SIPA Sentinel

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Small Investor Protection Association - A voice for small investors

The SIPA Sentinel is issued bi-monthly. From time to time articles and re-prints are included that offer opinions on subjects related to investment and regulation. These are meant to help increase investor awareness, and SIPA may not share these opinions.

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BE BOLD REGULATORS

Those still timorous and uncertain about introducing a best interest duty have a duty, themselves, to become decisive

By Neil Gross | October 31, 2016

Leaders reveal themselves in pivotal moments. Mostly, they gravitate to the forefront, although some may prefer to inspire and lead from the rear.

No one leads or inspires, however, by sitting on the fence. Yet, that's where some Canadian securities regulators remain in their seemingly endless meditation over whether investment advisors and dealers should be required to act in clients' best interests.

Careful, cautious deliberation is one thing. But we've had years of discussion, submissions and studies. The regulators have consulted eminent researchers who've delivered reports with unambiguous conclusions. Three of the country's most prominently active securities commissions have been able to solidify their own views on the matter and have, essentially, declared their positions. Their opinions aren't uniform, but at least we know where they stand. It's hard to see why the rest need to draw this process out further.

We all know the issue is complex, its implications profound. Everyone understands that the stakes are high. Still, those things don't excuse this persisting reluctance to act. They don't justify an endless spin cycle of enquiry or ceaseless fretting over unknown, unknowable and quite possibly phantom consequences downstream.

At some point, the analytical epoch must be brought to an end so that actual action can happen. Not timid action. Not half-hearted, ineffectual incremental steps. Not more disclosure that doesn't have a

hope of working, or a watered-down standard that would leave us with a second-best best interest duty.
The public has a right to expect more than that. People expect policy-makers to do more than just talk about what needs to be done. The expectation is that capital markets regulators will employ skill, judgment and good sense, but, above all, will act — and act boldly enough to truly and fully solve the problems they're supposed to fix.

So be bold, regulators. Be bold enough to embrace the profound nature of this matter and use it as an opportunity. This is the chance to fundamentally realign regulation with the reality of the investment business today — the reality that it's not about product selection but the provision of advice, and the reality of investor dependency on that advice. This is the chance to set our regulatory edifice on a modern and true-to-life foundation.

Be bold enough to face the fact, and the criticism, that such realignment will be disruptive; but stay focused on the acute need to foster objectivity in the provision of investment advice and the long-term benefits that best interests reforms will bring about for investors and for advisors yearning to become true professionals.

Be bold enough to dismiss alarmists who claim a best interests duty will destroy the investment business, and resist those who urge you to just make marginal changes rather than hard-hitting reforms that have real and practical impact on the root of the problem.

And be bold enough to do what needs to be done because it's the right thing to do. Take the principled path, not just for itself, but also so that the disruptive consequences can more readily be seen and accepted as being necessary.

Remember, too, that the public doesn't have infinite patience when it comes to the safeguarding of its interests. People expect regulators to protect them as an instinctive reflex; and there's a limit to how long Canadians can hold those officials in high regard while they appear to dither over that task, or seemingly must be persuaded to do it.

In effect, therefore, the best interests window is closing on Canada's securities regulators. At this pivotal moment, the table is set for fundamental and true reform by those unflinching enough to lead the way. But their chance on this issue could easily slip by, and certainly, if it doesn't happen now, it's unlikely to recur in our generation.

So, now is the time to climb down off the fence, to take action, to lead. The opportunity is passing. Now is the moment to be bold.

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SUITABLE ADVICE FOR LINDA'S RETIREMENT

Many are saving for retirement but too many are not receiving a return on their investments. The fundamental issue is that a so titled "Financial Advisor" is not required to look after an investor's best interests and often the lure of larger commissions entices your "Financial Advisor" to do what is best for him. This short video explains in every day terms how this can impact your retirement plans.

- https://youtu.be/FnsMSVng_nA

CHECKING AN ADVISOR'S REGISTRATION - Above the Law

SIPA has just released a report *"CHECKING AN ADVISOR'S REGISTRATION – Above the Law"* prepared by the SIPA Advisory Committee. Data was gleaned from the Canadian Securities Administrators over a period of several months to determine the registration category of industry representatives. Over 96% of so titled "Financial Advisors" are registered as sales persons. They are not required to look after your best interests but are only required to sell you suitable products. The registration classification is "Dealing Representative" of sales person. They are rewarded by sales commissions. Often the sales commissions are not disclosed so investors do not know how much it costs them to deal with a Financial Advisor.

