



A Voice for the Small Investor

SIPA Inc

Submission to

Standing Senate Committee on Banking, Trade and Commerce

It's a Matter of Trust

February 14<sup>th</sup>, 2005

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Standing Senate Committee on Banking, Trade and Commerce  
Senate of Canada  
40 Elgin Street - Room 1039  
Chambers Building  
Ottawa ON K1A 0A4

Dear Sirs,

It's a matter of Trust. Our society is based on trust. Canadians place their trust in our government. The government delegates regulation of the securities industry to the provinces. The provinces in turn delegate regulation to securities administrators. Finally, securities administrators delegate investor protection to self-regulatory organizations.

This approach to investor protection has failed Canadian investors. Many small investors have placed their trust in the investment industry and our regulatory system, but have lost their life savings due to industry wrongdoing. The magnitude of these losses is unknown but estimated to be in excess of \$1 billion per year ... many times greater than the sponsorship scandal being investigated by the Gomery commission.

The mutual fund market-timing scandal, partially exposed in December 2004, illustrates the cavalier attitude of the industry towards small investors and how widespread wrongdoing actually is. Some of Canada's top banks, brokerages and mutual fund companies were involved in practices harmful to small investors.

- Canadians need one national Financial Services Regulator
- Canadians need a national Investor Protection Agency
- Canadians need a national register of representatives accessible to the public

It is the responsibility of Government, Regulators and Police to enable all Canadians to live and work in a society that does not foster wrongdoing. We trust that the Senate Committee will make every effort to enable regulators to stamp out financial crime and ensure that Canadians may continue to trust and be secure in their investments. An investigative inquiry into widespread industry wrongdoing would seem a logical step.

Sincerely

**Stan I. Buell**

Stan I. Buell  
President

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## 1. Foreword

*"We are both in our fifties and our dreams of early retirement have been lost along with our faith in the system, whatever the system may be. Who can one trust? Our question to the [Regulator] is: Does [Brokerage] not have a responsibility to their clients to see that their representatives act in the best interest of their clients? What kind of ethics does [Brokerage] have?"*

A small investor – Feb 1999

Since its founding in 1998, SIPA has communicated with hundreds of small investors as well as industry participants, regulators and government. Our conclusion is that there are widespread practices of wrongdoing that are the direct cause of many Canadians being deprived of their life savings. Many of the victims are seniors with no hope of recovery. They lose not only money but also hope, faith in their fellow man, and trust in our society.

The Wise Persons Committee Report, released December 13, 2003 in its opening statement of the Executive Summary states:

*"Canada suffers from inadequate enforcement and inconsistent investor protection. Policy development is characterized by compromise and delay. Canada cannot respond as effectively or innovate as quickly as it should in the fast-changing global marketplace. The system is too costly, duplicative and inefficient. The regulatory burden impedes capital formation. Canada's international competitiveness is undermined by regulatory complexity."*

To make Canada's leaders aware of the problem of small investors losing their life savings due to industry wrongdoing, SIPA prepared a report and delivered it to leaders across Canada in February 2004. The report is entitled "SIPA Inc Five Year Review ~ the Small Investors' Perspective of Investor Protection in Canada".

*"The leaders of our Government and the investment industry have a social and moral responsibility to ensure that this essential industry is operated in a moral and ethical fashion, as well as a legal fashion. Industry leaders should not allow participants to flaunt the rules and regulations and then rely upon legal tactics to vigorously defend situations that are morally and ethically indefensible."*

The SIPA Report is available on SIPA's website at:

[www.sipa.to/library/Documents/SIPA\\_REPORT\\_2004Feb27.doc](http://www.sipa.to/library/Documents/SIPA_REPORT_2004Feb27.doc)

Also in 2004, SIPA associated with CARP, Canada's association for the 50 Plus, to prepare a report on the mutual fund industry entitled "Giving Small Investors a Fair Chance". It is available at [www.sipa.to/library/Documents/CARP\\_SIPA\\_report\\_2004Sep28.pdf](http://www.sipa.to/library/Documents/CARP_SIPA_report_2004Sep28.pdf). This report recommends a national Investor Protection Agency.

## 2. Our Society is based on Trust

*"I started investing with [RR] in 1986 when he was with [Brokerage]. ... He had my trust. [RR] was in a respected position of trust; first as Vice President of the company and secondly as my financial advisor. He abused this relationship."*

A small investor – 1999

Our society is based on trust. RCMP Commissioner Giuliano Zaccardelli addressed the SRO Conference in Toronto on January 27<sup>th</sup> 2005, and he said;

*"The single most important factor needed for societies to work effectively and for citizens to flourish is – trust. Trust is the bedrock of a civilized society."*

There is a feeling that many in our society no longer have any sense of values and standards and that the investment industry in particular can no longer be trusted. There are issues that are becoming more serious as each day passes.

Commissioner Zaccardelli also said;

*"When trust is diminished the ability of the collective to act for, protect and foster what is good and creative in our society, dissipates."*

Former OSC commissioner and securities lawyer Glorianne Stromberg stated in an article entitled "Listen up, Bay Street ":

*"The lack of trust in Wall Street (and by extension Bay Street) is said to be unparalleled since the 1930s. Polls indicate that a growing number of people believe the stock market is no longer a fair and open way to invest one's money and that the market is rigged by and for insiders. A recent New York Times article bluntly stated that the hidden hands of speculators profiting from bad-news rumormongering, good-news insidership, and no-news accounting has made markets unsafe for ordinary investors."*

Arthur Levitt, the former chair of the U.S. Securities and Exchange Commission, refers to the failures that the corporate scandals have revealed as "societal."

