ever with pension plans disappearing from employment packages. We need to be able to trust in the recommendations being provided by financial advisers."*
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> *"I sometimes view the whole financial services industry as a bit of a 'shell game'. Once you hand over the cash, it just seems to vanish into the maze, and there seems little to do except close your eyes and hope your adviser knows what he or she is doing. Often they just hand off the cash to managed accounts...and everyone takes home a pay cheque regardless of performance. Perhaps my sentiments are just rooted in current economic uncertainty, but I've never had terribly good fortune in the many years I've been in the market."*
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> *"I didn't know what he couldn't provide. It's like trying to decide between two mini vans. I wouldn't have known that the middle windows didn't roll down unless I went somewhere else and saw some that went down. I never asked 'can I buy individual stocks from you?' I only realized that two years later. What else didn't they tell me?"*
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> *"If my financial adviser tells me to invest $10,000 in a fund rather than paying off my credit card balance, is that wrong? How do you put that into law? I sometimes think I should be paying off my debt rather than investing. They just want money in their portfolios. A few years ago my cousin called to say he was borrowing money to invest in hot stocks. He already had debt to pay down. What's the best interest there?"*
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> *"I would like to see the value of what I put in versus the actual market value of my investment to see if I am ahead or not. With the effects of the last few years, I am not sure my portfolio is worth any more than the initial amount I put in. Have I made money?? It's hard to know sometimes."*
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> *"Provid[ing] indices or benchmarks to compare would help let me know how my particular investments are doing, and a brief explanation would be very helpful if they were above or below the index. If my fund out or underperforms, I'd like to know why."*
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> *"Getting/viewing prospectuses prior to making an investment. They arrive after the fact, full of details my adviser fails to tell me, and when I go looking ahead of time for something he's keen on, I can't find the particular one I need."*

Listen to what investor voices say. This will help you to understand how the investment industry operates and

why you must believe it is really "Investor Beware". Until investment industry representatives selling products and advice have a statutory fiduciary duty it will remain "Investor Beware".

CSA letter dated August 1, 2014 responding to SIPA questions

On March 28, 2014, SIPA sent an e-mail to the Canadian Securities Administrators asking for clarification on a number of issues that impact on small investors. SIPA believes that the public is being mislead when the regulators allow the industry to use titles of "Financial Advisor" and "Vice President" for persons registered as "Dealing Representative - A sales person". Most Canadians believe an "Advisor" has a fiduciary responsibility. Unfortunately this is not so. The Chair for the Registrant Regulation Committee of the Canadian Securities Administrators clarified many of the issues with the following e-mail response.

> *Thank you for your letter of March 28, 2014. It was referred to the Registrant Regulation Committee of the Canadian Securities Administrators (which I chair) for a response. We have tried to answer all your questions as fully as possible, but if you have any follow up questions, please feel free to contact me directly.*
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> ***Limitation Periods –***
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> *There are differing limitation periods for securities related matters in each jurisdiction. As a starting point, we would note that some limitation periods are found in the Limitation of Actions Act or Limitations Act in each jurisdiction (the Civil Code in Québec), which will set out general limitation periods for civil actions such as breach of contract, negligence, or breach of fiduciary duties. These limitations would apply where a person is taking civil action against another person, such as an action against a registrant for negligence.*
>
> *Securities legislation in each jurisdiction also contains limitation periods. There are limitation periods that relate to civil claims by a person for misrepresentations contained in a prospectus or other offering document, or for claims of secondary market liability. In addition to these limitation periods, securities legislation can also contain limitation periods that relate to administrative hearings of offences under the securities legislation taken by Commission staff before the Commission (in Québec, the Bureau de decision et de revision, an administrative tribunal) or for proceedings of offences under securities legislation prosecuted in provincial court.*
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> *Before an investor turns to the Commission for help, it is important to confirm that the Commission has the jurisdiction to bring a proceeding against a registered firm or its representatives. The nature of the dispute and the type of the registered firm will determine the investor's best course of action as well as which organization can help. In particular:*
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> *It is advisable to address any problem directly with the firm first. Most complaints can be resolved in this way.*
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> *As of August 1, 2014, all registered firms outside Québec must use the Ombudsman for Banking Services and Investments (OBSI) as the common dispute resolution service. OBSI is a free, independent dispute resolution or mediation service available to an investor that has an eligible complaint. In Québec, the Autorité des marchés financiers provides a mediation service for disputes.*
>
> *The Investment Industry Regulatory Organization of Canada (IIROC) investigates complaints and takes disciplinary actions against investment dealers. The Mutual Fund Dealers Association of Canada (MFDA) does the same against mutual fund dealers. Complaints about dealers and advisers*

who are not members of IIROC or MFDA should be made to the Commission. These include portfolio managers, scholarship plan dealers, exempt market dealers and restricted dealers.

A complaint against someone selling or advising without being registered should be made to the Commission.