Studies show that it can cost you 50% of your retirement savings. There are many situations where investors have lost all of their savings when they succumbed to using leverage for investment. By mortgaging your house, arranging a bank loan or using a dealer's margin account as recommend by a "Financial Advisor" many investors have suffered extreme loss during a market downturn. These downturns happen regularly but for investors who are not leveraged their savings will recover along with the market when it rebounds. The Conclusion is reproduced here. The complete report is available at http://www.sipa.ca/library/SIPAsubmissions/500_SIPA_REPORT_REGISTRATION-Above-the-Law_201611.pdf.

CONCLUSION

Why does the industry allow "Sales Persons" to use the title "Financial Advisor"?

Do regulators not understand that most Canadians and most dictionaries believe that Advisor and Adviser are simply spelling variations of the same word?

Is this a deliberate attempt to mislead Canadian investors into placing their trust and their savings with a commission motivated sales person?

Many Canadians have already lost their savings when they placed their trust in a sales person titled "Financial Advisor".

If Canadians deal with a "Financial Advisor" they can be one of two types of individual:

- *An outright con man or fraudster that is unregulated*
- *A regulated representative that is a commission motivated sales person*

Checking an Advisor's Registration will determine if he is not registered and therefore an outright fraudster, or whether he is registered.

Although your Advisor is in all probability registered he has a 96% chance of being registered as a "Dealing Representative" i.e. a commission sales person.

Whether it is an outright fraudster like Earl Jones and Bernie Madoff, or a regulated sales person like so many in Canada that have caused Canadians to lose their savings, the life-altering result is the same.

Victims' lives are altered in many ways. Their trust has been breached. They lose more than money. It causes health issues. Family legacies are lost. It is a lasting impact.

THE LAST NAIL ON BEST INTERESTS

By Joel Weisenfeld, Principal at Joel Weisenfeld, Mediator
November 16, 2016

While the securities industry, the investing public and securities regulators have engaged in an interminable series of conferences, roundtables, debates, submissions and consultations regarding the introduction of what is commonly referred to as a 'best interests standard' into what is required of dealers and investment advisers in their dealing with their clients, the end of days seems close at hand.

Depending on your position, the question is either 'why' or 'what took so long'. I stand in the latter group, somewhat mystified at the consternation as to why the four words 'in the best interests' has caused such turmoil and controversy.

Rule 31-5056 of the Ontario Securities Act, which deals with Registration Requirements of dealers and advisers, and particularly with the General Duties mandated of dealers and advisers, requires them to 'deal fairly, honestly and in good faith with their clients'. It is inconceivable how these duties do not encompass the duty to act in the best interests of clients. As that concept appears to be not universally or even generally accepted, clarification of the definition of these general duties is required by the inclusion of these words within Rule 31-505.

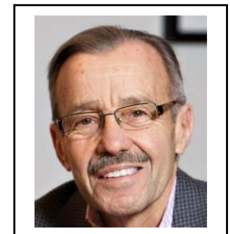
An historical example of a similar situation in securities regulation is when the 'know your product' rule was made explicit, even though the existing suitability rule obviously encompassed an obligation to know the investment product. How could an adviser's investment advice to a client as to the suitability of a recommended investment be suitable for that client if the adviser didn't know the attributes and understand the risks of the investment product? How could dealer supervision and

compliance be effective in reviewing a client's trading and account for suitability issues if, again, the 'product' was not known. However, in the early 2000's it became clear that clarity was required; that the meaning of the suitability obligation and how it manifested in the context of the then prevailing securities markets dictated the explicit enunciation of a 'know your product' obligation on the part of dealers and advisers.

