SIPA Sentinel

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Small Investor Protection Association - A voice for small investors

TAX FREE SAVINGS ACCOUNTS

The Tax Free Savings Accounts (TFSA) is one of the better types of investment accounts. Although the money you invest is not tax deductible. All of your gains and earnings in the account accumulate and are tax free when you withdraw money from your account. This is a big advantage over other Registered Plans which are simply tax deferral.

With Registered Retirement Savings Plans (RRSP) you are able to get a tax credit for contributions up to a certain limit. However all of the gains in the account are taxed as income when your money is withdrawn. Also when you reach a certain age you are required to convert your RRSP to a Registered Retirement Income Fund (RRIF) and to make defined withdrawals each year. These withdrawals are taxed as income without the tax favorable consideration of capital gains for non-registered investments.

Keep in mind that you may place the same type of investments in a TFSA as your would in an RRSP. Wise investors will likely place GICs, bonds, shares and ETFs in their investment accounts rather than mutual funds or segregated funds. Although there are a few funds that have proven to be good investments, the majority do not perform well because of the excessive commissions and fees for most mutual funds.

Be aware that there are many financial products being offered to investors by commissioner sales persons and these products are created to generate commissions for the industry. You should also keep in mind that sales persons are able to use the titles of "Financial Advisor" and "Vice President" as these are not regulated and are considered by the industry simply as business titles.

We contacted the Canadian Securities Administrators (CSA) regarding this issue and their response follows:

> *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.*
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> *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.*

We encourage all Canadians to open a Tax Free Savings Account. At the same time we encourage all Canadians to check the credentials of their Financial Advisor with the CSA. The CSA has a National Registration Database (NRD) which contains all representatives registered across Canada. Also if you already have an investment account, check your statement. If it shows your representative with the title "Financial Advisor" (spelled with an "O") then he is acting as a sales person when he deals with you even though he may have higher qualifications. This is one of the nasty tricks used by the industry in an attempt to avoid any responsibility for the performance of your investments.

Larry Eldridge Lethbridge Alberta

I first met Larry many years ago. He seemed like a straight shooter and had spent many years in the investment industry and was one of those who were serving clients well. He understood the issues and tried to make a difference from within but was thwarted by management. He resigned from the industry but has continued to work towards making a better investment environment for Canadians. I have had the privilege of associating with Larry for several years and feel he is one of the few who does have the best interests of investors in mind when he encourages change in the investment industry and regulatory system.
In February 2013 Larry submitted *"COMMENTS ON CSA Consultation Paper 33-403".*
A few of his comments are reproduced below:

> *1. The investment industry is perversely incentivized to increase profits even at the expense of doing intentional harm to investors' interests. The protective duty owed to the public interest by industry, and by regulatory and self regulatory agents, appears to have been lost, forgotten, or silenced. I have found this to be the case time after time. Despite all attempts to portray the industry as professional body acting in positions of trust, this submission will attempt to show how far short the industry has come in living up to the promises.*
> *2. The regulatory industry appears to have become a "business within a business", earning considerable salaries and job security by catering to the investment industry, while acting willfully blind to numerous public harms. Provincial regulator salaries of triple to quadruple those paid to provincial premiers, have ensured a loyalty and a protective bias towards the industry*
> *Regulatory actions appear to be aimed only at the smallest and least important players, while large scale or systemic crimes against the public have an investigation or prosecution rate that is statistically zero. It is an industry where it appears that "anything goes" as long as it is profitable to the strongest financial institutions in the world.*
> *One result of the "sale" of the public protective interests by regulators is that the average Canadian could be cheated, shortchanged or abused by persons in positions of trust, to an extent where half of their future retirement (or more) could be removed from them, and placed into the hands of those persons posing as trusted professionals.*

See additional comments from Larry and become enlightened by visiting his Videos on YouTube.

POINT OF SALE DISCLOSURE

A long time ago there was an initiative to introduce Point of Sale Disclosure for mutual funds so that investors would know the details of the mutual funds being sold to them. However the industry reacted strongly against this initiative to provide investors with information that could help them make an intelligent investment decision. The industry lobby was successful in having the initiative derailed and replaced by a two page data sheet called "Fund Facts". In fact the document that was produced by the regulators did provide good information for investors but once again the industry lobby managed to have it delayed so that it was only required to be provided two days after the sale.