*"These failures reflect a deterioration of values and the recognition that many people have no standards or values, which is something we should all be gravely concerned about."*

David A. Brown, Q.C., Chair, Ontario Securities Commission, has also played a role in the Canadian Centre for Ethics & Corporate Policy as a member of the Board of Directors and later as Executive Director. In his remarks "Beyond Product Sales: Considerations Other than the Bottom Line" to the Centre, in Toronto on April 1, 1999, he stated:

*"The basis of any ethical system is values; including the way individually and corporately we treat one another on a micro and macro scale, the manner in which we support the larger community and the care with which we preserve or restore this fragile planet, our home."*

In her 2004 New Year's message Governor General Adrienne Clarkson said:

*"The public good is expressed in the way we live ... we can look confidently towards the future in whatever we do if we know that we have anchored ourselves today in what is good and what is right."*

The Auditor General Sheila Fraser is quoted by the press:

*"Our findings on the government's sponsorship program from 1997 to 2001 are deeply disturbing. Rules were broken or ignored at every stage of the process for more than four years. Even though the government has cancelled the sponsorship program, I am deeply disturbed that such practices were allowed to happen in the first place. There has not been an adequate explanation for the collapse of controls and oversight mechanisms."*

On June 15<sup>th</sup> 2002, the New York Times quoted Treasury Secretary Paul H. O'Neill from a speech on Thursday:

*"I think people who abuse our trust, we ought to hang them from the very highest branch"*

Ralph Goodale, Minister of Finance, wrote to SIPA on May 31, 2004;

*"I share your view about the importance of investor protection. Indeed, one of the fundamental objectives of securities regulation is to protect investors from unfair practices. It is imperative that any reforms to our current system of securities regulation measure up to this objective."*

Commissioner Zaccardelli said;

*"Because of corporate corruption societies trust and confidence is undermined, business practices become suspect and the economic potential of Canada is compromised. Because of financial crime, investors lose their savings, pension plans lose their assets, companies lose their reputations and the markets lose the trust of investors."*

The vast majority of Canadians still believe in honesty and integrity. Why then do we tolerate the widespread wrongdoing, cover-up and fraud?

It is time that our government, regulators, and police take action to provide investor protection to restore Canadians trust.

### 3. Investor Protection

*"These 4 years have been a horrible nightmare, a lifetime of hard work and saving and dreaming is gone. What has happened to me seems incredible. Not only is my money gone, but also the broker continues to work and the wheels of justice just don't seem to be working at all."*

A small investor - Nov 2003

The Wise Persons Committee Report incorporates a statement submitted by Jarislowsky Fraser Limited of Montreal, Quebec:

*"The greatest weakness of the regulatory system is that it does not protect investors.... There is ever more red tape and no real enforcement! The crooks rarely go to jail."*

In recent years the investment industry has developed products that are being sold by banks, insurance companies, mutual fund companies and investment dealers. These products, including mutual funds, segregated funds and pooled funds, are perceived as similar by small investors but are regulated by different agencies.

Financial predators take advantage of the lack of investor knowledge and the propensity of Canadians to trust. Seniors are particularly susceptible to smooth talking blue suits and fraudsters.

On January 27<sup>th</sup> 2005, at the SRO Conference in Toronto, RCMP Commissioner Giuliano Zaccardelli said;

*"I vividly recall the small and deeply personal stories of harm and pain caused by financial crime. I have seen the economic devastation it can wreak on individuals, many of them seniors, who saw savings patiently accumulated over a lifetime, callously wiped out in a heartbeat."*

SROs are unable to offer adequate investor protection due to their inherent conflict of interest. The regulators appear unable or unwilling to order restitution even when industry representatives are found guilty of wrongdoing, including breach of fiduciary duty and fraud. Indeed, in the case of fraud it is rare that criminal proceedings are initiated.

Small investors need investor protection that is not industry sponsored. While some have suggested a federal regulator similar to the Securities and Exchange Commission in the United States would be appropriate, recent action by the New York State Attorney General Eliot Spitzer reveals even the S.E.C. has limitations.

Spitzer's great concern, he said, is the fundamental effectiveness of how Wall Street polices itself for the benefit of investors;

*"The major failure has been at the SRO (self-regulatory organization) level," Spitzer told The Post.*

Studies, reviews and reports have for many years examined the regulatory system, recognized the problems and recommended solutions. The investment industry is reluctant to change and has co-opted efforts to provide improved investor protection. Some recent proposals appear to be contrary to investors' best interests.

