Concerned Canadian Seniors and Investors - CCSI

Consumers and Investors in the Wild West

A proposal to the political parties to correct what Paul Martin has called "an unacceptable imbalance in the relationship between consumers and their financial institutions"

January 9th, 2006

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An Open Letter to Canada's Political Parties

The Small Investor Protection Association and United Senior Citizens of Ontario represent hundreds of thousands of Canadians and are collaborating with a number of organizations and advocates on issues concerning small investors and seniors. We also talk for at least ten million Canadian voters who are urgently concerned about the many investors, especially seniors and widows, who have lost their life savings or are in imminent danger of doing so because of corruption in, and inadequate regulation of, the financial services industry. It's time for politicians to understand the issues and take some specific actions as detailed below.

Widespread and well-documented corruption in the financial services industry is only the tip of the iceberg: the larger problem is inadequate enforcement by governments and regulators of laws already on the books. The situation will get worse until perpetrators begin to be sent to jail rather than sent on their way with a friendly reprimand. Investors and seniors are concerned enough for this issue to influence the way they vote in the coming General Election.

The issue is vital for all Canadians. David Dodge, the Governor of the Bank of Canada, has several times recently voiced his concern at the deteriorating standards in Canadian financial markets in the strongest possible terms. The situation, he has made clear, is bad enough to make us a laughing stock and give Canadian financial services the global reputation of being better suited to "the Wild West" than a serious world power. We have a crisis that reaches far beyond the thousands of seniors and investors who have had their life savings decimated or destroyed by pitifully inadequate regulation of the financial services industry.

The RCMP is investigating and the U.S. Securities and Exchange Commission is reviewing the alleged illegal insider trading of income trusts and dividend paying common shares before the government's public announcement on taxation of income trusts and dividends on November 23, 2005. It is suspected that some investment professionals have been trading income trusts for their own gain, at the expense of small investors.

The abuse of Income Trusts is a concrete example of unregulated trickery, whereby many of the business trusts essentially are pyramid schemes. Unit-holders are receiving cash that is well in excess of what is legitimately being earned by the trust organization. As a consequence, false exaggerated yields are being quoted to unit-holders so as to mislead them. Many business trusts have collapsed, and many more will collapse when their money becomes exhausted. Nevertheless, Canada's securities regulators and auditors have remained silent while seniors' savings are being pillaged. It is just a matter of time until the U.S. regulators will be forced to intervene and prosecute for offences against U.S.

citizens by promoters of these illegal (in the U.S., at least) trust structures. Canadian seniors should not be dependent on U.S. regulators to protect them.

Income trusts, however, are only one example of a financial and market system that is increasingly unable to perform efficiently or honestly, to the dangerous detriment of small investors and seniors. So we are calling for the political parties to make an urgent commitment to four specific actions which are totally feasible and which will have an immediate impact. We are deliberately confining our request to measures that are within the power of the federal government to do immediately and simply. All of these measures have been fully researched and publicly justified in great detail (see our attached backgrounders and bibliography for further elaboration).

We call on the political parties to commit to the following actions as a fundamental part of their policy platforms:

1. ***Create an independent Federal Consumer Council on Financial Affairs (CCFA) with statutory authority -- and its own budget -- to represent the investor and consumer point of view to governments (federal and provincial), regulators, law enforcement bodies, financial institutions and voters as a whole.*** It should have the power to investigate and independently publish its findings, possibly modeled partly on the very successful Financial Services Consumer Panel in the UK. It should be compelled by its mandate to report on how adequately regulators and others are performing their functions in protecting investors.

2. ***Establish a totally independent body for setting accounting and auditing standards, to place Canada on-side with our trading partners.*** New balanced rules, and enforcement thereof, are required to minimize the extensive financial abuse that is occurring in Canada. The current standard-setters appear to have long abandoned public and investor interests.

3. ***Pass a comprehensive Whistleblower Protection Act to protect all Canadians.*** It should be drafted and implemented both to protect those reporting abuses and to aid the regulators in unearthing market and competition irregularities.