A best interests duty might affect the structure of the industry, its practices and civil and regulatory liability exposures. Do we have to know all of the possible ramifications before the addition to the existing duties is made explicit, and then deal with them in regulatory policies and regulations? The duties of acting 'fairly, honestly and in good faith' were not similarly rope-fenced, and there is no good reason to do so now. In any event, bit by bit, Judges (and even dealers and advisers) have begun the interpretation of a best interests duty in specific Court cases (see my Comment piece of August 2014). The securities industry is only harming its own reputation and needlessly alienating clients, the investing public and securities regulators in fighting the obvious future.

Loyalty Points – A Victory for Consumer Advocates and a Lesson for Investor Advocates

By Harvey Naglie



In late 2011 LoyaltyOne, operators of the Air Miles program, announced that any unused loyalty points collected before 2012 would expire effective January 1, 2017 and points earned from 2012 onward would expire on a quarterly basis upon reaching their fifth anniversary. In effect the introduction of this five-year time limit meant that consumers would either use the points they earned within that time frame or see them expire without any value.

Consumer advocates did not initially react to the 2011 announcement but as the January 1, 2017 expiry deadline drew closer they marshalled their forces and intensified their lobbying efforts across the country, and most particularly in Ontario. In response to their appeals, Liberal MPP Arthur Potts (Beaches-East York) tabled a private member's bill, Protecting Rewards Points Act, proposing that expiration of points in rewards programs be banned (the bill was subsequently changed to limit the prohibition to instances where the expiry was related exclusively to the passage of time). Reflecting the effectiveness of the lobbying effort, the bill enjoyed almost immediate all party support in the legislature and was on its way to a speedy passage.

On December 1, in the face of consumer criticism and the impending Ontario legislation, LoyaltyOne announced that it had shelved its plan to begin cancelling unused points. In its statement the company said that it "believes that cancelling the expiry policy will lead to more meaningful conversations between government and industry, helping to ensure loyalty programs remain viable in all provinces and that Canadian consumers continue to reap the rewards of loyalty programs, regardless of the province in which they live."

The success of consumer advocates in thwarting LoyaltyOne's ill-conceived attempt to limit consumers' ability to use loyalty points that they had previously earned represents a bona fide 'feel good' victory. It also effectively throws down the gantlet to investor advocates by offering a lesson of effective government lobbying at a time when investors in Ontario are confronting a potential loss even greater than that represented by the premature expiry of loyalty points. Based on the most recent government announcement, Ontario investors will lose the Ontario Securities Commission (OSC) within the next 24 months.

While the OSC has been, and will always be a target for investor complaints and criticisms, even the most passionate investor advocate would acknowledge that it has consistently been the most investor-responsive securities regulator in Canada and its commitment to investor protection has become even more focused and more effective in recent years. For example, the OSC led the CRM initiative; it was the first (and remains the only) securities regulator to establish an Investor Advisory Panel; it established Canada's first securities whistleblower program offering financial incentives for actionable information; it recently set up a seniors expert advisory committee; and it is currently championing replacing suitability with a best interest standard and the elimination of mutual fund trailer fees. Yet in the face of this track record of increasing investor responsiveness, the Ontario government is proposing to eliminate the OSC and investor advocates appear reconciled, if not supportive of the decision.

To be clear, when it eliminates the OSC, the Ontario government plans to replace it with a new regulator that it is currently developing cooperatively with the governments of British Columbia, Saskatchewan, New Brunswick, Prince Edward Island, Yukon and Canada and is expected to be operational by the end of 2018. However, based on the information currently available about this proposed new regulator, there is no indication that it will exhibit anywhere near the OSC's commitment and responsiveness to investor protection. The draft legislation setting up this new regulator does not incorporate an Investor Advisory Panel or a seniors expert committee, it retains a suitability standard with no commitment to move to a best interest standard, it does not introduce a mandatory independent binding dispute resolution service and it does not address the chronic enforcement shortcomings of IIROC and the MFDA.

When queried about this absence of investor protection provisions, government officials disingenuously suggest that these items will be addressed by the new regulator once it is up and running. The biggest problem with this "trust us" approach is the governance structure of the new regulator. Whereas the OSC is directly accountable to an elected government minister, the new regulator will instead be directly accountable to a government appointed board and only indirectly accountable to a Council of Ministers. The members of the inaugural board were announced earlier this year and while they constitute an illustrious and accomplished group, not one member would be identified as an investor representative, let alone an investor advocate. Also, while the Ontario Minister will sit on the Council of Ministers, his or her ability to promote the interests of Ontario investors will require enlisting the support of ministers from other jurisdictions, jurisdictions that have not historically exhibited the same commitment to investor protection as Ontario.