Glorianne Stromberg states in an article entitled "Listen up, Bay Street ":

*"It is obvious that all of the gatekeeping mechanisms designed to protect investors and to ensure a fair and efficient marketplace have either failed or shown serious shortcomings. Auditors, boards of directors, individual directors, lawyers, investment bankers, rating agencies, standard setters, analysts, regulators and lawmakers have each in their own way failed the public. Their failures have produced what many are referring to as a crisis of faith in the entire market system."*

John Lawrence Reynolds is well known for writing on financial and investment matters. His book "Free Rider: How a Bay Street Whiz Kid Stole and spent \$20 million" describes how a broker with a major brokerage used fraud and deceit to take money from his clients. In his latest book "The Naked Investor; Why almost Everybody But You Gets Rich on Your RRSP" Reynolds writes:

*"It is my view that avoidable RRSP/RRIF losses are rooted deeper than investor inattention and advisor malfeasance, They represent an attitude that permeates the industry at the top levels of many brokerages, including those owned by Canada's chartered banks. The evidence seems to indicate that pressure is applied on individual brokers to maximize their commissions to the detriment of other more critical concerns, including the growth and security of the client's investment portfolio."*

Reynolds conclusions reflect those of many industry participants who express their opinions confidentially. Recently a retired registered representative, upon reading the Naked Investor and an article in the National Post by Jonathan Chevreau, was prompted to write an Open Letter to Canadians. In this letter he described some of the corporate behaviour he had witnessed during his career. It seemed to be from the heart and very critical of the investment industry attitudes that seem to be systemic. The letter was carried on several websites. It was not surprising when the letter disappeared within a few days.

It is not the first time we have seen what appears to be very deliberate attempts by industry to cover up the dark side of the business. It is not so many years ago that two small investors took a major bank owned brokerage to court over Bre-X, billed as the scam of the century. As the "scam of the century" impacted negatively on most Canadian investors, either through direct ownership of shares or through owning mutual funds, it seemed that the trial would be a major newsworthy event.

On the first day of the trial two Ottawa evening papers carried coverage. Not surprisingly the Toronto papers and the rest of the news media seemed strangely uninterested in reporting on the involvement of a major bank-owned brokerage in the "scam of the century". That evening the Ottawa papers were also silent.

All of the evidence indicates that investor protection is lacking and that current enforcement does not discourage widespread industry practices of wrongdoing that result in investors unfairly losing their life savings. It is disturbing that the problem of widespread wrongdoing



appears to be systemic and extends to the very top of organizations. The fund market timing vividly portrays this.

The following is an excerpt from the SIPA Sentinel January 2005:

*Toronto, Dec 16 - A panel of Commissioners of the Ontario Securities Commission (OSC) approved four settlement agreements today that will result in \$156.5 million being distributed to mutual fund unit holders who suffered harm from market timing activities in those funds. The settlement agreements, approved in the public interest, were reached earlier this week by OSC Staff with CI Mutual Funds Inc., AGF Funds Inc., I.G. Investment Management, Ltd. and AIC Limited. The text of the agreements is available on the OSC website.*

*Toronto, Dec 16, 2004 – The Mutual Fund Dealers Association announced a settlement agreement with Investors Group Financial Services regarding market timing. IG has agreed to compensate investors effected by their conduct by making a payment of \$2.65 million, and will also pay a fine of \$2.65 million to the MFDA as well as costs of the MFDA investigation of \$50,000. The text of the settlement agreement is available on the MFDA website.*

*Toronto, Dec 16, 2004 – The Investment Dealers Association penalizes TD Waterhouse \$20,698,713.38, RBC Dominion Securities \$16,975,302.08 and BMO Nesbitt Burns \$3,693,139.20 regarding market timing. The text of the settlement agreements is available on the IDA website.*

The most prominent companies in the investment industry were penalized by the regulators for mutual fund market timing that had a negative impact on a multitude of small investors. This one episode alone clearly illustrates the cavalier attitude of industry towards small investors and the rules and regulations. At the same time it emphasizes how widespread and systemic investment industry wrongdoing actually is.

Investor Protection should be delegated to a government authority on a national basis. The CARP/SIPA report "GIVING SMALL INVESTORS A FAIR CHANCE" was presented to the Honourable Tony Ianno in September 2004. The report recommends:

*"In order to ensure investor protection, a federal Investor Protection Act should be passed which includes the establishment of a single, national independent Investor Protection Agency (IPA)"*

#### 4. Educating Investors

*"With my father's limited investment experience (until the above unfolded, he had never invested in mutual funds or the stock market) and limited education (grade 7), I tend to get called upon in times of financial or legal confusion, which is what my father did when he began to suspect that something wasn't quite right. I firmly believe that (Big Brokerage)'s actions were unprofessional, and very possibly illegal, but I'm frustrated at not knowing where to turn."*

A small investor - Feb 1999

While investor education is not the panacea that some proponents would suggest, it is important that Canadians receive financial education in the school curriculum to prepare them for their productive life so they will be in a better position to make informed decisions with regard to their financial resources and savings.

Many Canadians know very little about the investment products that are being held in their Registered Retirement Savings Plans. They do not understand the details of their investments, the costs of buying and selling their investments, or the risks of the investment products and investment strategies employed.

There is such a proliferation of investment products that individual investors are not able to evaluate them. Indeed many investment advisors are not able to evaluate these products or in the alternative they deliberately sell products that are inappropriate for their clients. New products are being developed on an ongoing basis thus aggravating the problem for small investors, and making the qualification and continuing education of investment advisors ever more necessary.