We encourage investors to call the Commission for further information and guidance. http://www.securities-administrators.ca/investortools.aspx?id=90.

Registration Classifications

The registration categories under securities legislation are set out in National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations. They are: dealing representative, advising representative, associate advising representative, ultimate designated person and chief compliance officer. These are the descriptions that apply to individual registrants for the purposes of registration. An individual who is acting as an adviser on behalf of a portfolio manager will be registered as either an advising representative or an associate advising representative. An individual who is trading in securities on behalf of a dealer (such as an investment dealer, mutual fund dealer, exempt market dealer, restricted dealer or scholarship plan dealer) will be registered as a dealing representative.

We do not prescribe specific titles to be used by those persons who are either dealing or advising in securities. Most securities legislation requires that an individual who holds themselves out as being registered to in fact be registered and to indicate the actual category of registration.

Financial Advisor, as you noted, is a common title which many persons use, whether they are registered under securities legislation or not. The use of this title is not generally prohibited, and may be used by anyone, including persons who are only licensed to deal in insurance products, mortgage brokers, deposit agents, or employees of financial institutions. Some jurisdictions regulate the use of some titles. For example, in Québec, no person may use the title Financial Planner without holding the appropriate certificate issued by the Autorité des marchés financiers. The title Financial Advisor may not be used by anyone as it is considered similar to the title Financial Planner. Having said that, most jurisdictions do not regulate the use of Financial Advisor, and as such it is widely used.

As with Financial Advisor, the title of Vice President is increasingly a common title used in the financial services industry. While an officer of a firm may be designated to be a vice president, the use of the title is not reserved to actual officers of a corporation. As such, it is not safe to assume a person described as a vice president is in fact an officer of that corporation.

Suitability –

CSA staff published on January 9, 2014 CSA Staff Notice 31-336 Guidance for Portfolio Managers, Exempt Market Dealers and Other Registrants on the Know-Your-Client, Know-Your-Product and Suitability Obligations. We believe this notice will assist in understanding the suitability requirement and our expectation of registrants.

Fiduciary –

A common law fiduciary duty may apply to portfolio managers or other registrants, depending on the circumstances. Typically, Canadian courts have identified five interrelated factors to be considered when determining whether "financial advisors" stand in a fiduciary relationship to their clients:

vulnerability of the client in the relationship, the trust and reliance that clients place in their advisor, the extent to which the advisor has power or discretion over the client's account or investments, and the professional rules and codes of conduct of the advisor. In Québec, where a civil law regime applies, the fiduciary duty does not exist since it is specific to the common law. For further information, see Parts 3 and 4 of CSA Consultation Paper 33-403, including specifically the table in Part 4.

Best Interest –

Four provinces (Alberta, Manitoba, Newfoundland and Labrador, and New Brunswick) have a statutory requirement that when advisers or dealers have discretionary authority over their clients' investments, the adviser or dealers must act in the clients' best interests. Investment fund managers are also subject to a statutory best interest standard all across Canada. In Québec, according to both the general civil law and the Securities Act (Québec), registered dealers and advisers are currently subject to a duty of loyalty and a duty of care and must act in the client's best interest. The extent of these obligations under the Civil Code varies depending on the legal context and nature of the investment advisory relationship (e.g. discretionary account or non-discretionary account, executing broker only), taking into account the degree of trust, dependence and vulnerability of the client. For further information, see Part 4 of CSA Consultation Paper 33-403.

Hopefully this answers your questions. As mentioned above, please feel free to contact me directly with any follow up questions you might have.

Chris Besko
Acting General Counsel & Acting Director
The Manitoba Securities Commission

How are small investors protected by the regulators?

The regulators claim to provide preventative investor protection. The few examples above of representatives being fined for wrongdoing illustrates the fact that regulators are unable or unwilling to stop fraud and wrongdoing from happening. So what is the fundamental problem?

It is established fact that most Canadians believe so-titled "Financial Advisors" owe them a fiduciary duty. However, the Besko letter confirms that "Financial Advisor" and "Vice President" are unregulated titles commonly used by sales persons. Canadians are being deceived by the industry and regulators and place their trust and life savings in the hands of commission motivated sales persons who are not required to act in their clients' best interests.

It is unconscionable that Government and delegated regulators continue to allow this Grand Deception to continue that results in the financial rape and pillage of the Canadian people. What is absolutely abhorrent is that the trust created by the use of false titles is routinely breached and yet no changes are being made.

The extent of this financial damage is covered up so well that Canadians only find out how bad it is after they themselves have been victimized. I shudder each time I hear someone say "I trust my Advisor". They do not know that their Advisor is a sales person until they have been leveraged and sold unsuitable products that result in the decimation of their life savings and they suffer a life-altering event. The realization that their life savings are gone and their trust has been betrayed is often cause for health to be effected, families to be broken up and sometimes suicide. It is indeed Investor Beware.