Now one might wonder why a fact sheet developed for a particular fund could not be provided on the day of the sale before the investor made a decision instead of two days after the fund was bought. Could this be considered trickery by the industry to prevent investors from receiving information that could influence their decision?

Last year it was decided the time had come to make Fund Facts available at the time of the sale rather than after the sale and the date for implementation was set for a year later, May 2015. Now the industry is once again lobbying to have this date delayed. SIPA has joined others in making submissions to the regulators to try to have them continue with the planned schedule. The following is part of our submission to the Canadian Securities Administrators and the complete submission is now available on our website.

> *We feel it would be irresponsible for the regulators to back down from the implementation date on a broad basis. There are already some decent firms that are providing, for the first time ever, costs related to investment transactions before they will take action. Also numerous professionals in the industry support better disclosure of information.*
>
> *The current situation of failure to disclose is a force driving investors to Do It Yourself investing rather than risk dealing with an industry representative who is commission driven and selling products without adequate disclosure. Too many Canadians are losing their savings when they place their trust in a so-titled "Financial Advisor" who is simply a commission driven sales person.*
>
> *The practice of regulators allowing the industry to use unregulated titles is appalling. If the regulators allow industry to delay the implementation of CRM2 it will be tantamount to telling the public they are representing the industry's best interests.*
>
> *The provision of the costs of investing and the percent return is fundamental to being in the advisory business. Each month that goes by, hundreds of millions of dollars of fees are not given the visibility needed for investors to make informed investment decisions. It's time to stop the decades long cycle of foot-dragging and make a determined decision to act in the Public interest.*
>
> *We urge you to stay with the established schedule and not accept any further delay.*

INVESTOR AWARENESS

The regulators continually promote investor education and provide endless information, but lets face it most of us don’t have time to gain knowledge of all the different products available and the risks associated with them. However the fact that so many Canadians are losing their savings while relying upon a trusted “Financial Advisor” has caused many investors to become Do It Yourself investors. Some simply invest in shares, bonds or fixed income, and ETFs.

Others have simply invested in bank GICs which pay very little interest but keeps their money safe. This works for those people who benefit from workplace pensions and have enough to support the rest of their life so they have no need for income.

Because many investors have invested in the original ETFs for shares, bonds, or dividends, the industry has created funds they label as ETFs. However these industry created products provide the industry with higher fees than the very low management fees of the ETFs like those now managed by Blackrock.

There are also some good mutual funds but the average investor is not in a position to evaluate. Some of the earlier funds provided diversity and had reasonably good track records. However the firms selling the funds could see that the management fees were significant when compared to the selling commissions they received. As a result many firms created their own funds (called propriety funds) which could not provide the same performance as those managed by well qualified professionals.

Investors started comparing returns to established benchmarks and could see that most funds were performing at about 3% less per year (which is the usual amount of fund fees also not disclosed). However, the industry is quite creative and so they developed bench marks based upon peer performance. That is they took the performance figures from like funds to produce an average performance figure. If they were simply above average they could show they beat the benchmark.
As part of our Investor Awareness program we are publishing recent discipline reports in the Sentinel to help investors understand the type of behaviour that continues unabated in the regulated investment industry. We believe investor awareness will help investors avoid being fleeced by an industry motivated by commission and failing to consider what is best for the investor.

WHY IT IS IMPORTANT TO CHECK YOUR ADVISOR'S CREDENTIALS

It seems that many Canadians are still not aware that their so-titled "Financial Advisor" may be simply a sales person pushing financial products and motivated by commission. It seems it is only after the investor has lost a substantial portion of his savings that he takes the time to learn the horrible truth. It happened to me and is happening to many others all the time.

There are many in the industry that play fast and loose with investors money. That is why so many Canadians today are trying to manage on limited budgets even though they had saved for a lifetime thinking they would have a comfortable retirement. It is an extreme shock for anyone in their fifties or sixties that most of their savings are gone. To help you to better understand what every investor faces read the Voices on our website at http://www.sipa.ca/library/voices.htm.

MORE ON MUTUAL FUNDS FROM KEN KIVENKO

The following are excerpts from the Canadian Fund Watch website written by Ken Kivenko who is also Chair SIPA Advisory Committee. The complete article and more are available at CanadianFundWatch.