Many companies recommend a leveraged investment strategy for all clients regardless of age or financial situation without ensuring that the investor understands the additional risk that accompanies this strategy. Investors accept inappropriate products and inappropriate investment strategies recommended by their investment advisor because they lack investor education and trust that their advisor is qualified and that the industry is well regulated.

With the evolution of the investment markets, a multitude of new products and the volatility in today's markets, the risks appear much greater than ever before. When newly developed products that are not fully understood by the sellers because they have not been market tested are combined with leveraging strategies the risk of disastrous loss is increased substantially.

Investor education should be included in school curricula across the country. All Canadians should be taught the fundamentals of investment to make them aware of different types of investment vehicles and how the investment industry operates. Investor education is only part of the answer and education of investment advisors is essential.

Regulators must recognize that Canadians are not educated as investors and ensure that safeguards for uneducated investors are provided in the regulatory system. Regulators should make industry and investors aware that the investment industry is knowledge based, and therefore carries a fiduciary duty that endures.

## 5. Regulation

*"THE REGULATORY BODIES DO NOT PROTECT THE INVESTOR."*

A small investor - Nov 2003

Glorianne Stromberg's 1998 report entitled "Investment Funds in Canada and Consumer Protection" states:

*"The unsatisfactory situation for the consumer/investors that results from continuing the fragmented regulatory structure reinforces the need for an integrated regulatory and supervisory structure"*

The Wise Persons Committee report in December 2003 confirms little has changed. A regulatory system will not provide investor protection if enforcement allows industry to circumvent the rules and regulations in place, or participants are able to satisfy the regulators by accepting wrist slaps.

Rules and regulations without enforcement are worse than no rules at all. Our society is based on trust and most ordinary Canadians expect the rules to be followed. They also trust that the government and the regulators will ensure that the rules are fair and that investors will receive fair treatment.

The Canadian regulatory framework includes provincial responsibility for regulation of securities, pensions and insurance. This results in numerous regulatory organizations across the country, duplication of effort and lack of co-ordination amongst regulators. A national regulator would resolve these problems.

One of the many regulators is the Investment Dealers Association (IDA). It is one of Canada's SROs and bills itself as "Canada's national self-regulatory organization for the securities industry". The IDA claims to regulate the activities of investment dealers and states that investor protection is a top priority.

The IDA's stated mission is to protect investors and enhance the efficiency and competitiveness of the Canadian capital markets. However it also states:

*"Under supervision of securities commissions, it aims at a balanced approach to regulation taking into account the often complementary, but occasionally conflicting, goals of investor protection, efficiency and competitiveness."*

This IDA mission statement is an admission of the inherent conflict of interest between industry regulation and investor protection.

The Wise Persons Committee Report issued in December 2003 strongly recommends a national securities regulator. The WPC reviewed the regulatory system and many previous studies and reports prior to arriving at their conclusion.

Québec stands out as appearing to be the most socially responsible province and has evolved a new Autorité des marchés financiers reporting to the Minister of Finance. Québec has effectively created a single regulatory system for the province by creating the new Autorité that combines the financial services regulators. The website of the Autorité states:

*"The Autorité des marchés financiers administers different laws and regulations applicable to Québec's entire financial sector. For each of four sectors of activity, the laws, regulations, guidelines, and all other legal texts concerning the organizations merged into the Autorité."*

The Honourable Yves Seguin, Quebec Minister of Finance, wrote to SIPA May 5, 2004:

*"An indemnity fund exists in Quebec for the victims of fraud in insurance and in mutual funds. We are studying with interest the possibility of expanding this indemnity to the victims of fraud in securities sector as well."*

Québec seems to be far in advance of the other provinces with their approach to investor protection.

In Manitoba the provincial government has taken an initiative that should prove beneficial for small investors in Manitoba. Greg Selinger, Manitoba Minister of Finance, advises:

*"The Government of Manitoba shares the views of the Small Investor Protection Association (SIPA). That is why we amended the Manitoba Securities Act in 2003 to allow the Manitoba Securities Commission to order financial compensation (restitution) to an aggrieved investor after an administrative hearing."*

There should be no impediment to all the provinces and territories following suit.

For many years it has been said that the national regulator in the United States, the Securities and Exchange Commission, was much superior to our fragmented Canadian approach to regulation. However it was not until Eliot Spitzer took a fresh approach and proceeded to attack the investment industry on the basis of investment protection, with his Bureau of Investment Protection, that extensive wrongdoing by the investment industry was revealed to the public and corrective action taken.

Spitzer was empowered to act by legislation ... the Martin Act (1921) and the Sarbanes/Oxley Act (2002), but also was assisted by TruthTeller (or whistleblower) protection that encourages TruthTellers to come forward. Indeed it was a Ms. Harrington, who worked in the mutual fund industry, alerting the Attorney General's office of some of the activities of wrongdoing that enabled investigators to do their job.

Canadian regulators require updated legislation to allow them to deal with today's investment marketplace. They must be able to move more quickly to minimize the number of potential victims due to wrongdoing that often continues for years while the regulators are investigating or engaged in lengthy court battles.

Industry appears in favour of self-regulation and Recommended Guidelines and Best Practices. However, the investment industry has demonstrated that they are not only unable to follow mandatory rules and regulations established by the regulators but also have difficulty following their own corporate guidelines. Some industry executives seem to believe that the established rules and regulations are merely guidelines.