The elimination of the OSC would represent a major loss for the cause of investor protection; the elimination of the OSC without statutory guarantees that its investor initiatives will be maintained and enhanced would be a tragedy. Consumer advocates could rally their forces and save loyalty points from a premature demise. Shame on us as investor advocates if we cannot put enough pressure on governments to save the OSC or at least ensure that the investor-centric focus of the OSC is baked into the legislative structure of the new regulator before it becomes operative.

ARE THE REGULATORS EFFECTIVE?

It is a regular occurrence to see disciplines by the Self-Regulatory Organizations and many representatives found guilty of breaching the rules:

- Firms failure to supervise
- Reps using pre-signed account forms
- Fabricated KYCs
- Excessive Trading

And a long list of infractions against unsuspecting clients. There is no question whether the firms and representatives are guilty, yet the regulators do not reimburse the victims. Reading about the enforcement practiced by the industry gives one the sense that the regulators are not effective in protecting investors, but seem to be reinforcing the perception that the regulators are doing their job.

Instead if the fines are collected and ill gained profits are disgorged the money goes into the SROs coffers and is not used to pay restitution to victims. A couple of recent examples of ineffective regulators follow.

MUTUAL FUND DEALERS ASSOCIATION

CASE SUMMARY # 201635 September 9, 2016 MFDA Case Summary Enforcement

This case summary was prepared by Staff of the MFDA. Hearing Panel Imposes Penalties on Zohar (Michael) Barak Zohar (Michael) Barak entered into a Settlement Agreement with MFDA Staff where he admitted that he, or his assistant for whom he was responsible, obtained, possessed, and in two instances, used to process transactions, 54 pre-signed account forms in respect of at least 28 clients, contrary to MFDA Rule 2.1.1.

The Hearing Panel accepted the Settlement Agreement and imposed the following penalties:

- *a fine of $9,000;*
- *costs of $2,500;*
- *and an order to comply with MFDA Rule 2.1.1 in the future.*

NOTICE: This case summary has been prepared by Staff of the MFDA, based upon the previously published Decision and Reasons of an MFDA Hearing Panel presiding over this matter. Every effort is

made to ensure that this case summary accurately reflects the content of the Decision and Reasons. However, where there is a discrepancy between this case summary and the Decision and Reasons, the Decision and Reasons will prevail.

INVESTMENT INDUSTRY REGULATOR OF CANADA

Enforcement Notice Decision - IN THE MATTER OF Edward Jones - Settlement Accepted

TORONTO, Nov. 10, 2016 /CNW/ - On October 28, 2016, a Hearing Panel of the Investment Industry Regulatory Organization of Canada (IIROC) accepted a Settlement Agreement, with sanctions, between IIROC staff and Edward Jones.
Specifically, Edward Jones admitted to the following violation:

- *From 2008 to March 2013, Edward Jones did not meet the minimum standards for retail account supervision in five cases, and client accounts and activities of its Registered Representatives were not sufficiently supervised, contrary to IIROC Dealer Member Rules 38.1 and 2500.*

Pursuant to the Settlement Agreement, Edward Jones agreed to the following penalty:
(a) A fine of $250,000.
Edward Jones also agreed to pay costs in the amount of $50,000.
The Settlement Agreement is available at: http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=384F2A79B2194F5F8009A49E0021DB19&Language=en

SIPA now using social media

SIPA is now using social media including Facebook and Twitter. Links for both are on the Home Page of SIPA website www.sipa.ca.
Visit our Facebook to see comments. A couple of our tweets are shown below. We encourage investors to use twitter to help raise awareness and make your voices count.

SIPA @SIPA1998 2h2 hours ago

"There is an abundance of academic research shows investors are harmed by lack of fiduciary duty or best interests standard" Menke Chair IAP

SIPA @SIPA1998 20h20 hours ago

Why doesn't Government care? http://www.piac.ca/our-specialities/financial-consumers-betrayed-by-finance-ministers-obsi-decision-2/ …