CanadianFundWatch.com

This web site is dedicated to investment fund investor education and protection. The multi-billion fund industry plays a key role in the savings and retirement plans of millions of Canadians. Many industry practices provide beartraps for the unsuspecting investor and securities regulations have not kept up with the pace of change in the industry.

…

> *Return of Capital funds (ROC funds; also known as T class funds).) are designed to provide a monthly income to yield- hungry investors. Seniors and retirees are often the target market. ROC funds have been described as "high payout funds" and been sold as a way of financing cash flow needs. These funds have been the source of a lot of mis-selling that has given rise to a lot of client complaints. Many of these funds cite unrealistic rates of 8 % or more, which to the unsuspecting retail investor is very attractive. Much of the fund's distribution is actually return of capital ,not real income earned by the fund. Return of capital is not immediately taxable. Instead, it is deducted from your Adjusted Cost Base (ACB), which gives rise to a larger capital gain – or smaller capital loss – when the fund is ultimately sold. The advertized "yield" and the perceived tax-friendliness make ROC mutual fund units an easy sell for an unscrupulous "advisor". These dealer Reps mischaracterize the nature of the distributions believing most retail investors will likely not read or understand the warning text in the Simplified Prospectus and will buy into the mirage.*

The typical sales pitch is as follows:
a) the ROC mutual funds' distributions are presented as dividend or interest payments;
b) borrowing to invest is a smart move- the ROC mutual funds can be relied upon to make distributions to investors each month which would be at least equal to or greater than the borrowing costs associated with the clients' investment loans;
c) excess distributions made by the ROC mutual funds could be used by the clients as extra spending of the investment loans on an accelerated basis;
d) the investment loans would be paid off entirely by the distributions from the ROC mutual funds;
e) the ROC mutual funds purchased with the investment loans would continue to grow in value over time and, once the investment loans were repaid, the clients would own the ROC mutual funds, which would continue to grow in value and continue to generate distributions for use by the clients; and
f) the Leveraged Investment Strategy is classified as no or low risk.

…

Back in 2011, respected fund analyst Dan Hallett wrote a blog Leveraging + High Payout Funds = Unhappy Ending http://thewealthsteward.com/2011/11/leveraging-high-payout-funds-unhappy-ending/ critical of the sales pitch surrounding ROC funds. Hallett also discusses some tax related risks. He concluded " ... But the above-noted strategy that I've heard so much about strips the investment of its most powerful force – i.e. compounding reinvested distributions – while jacking up the cost of the loan. And that's a leveraging strategy that seems destined to end badly.".

…

There are far too many examples of where such mis-selling has happened, so beware of the sales pitches that accompany ROC funds. Don't count on the risk disclosure in Fund Facts - Volatility is not the only big risk with this type of fund. If you are taking a ROC fund's distribution in cash (and spending it) you had better check to see if the distribution is sustainable. More often than not, it isn't.

INVESTING IN HEDGE FUNDS

The investment industry creates new and innovative financial products to entice investors. Unfortunately there is no magic formula to investing. The market is fickle. No one can foresee the future. Surprise events impact the wider market. Who could foresee oil at less than $50 per barrel? The stock market goes up at times but it also goes down. That is why investors will diversify their holdings and hold a combination of stocks and bonds.

Stocks would include shares in companies and other created products like ETFs, mutual funds, segregated funds and other structured products where the value is based on products whose value fluctuates with the investment market.

Bonds would include fixed income products when the value does not fluctuate with the market. For example Canada Savings Bonds are cashable anytime for full face value. Most bonds are initially sold at face value with a fixed rate or return and a maturity date. However the market value does fluctuate as interest rates vary, so if the bonds are cashed before maturity the realized value could be much less than face value. But if the bonds are held to maturity the full value will be received.
However few investors with a "Financial Advisor" would hold bonds because the commission rates do not compare with mutual funds. So those who want to invest in bonds will most likely have a Bond Fund because the commissions for their representative are much higher funds.

The following article shows that Hedge Funds can lose value at a rapid pace … faster than you can react.