There are those in the industry who demand practices that may maximize profit but are not in the best interests of the investors whose savings are used to generate commissions and resultant profits.

There is no doubt that guidelines should be established for acceptable business practices but these should be mandatory if they are to have any effect.

Industry generally fails to provide statements that fully inform the investor. Good reporting is available. Clients who are aware can ask for and receive meaningful reports. Generally, sophisticated investors are able to receive such reports, but industry often fails to properly inform those who most need to be informed.

Some in the industry do not believe in disclosure or transparency and some have in fact resorted to fraudulent reporting to prevent clients from learning the truth. This type of behaviour should result in punitive measures against the registered representative and against management for allowing it to happen.

Regulators should investigate wrongdoing beyond the immediate complainants to identify all victims of the wrongdoing and levy appropriate penalties for perpetrators and supervisors including a requirement to pay restitution to victims.

## 6. TruthTellers

*"They (investors) should never allow themselves to be befriended by a broker or advisor but treat them simply as a sales person who has their own best interests in mind and in many cases, because the laws and regulators are essentially impotent, are not above lying and defrauding them using numerous, devious schemes, all carefully designed to separate them from their savings."*

A small investor – Jan 2004

The federal government has introduced TruthTeller legislation for civil servants and this should be expanded to all Canadians. Canadian TruthTellers who have come forward in the past have not only lost their jobs but also their careers. They do not receive support. TruthTellers should be protected and supported, not only because of their actions but because it will help the regulators to do their job with fewer resources and less cost.

The death of Kent Shirley in December 2004 is tragic. Kent had identified what he believed to be wrongdoing and reported to the Saskatchewan Securities Commission and turned over evidence that he believed supported his allegations. No one knows the details leading to his death but it must be devastating for a young man who believes he is doing what is right to discover that there is no support and that his chosen career is in jeopardy.

It is not possible for regulators to monitor all the activities of the investment industry. Market Regulation Services is able to effectively monitor computerized market trading but selling processes are not so easily monitored. Inevitably individuals become aware of wrongdoing and they should be encouraged to report to the regulators.

It is time for our government, regulators and police to address this issue and provide appropriate legislation, regulation and communication to protect and reward TruthTellers for coming forward. TruthTellers should be protected from threats and reprisals.

The practice of SROs reporting back to member firms when registered representatives raise issues with the regulator should be prohibited. This feedback leads to threats, or sources of information being compromised.

Federal TruthTeller legislation subsequent to the Fraser Report should be extended beyond the federal government and apply to provincial and municipal governments, corporations, the investment industry and the regulators.

## 7. Sellers of Financial Products

*"I have a Financial Advisor who gave me totally inappropriate advice. It has cost me practically everything. The FA did not disclose the product he put me into, manipulated information to get the product, ignored my request to cancel the product four days later, changed the loan details twice, ignored my messages and cost me to date 50% of the small amount of savings I had.*

A small investor - Jan 2000

The investment industry advertises that small investors can place their trust in the industry. The investment industry is knowledge based and therefore owes a fiduciary duty to the investor. In order to fulfill that fiduciary duty it is incumbent that the industry ensures that registered representatives acting as investment advisors and selling financial products are properly educated and trained to be competent to offer advice that has such a major impact on the lives and well-being of small investors.

The evolving marketplace has resulted in the four pillars of financial services developing similar products that appear very much the same to small investors. Mutual funds, segregated funds, pooled funds and other financial products are not understood by average Canadians; and so they must rely upon and place their trust in their investment advisor. In many cases the investment advisor is no more than a seller of financial products and may not himself understand the risks inherent in the products being sold or the investment strategies being recommended by his company.

Sellers of financial products are commonly rewarded on the basis of commissions and bonuses based upon what and how much they sell rather than client service. Often the

investment strategies employed by investment advisors are the same regardless of the investor's age or financial situation and are directed from the top down. It is difficult to imagine that an investment strategy of leveraged high risk investments is appropriate for seniors in their 70s or 80s, yet it happens regularly.

Regulators should ensure that registered representatives have the requisite knowledge to understand the long term functioning of the markets and the risks associated with various investment products and investing strategies.

## 8. Disclosure and Transparency

*"When I finally learned of my loss I felt devastated, especially after the death of my spouse. It was a terrible let down and breach of faith. I feel I cannot trust anyone in this industry anymore. It has had an adverse effect on my health since October 2001."*

*A small investor - Dec 2003*

There is a lack of disclosure and transparency in the investment industry generally. When disclosure is made, as is the case with prospectuses, it is often in language that ordinary Canadians do not understand. Investment advisors often fail to provide sufficient information to investors and encourage investors to depend entirely upon them to look after the investments. That is until there is a problem. Then it seems the investment advisor claims he has only been there to take instructions from the investor and claims the investor is now sophisticated.

Investment advisors should be required to disclose the risks associated with any recommended investment strategy at the earliest opportunity and prior to completing the New Account Application Form. Investment advisors should be required to disclose the risks of every investment product at the point of sale and how that will be impacted by the chosen investment strategy. Information technology enables companies to provide information in a way that was not possible a few short years ago, yet many Canadians are still not receiving statements that are sufficiently informative to enable them to make appropriate decisions regarding their investments.

While universal investor education would help to relieve this problem, the investment industry should take the initiative to provide meaningful reports to investors. Failure to provide sufficient information to properly inform investors should be considered as negligence at best, or deliberate attempts to deceive at worst.

It is also incumbent on the regulators to inform investors of wrongdoing or they become culpable by contributing to the investors loss by not revealing significant information. The proposed central registry should be accessible by investors to carry out their due diligence when seeking an advisor.

Many investors have lost their savings because there is no First Alert System. Regulators fail to disclose ongoing investigations so small investors are left as food for the sharks.

In many cases of wrongdoing the disclosure is couched in language that is not informative. "Conduct unbecoming" and "failure to keep proper records" can cover up fraudulent actions.

When regulators uncover wrongdoing there should be full and complete disclosure rather than cover-up. Gag orders should not be allowed on dispute settlements.

## 9. Wrongdoing

*"We have found out with our case there are at least three others with the same complaint about the same broker. It was very difficult to find out what to do, where to go, and who didn't have a conflict of interest just to get the ball rolling."*

A small investor - Dec 1998

Investors who do experience significant loss expect to be made whole if the loss is due to industry wrongdoing, however the current regulatory and supervisory structure makes the dispute process complicated and painfully slow. Some victims take years to have their complaints addressed by the regulators only to find out that the regulators will not get their money back, but only investigate to determine if the rules are broken. Many of the victims find that they do not even have the chance to tell their side of the story to the regulators. If their investment advisor contradicts their written submission, the regulators often say they do not know who to believe and so close the file.

The myriad of investor complaints varies but most are based upon breach of trust, unauthorized trading and inappropriate investments that have resulted in major loss. Many of the victims are seniors, but victims come from all walks of life. The common complaints are that the value of the account has suffered serious degradation. In the worst cases the investor has been concentrated in one product or one type of product, and has been leveraged with a bank loan, a mortgage loan, or a margin loan.

In all cases the investor has trusted the investment advisor.

The unfortunate aspect is that investors are not only victimized by financial loss, but the victims are often treated with indifference or callousness by the industry when they attempt to resolve the dispute. Dr. Pamela Reeve addressed this issue in her submission to the Ontario Securities Commission regarding the Fair Dealing Model on August 9, 2004.

Dr. Reeve provides an analysis of client relationships with the investment industry when complaints are pursued, and suggests that these relationships are impaired relative to the



factors that constitute fair dealing, because of inherent conflicts of interest. In her analysis Dr. Reeve concludes:

*"There are strong reasons for the Ontario Securities Commission to consider stricter standards of business conduct for firms that provide these (investment) services."*

A copy is available at: [http://www.sipa.to/library/Documents/OSC-FDM-Reeve\\_040809.pdf](http://www.sipa.to/library/Documents/OSC-FDM-Reeve_040809.pdf)

In 2002, an 80-year old widow became concerned about her investments, and complained that she didn't authorize the trades and didn't understand the investments. Ultimately, the bank owned brokerage decided to settle the matter by paying her \$250,000. She signed a settlement in release form, but the firm did not. In March 2003, the firm then sued her broker for breach of his employment contract and initial claim of damages for \$250,000. In February 2004, they added the widow as a defendant, claiming that her broker refuted her testimony. This seems a rather callous treatment of an 80-year-old widow.

It may be that it is not only a lack of knowledge on the part of the advisor, but in some cases it seems there is a culture of non-compliance with rules and regulations as well as normal levels of morality and ethics.

It is time that we focus on what is right and what is wrong and establish an authority to ensure that those who suffer from wrongdoing are treated fairly and made whole again.

The Canadian market timing scandal reported in December 2003 is indicative that widespread wrongdoing is systemic in the investment industry.

## 10. The Iceberg Problem

*"As a result of the activities of this broker, I not only lost my entire life savings, I lost the savings of my company and I found myself in debt to the tune \$1.8 million. I can tell you there was the day when I stood on the deck of my boat with a 50 pound weight tied around my waist because I had to put an end to ... (unintelligible) ... and it is only because of the intervention of my wife, a very timely intervention, and the subsequent support of my two children that I am here before you today."*

A small investor – Nov 1999

A SIPA member made the above statement at a SIPA member's meeting. The public is not aware of his story or the multitude of investor's stories about how they lost all and often more than all of their life savings when they placed their trust in the investment industry.

Like the iceberg, the extent of this problem of investors placing their trust in the investment industry and losing their life savings due to widespread industry wrongdoing is largely hidden and only a very small portion is visible. Why is this so?

The penny stock dealers are a good example of the wrongdoing that takes place. Their modus operandi is to purchase penny stocks of listed companies that have little or no value. They then start a marketing campaign of selling these shares to unsuspecting small investors. They manipulate the price upwards for a period of months until they have sold all of the shares. Then the price plummets back to its original value of a few pennies a share. The SIPA Report, referred to elsewhere, includes an excerpt from the Settlement Agreement reached between the Ontario Securities Commission and Norm Frydrych of Marchmont and MacKay Ltd. Marchmont were put out of business by the OSC in 1999 after a long legal battle. Of the \$17 million on their books for client accounts at the time they declared bankruptcy, only \$7.5 million represented valid investments. The remainder represented securities that had little inherent value and would be essentially worthless when the Marchmont marketing program stopped.