Manager 'truly sorry' for blowing up hedge fund

Lawrence Delevingne | @ldelevingne
Wednesday, 21 Jan 2015 | http://www.cnbc.com/id/102356275

Owen Li, the founder of Canarsie Capital in New York, said Tuesday he had lost all but $200,000 of the firm's capital—down from the roughly $100 million it ran as of late March. "I take responsibility for this terrible outcome," Li wrote in a letter to investors, which was obtained by CNBC.com.
"My only hope is that you understand that I acted in an attempt—however misguided—to generate higher returns for the fund and its investors. But even so, I acted overzealously, causing you devastating losses for which there is no excuse," he added. Li is a former trader at Raj Rajaratnam's Galleon Group, which collapsed amid insider trading charges. Rajaratnam is now in prison for the illegal activity, but Li was never accused of wrongdoing.
Li's lieutenant at Canarsie is Ken deRegt, who joined in 2013 after retiring as the global head of fixed income sales and trading at Morgan Stanley. His son Eric deRegt also worked at Canarsie, according to filings with the Securities and Exchange Commission as of March 2014.Li and the deRegts did not immediately respond to emails seeking comment. No one picked up a phone call at Canarsie's offices and no valid voicemail was available, according to an automatic telephone company recording.
Li said in the letter that he made a series of "aggressive transactions" over the last three weeks to make up for poor returns in December. He said he bet on stock price options, predicated on the broader market rising. But stock indexes fell, causing the huge losses along with several undisclosed direct investments, according to the note.
Li noted that he has retained counsel and is working with the fund's service providers to determine additional details on the loss for clients. SS&C Technologies is listed as Canarsie's administrator, according to the March SEC filing. SS&C did not immediately respond to a request for comment. Canarsie's prime broker is listed as Morgan Stanley on the same filing, but two people familiar with the situation said that they are no longer a client. A spokesman for the bank declined to comment.

IIROC NEWS RELEASE – January 23, 2015

IN THE MATTER OF Paul Christopher Darrigo – Penalty Decision
January 23, 2015 (Toronto, Ontario)
– Following a penalty hearing held on December 19, 2014, a Hearing Panel of the Investment Industry Regulatory Organization of Canada (IIROC) imposed the following penalty on Paul Christopher Darrigo:

- *a. A global fine in the amount of $115,000 broken down as follows:*
  - *i. A fine of $60,000 in relation to count #1, representing disgorgement of commissions of $50,000, plus an additional fine of $10,000; and*
  - *ii. A fine of $55,000 in relation to count #2, representing disgorgement of the loan proceeds of $45,000, plus an additional fine of $10,000; and*
- *b. A 12-month period of strict supervision.*

Mr. Darrigo is also required to pay costs in the amount of $65,000.

The penalty decision can be found at:
http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=EDE994FAD1594E5F9215043D5B8BF61D&Language=en.

In an earlier decision dated October 16, 2014, the Hearing Panel found that Mr. Darrigo solicited buys and sells of mutual funds on a deferred sales charge basis that were not to the benefit of his clients and that he

engaged in inappropriate personal financial dealings with two elderly clients. The Hearing Panel's liability decision is available at:
http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=83D470FF8C4B40ABA5E3CB3AC853B230&Language=en.

SIPA COMMENT ON THE IIROC NEWS RELEASE

Upon checking the CSA NRD we find that Paul Christopher Darrigo was registered as a Sales Person, or a Dealing Representative or a Registered Representative with several different firms over several years but he is no longer registered. When he is no longer registered it means that IIROC has no power to collect the fines imposed unless he becomes registered again.

- PCD was first registered with Scotia Capital as a Salesperson from 2003 to 2005.
- PCD was next registered with TD Waterhouse as a Salesperson from 2005 to 2009.
- PCD was next registered with HSBC Securities as a Sales person in 2009.
- In 2009 he was registered with HSBC as a Dealing Representative (Salesperson) from 2009 to 2011.