Some penny stock dealer's greed was such that they did not stop at selling worthless shares but also sold fraudulent shares. Non-existent companies were created on paper and these shares were sold to unsuspecting investors. While this was outright fraud and effected many victims there were never any criminal charges and no one faced jail terms. It seems the investment industry is untouchable.

Human nature causes many people to feel shame that they have been duped and the result is they are reluctant to come forward. Others have tried to come forward but found that after expending much effort nothing could be accomplished. Still others have believed that there was wrongdoing and pursued their quest to have their issue addressed. It does not take too long to realize that this is almost an overwhelming task.

It took Armand Laflamme ten long years and a Supreme Court judgment to get his money back. Monsieur Laflamme began his battle at age 61 and was 71 when he won. He appeared older than his years. It is probably difficult for anyone who has not battled to recover life savings to understand how stressful it is. See your remaining savings flooding away in the pursuit of a legal battle, where there is no certainty of winning even though you are right, can take its toll.

Victims of financial crime who engage in the "Battle for Restitution" discover that they will need substantial resources in money, time and physical and mental stamina to stay the course. They experience an industry attitude of defending vigorously situations that to normal moral and ethical standards would seem indefensible.

Realizing the obstacles thrown up by industry, the delaying tactics employed, and the lying and cover-up that seems to extend to the very top, many decide to accept an out-of-court settlement to enable them to resume some sort of normalcy in their lives. Inevitably these settlements include gag orders and so once again the "Iceberg Problem" continues to menace the unsuspecting the Canadian public.

People who have not suffered substantial loss are generally not aware of the "Iceberg Problem". Many investors are losing their savings but do not realize it because the reports they receive are not meaningful. Others who have lost are occupied with their own battles and these battles consume all of their resources.

SIPA is attempting to quantify the extent of this problem. We have few financial resources and rely upon volunteer effort. Fortunately there are a few retired business people who are willing to devote their time and energy because our government has failed to provide adequate investor protection. To pass the buck down to the SROs to provide investor protection is absurd. Many pundits have likened it to "*the fox guarding the chicken coop*".

One of our volunteers has contacted the Canadian Securities Administrators in each province with a request for information that could help to better define the extent of this problem. The response received to date is less than satisfactory.

The regulators are aware of the practices that are going down. They are aware of industry practices of leveraging small investors to accumulate additional assets on which to generate earnings for the companies without consideration whether this is an appropriate investment strategy for the investors. In most cases it is not.

The Ontario Securities Commission has moved against Portus Alternative Asset Management. James Daw, Toronto Star, writes, "*The aggressive marketer of principal-protected funds, made up of several hedge funds, is under suspicion of selling to unsophisticated retail investors without benefit of an approved prospectus.*"

While the CSA's do good work in providing preventative investor protection the problem remains for those investors who have already lost their savings due to industry wrongdoing. An authority that provides remedial investor protection is needed. The CARP/SIPA Report recommends an Investor Protection Agency as a solution for protecting Canadian investors.

We ask that the Senate call for an inquiry into this problem of investors losing their life savings due to investment industry wrongdoing.

## 11. Dispute Resolution

*"The Ombudsman's Office seems to have sided with the I.A. on all matters. Regarding all the forged initials on my Application/Agreement, they say the I.A. said I signed them. Although I know the Assistant Ombudsman really knows they are not my initials, he is still saying, "Prove it!"*

A small investor – Nov 2003

There are industry sponsored dispute resolution mechanisms but these are designed to arbitrarily reach a resolution rather than to arrive at a just decision. These mechanisms display an industry bias. The regulators advise investors with a dispute to try to resolve it by first approaching the company management including the compliance officer. Feedback from victims suggests that victims are commonly treated with disrespect and claims are routinely dismissed. In house compliance officers seem to fully support investment advisors and other management even in cases of obvious wrongdoing.

The next step is the ombudsman if the firm has one. The banks have an ombudsman service, but feedback suggests that victims do not receive fair treatment.

Several years ago the federal government attempted to create a national ombudsman for financial services. Industry was quick to step in and offer to provide such a service by converting the Canadian Banking Ombudsman to the Ombudsman for Financial Services and Investments, offering that it would be paid for by industry and thus save tax dollars. The general perception of this industry-sponsored agency is that it is industry biased. When investors see that many of the directors on the OBSI board are also officers of companies that have participated in widespread practices of market-timing wrongdoing, they are concerned that it will not be possible to get fair treatment.

The OBSI annual report for 2003 includes a case study of an investor's complaint where OBSI finds the investor should have taken action to mitigate the losses when they became aware of the problem. OBSI rightfully found the broker at fault but, we believe wrongly, limited the amount of the reimbursement for losses up to the date the investor became aware of the losses while the account was still open with the brokerage.

*"OBSI concluded that the clients' investments were not in keeping with their investment objectives and risk tolerances. The firm did not have evidence to show that their objectives or risk tolerances had changed. However, from March 2001 the advisor had given the clients numerous opportunities to reduce the risk in their portfolios. Since the clients were aware of the risks associated with their investments after March 2001, they had a responsibility to mitigate their losses but chose not to make changes."*

With regard to client responsibility to mitigate losses, the Supreme Court issued a judgment in the Laflamme case that suggests the firm has a responsibility that cannot be laid off on the investor. The Supreme Court judgment reads in part:

*"The trial judge noted the state of mind and the knowledge of the Laflamme family, who held onto securities in reliance on assurances given by the respondent Roy, whom they trusted. The losses caused by the bad advice and grossly negligent management by Roy cannot be laid at their doorstep. It is reasonable to assume that an average investor faced with similar circumstances would have been indecisive and hesitant when faced with the various options: selling the securities and taking the loss, holding onto them and hoping that they would go back up in*

*value, or transferring the account to another manager. Nor was any evidence tendered to suggest that, on the information available to them at the time, any of these options would have been beneficial. For all these reasons, the Laflamme family cannot be faulted for failing to take further measures in the hope of minimizing the losses. Those losses were sustained as a result of mismanagement by the respondents, which, as the trial judge found, continued until the account was closed."*

The civil courts appear to be the only means to achieve a just resolution, but even the civil courts appear unable to provide true justice. The legal process is long and costly and there is no recognition of the detrimental impact on the victim's life.

The industry employs a strategy of high priced lawyers, legal maneuvering and delay. The tactics employed coupled with a judiciary that is not always conversant with the ways of the investment industry can result in justice denied.

There is a need for a special court to deal with white-collar crime with a judiciary educated and trained to deal with these types of issues. The education and training of specialized judiciary should include not only the applicable laws and regulations, but also the impact on victims of financial crime.

It is time that white-collar crime is recognized as a serious issue and that its impact on people's lives can be sufficiently devastating as to be life threatening. Perpetrators should be punished for their wrongdoing and made to pay restitution, punitive damages and fines that discourage repeat offences. Management should be held responsible.

Regulators should not delegate dispute resolution to SROs, and should ensure that investors have access to alternate dispute resolution that is not industry sponsored.

## 12. Disciplinary Action

*"His boss, who happened to be a Director of the Investment Dealers Association and chairman already of the Discipline Committee, promised a "forensic investigation" the product of which has stalled ever since. I accused my then broker of churning \$60,000 in commissions out of my account in 1996. I'm debating with myself whether to sue over that and a dozen items of damages. ... I am retired; I practiced law for some 45 years and am now contemplating litigation."*

A small investor - Nov 1998 (deceased)

Regulators have not been able to discourage widespread practices of wrongdoing in part because they appear not to have the power to order penalties but must resort to negotiating settlement agreements. The penalties contained in settlement agreements often pale in significance to the gains made by those involved in wrongdoing. Industry

faced with the choice of excessive profit due to wrongdoing, or taking the risk of getting caught and paying minimal fines, often choose profit over social responsibility.

Individually the leaders of industry may seem like honest caring individuals. However the pressures for performance affect the leaders and representatives alike. Anecdotal evidence suggests that it is not unusual for registered representatives to engage in practices that they believe are inherently wrong because it seems to be accepted practice.

Wrongdoing should be taken seriously and strict penalties imposed. The industry would have the public believe there are only a few “rogue brokers” and a few “renegade compliance officers” responsible for the wrongdoing. Information technology in use today enables managers to monitor all trading activity and identify activities that should raise red flags.

Managers and directors failing to properly supervise their representatives should be held jointly responsible and share in penalties levied for wrongdoing. Those found to be repeat offenders where the wrongdoing results in serious harm to investors should be banned from the industry nationally.

Companies and individuals who breach the rules should be listed in a central registry that contains their transgression and the penalties imposed, and this information should be available to the public to enable investors to carry out due diligence.

### 13. A Final Comment

*“The trouble that banks and their brokerages are in, I do not trust them”*  
A small investor - Feb 2004

Canadians deserve a well-regulated industry upon which they can rely and be entitled to fair treatment. Our Government, the regulators, and the leaders of the investment industry have a social and moral responsibility to ensure that this essential industry is operated in a moral and ethical fashion, as well as a legal fashion.

It is time that our leaders look at the fundamentals of right and wrong. Widows and seniors losing their life savings, when they have placed their trust in the industry, is fundamentally wrong.

Industry representatives or companies with a culture of non-compliance should not be allowed to subject investors to financial predation and subsequent abuse. Regulators should not allow industry participants to flaunt the rules and regulations and then rely upon legal tactics to vigorously defend situations that are morally and ethically indefensible.

TruthTeller protection must be enhanced to protect those who come forward so they may do so without fear of reprisal. TruthTellers will assist regulators in their role of regulating the investment industry.

Enforcement must give priority to protecting investors. Some regulatory resources should be allocated for small investor protection issues rather than committing all the resources to addressing major corporate issues.

White-collar or financial crime must be recognized for the extreme impact it has on victims. It is not just money that is lost. Victims lose faith, hope and trust ... sometimes their health, family and tragically their life.

Special courts should be established with a judiciary that is not only well briefed on the intricacies of the investment industry but also cognizant of the impact on and the needs of the victims of financial crime.

An Investor Protection Agency as recommended in the CARP/SIPA Report would resolve many of the issues related to investor protection.

Government must take action to enable Canadians to trust. Canadians need:

- One national Financial Services Regulator
- A national Investor Protection Agency
- A national register of representatives accessible to the public

SIPA asks that the Senate call for an inquiry into this problem of investors losing their life savings due to investment industry widespread practices of wrongdoing.