Upon checking for disciplines on the IIROC website we find his discipline record at this link:
http://www.iiroc.ca/IIROCSearch/Pages/Results.aspx?k=Paul%20Christopher%20Darrigo%20(scope:%22Disciplinary%20Cases%22)
It is interesting to note that this issue has been going on since March 2011 and that PCD is no longer registered with IIROC. However as noted above the CSA provides his registration history. Although registered as a Salesperson it is highly probable that he used the title of Financial Advisor as that is the practice in the investment industry. This title is used to gain trust from those who might not be quite so trusting of a Sales Representative.
The following is from an IIROC News Release February 10, 2014, almost one year ago:

> *Specifically, the allegations are that: 1. Between October 2009 and January 2011, Mr. Darrigo acted against his clients' interest by effecting mutual fund transactions that triggered unnecessary deferred sales charges to his clients and undue commissions to himself, contrary to IIROC Dealer Member Rule 1300.1(o). 2. Between October and December 2010, Mr. Darrigo engaged in inappropriate personal financial dealings with two clients by borrowing from them, contrary to IIROC Dealer Member Rule 29.1. 3. On or about November 7, 2011, Mr. Darrigo failed to attend and give information in respect of an investigation being conducted by IIROC staff, contrary to IIROC Dealer Member Rule 19.5. IIROC formally initiated the investigation into Mr. Darrigo's conduct in March 2011. The alleged violations occurred when he was a Registered Representative with the Oakville branch of HSBC Securities (Canada) Inc., an IIROC-regulated firm. Mr. Darrigo is no longer a registrant with an IIROC-regulated firm.*

It is also noted that *"IIROC formally initiated the investigation into Mr. Darrigo's conduct in March 2011"* so the process has taken some four years. Investors need to be aware that the processes used by the regulators are a matter of years.
Investors need to be aware that in Ontario until several years ago, the Limitation Period was six years. That is the time that claimants had to submit a Statement of Claim after the events that caused loss or be statute barred from proceeding with civil action if there was no fiduciary duty. Since few industry people have fiduciary duty by law it means that claimants must be prompt with initiating a legal claim.
There are circumstances that enable a claim to proceed later than that and so we recommend investors with a claim first seek legal counsel with a good securities litigator as their first step, before even making a submission to the regulators.

In summary if something does not seem right about your investment account you need to make inquiries. Check your "Financial Advisor" credentials and discipline history. That could be revealing. Then talk to a securities litigator. A few hundred dollars could be the best investment you ever make.

U.S. charges Canadian man with trading fraud

EMILY FLITTER, REUTERS
TUESDAY, JANUARY 13, 2015

NEW YORK - U.S. authorities opened a new chapter in policing high-speed stock trading on Tuesday when they charged a Canadian man with fraud for manipulating stock prices through a process called "layering," according to prosecutors.

The case is the first of its kind to be brought against a trader in the stock market, the authorities said in press releases.

Federal criminal prosecutors in New Jersey charged Aleksandr Milrud, 50, who they said was from Ontario, with one count of wire fraud and one count of conspiracy to commit securities fraud. The U.S. Securities and Exchange Commission filed a separate civil case against him. He was arrested at a home he owns near Miami and was scheduled to appear in federal magistrate court in Miami later on Tuesday.

Reuters could not determine whether he had obtained legal representation.

The SEC and federal prosecutors said Milrud used a network of overseas traders and brokerage accounts to place fake orders for individual stocks to move their prices in a particular direction. The fake orders would be canceled before they could be filled, but traders working for Milrud would also make real trades in the stocks to take advantage of their temporarily inflated or depressed prices.

The practice of high-speed trading, which uses high-powered computers to make trades in fractions of a second has come under criticism by some market participants who claim it creates an unfair advantage for the largest and most sophisticated trading operations.

Critics have warned that high-speed trading could make it easier to engage in practices such as "layering" or "spoofing," both of which involve placing fake orders to create the appearance of increased activity in a stock or other asset in order to move its price.

According to prosecutors, Milrud hired a software company to program "hotkeys" so orders could be made and canceled using just a few keyboard strokes. Milrud allegedly believed his fake orders would be untraceable, but U.S. authorities convinced the owner of an offshore broker-dealer he was using to cooperate with their investigation. Prosecutors said Milrud explained his scheme in detail to the cooperator.

"Milrud's elaborate efforts to disguise this manipulative trading scheme were ultimately unsuccessful," said Joseph G. Sansone, co-deputy chief of the SEC's Market Abuse unit.

The first U.S. federal criminal case stemming from the practice of "spoofing" was filed on Oct. 2 against high-frequency commodities trader Michael Coscia.

BECOME AWARE – CHECK YOUR ADVISOR’S CREDENTIALS BEFORE IT’S TOO LATE