4. ***Create a division within the proposed CCFA to provide a one-stop mediating and remedial service for all consumer redress concerns, whether in investment, banking services, real estate or insurance.*** Such a body can mediate concerns consumers have with provincial as well as federal bodies, even if it cannot directly impose solutions on non-federal bodies. It should, however, be given full authority to publicize abuses and to draw them to the attention of police and other law enforcement agencies.

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The time for pious expressions of concern is long past. Investors and seniors are increasingly prepared to use their votes to get action from the political parties. We will carefully monitor your response to the CCSI's proposals as well as to those from other representatives of seniors and investors.

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1. Scale and urgency of the problem

In a free market system such as Canada's purports to be, competition is the best form of protection for consumers and investors. As the marketplace becomes ever more complex, however, the laissez faire attitude to competition by governments and their regulators in Canada is increasingly inadequate to ensure genuine competition. Nowhere is this more evident and dangerous than in the area of investment and financial services. The transformation of the structure of the financial services industry in the 1990s, the eroding of the four pillars, was trumpeted to create greater competition in the industry. In some ways it did, but not the kind of competition that protects investors and consumers.

Changing demographics and the newly deregulated financial services industry in Canada have arrived together, and resulted in a little noted but very extensive and serious crisis. The enormous baby boomer cohort is reaching retirement age with little knowledge of how to protect, let alone grow, its life savings. Heart-breaking evidence of criminal abuse of these people is widespread. It is systemic and institutional in that even strictly legal actions by the financial services industry are damaging all but the most sophisticated investors and the integrity of the overall financial system. Canada, it's been observed, has changed from a nation of savers to a nation of investors. The scale of the change is massive. Just two examples of this change:

- Investment in mutual funds alone has grown from $30 billion in 1990 to $556 billion in November 2005, and shows no sign of slowing.
- There's a very widespread move from defined benefit pensions to defined contribution schemes and self-directed retirement schemes, transforming consumers into inexperienced and vulnerable investors responsible for very large amounts of money

Inaction in dealing with these changes will not only hurt the investor. It will also, as David Dodge has cogently pointed out, pose a serious risk to the financial system if it is mismanaged. Finally it could also pose a risk to the political system if consumers and investors fundamentally lose faith in Canada's financial institutions.

It is no longer enough to dismiss this with the slogan, "Buyer Beware", or to promote consumer education, which will only be effective a generation hence at the earliest.

The Gomery commission has alerted the public that Canadians are being cheated with their own tax money. But it is just one event and man others have had a bigger though less well-publicized effect. The mutual fund market timing scandal. The Portus, Crocus, and Norshield fiascos. The ASC scandal. The Felderhoff trial, rekindling memories of Bre-X. The white-collar criminals being sentenced to jail in the U.S. The U.S. charging Canadian Lord Black with criminal activity. All of these events are alerting the public to massive wrongdoing that is largely uncontrolled in Canada.

There is a lack of control of governance and accountability and investors can no longer depend on the veracity of CEOs, the Auditor’s statements, the analysts’ reports, or the recommendations of their advisors. All are conflicted because there is no regulatory authority responsible for consumer/investor protection.

Canadians are being told they must become educated, must do their own due diligence, and must protect themselves.

In September the finance minister’s statement made income trusts an issue. The public was not aware that many of the business income trusts were and are totally unsuitable as an investment for seniors. The public was misled.

Experience throughout the free market world has shown decisively that governments and regulatory regimes need to play a far more active role enforcing regulations and redressing genuine grievances in the area of financial services. Governments’ and regulators’ responses so far have been overwhelmingly lip service.

At the federal government level, a number of high profile scandals in the industry in the late 1990s laid bare the vulnerability of the average investor, and the willingness of even the most respected banks and companies to take advantage of this vulnerability. Prime Minister Paul Martin (in his then capacity of Finance Minister) responded by introducing *An Act to establish a Financial Consumer Agency of Canada* and said unequivocally that there was an “unacceptable imbalance” in the relationship between consumers and their financial institutions. He said the Financial Consumer Agency (FCA) was being established because “We need to help guard against this imbalance by clearly identifying areas of responsibility for consumer protection and by putting a framework in place to ensure it” (June 25, 1999).

This was a welcome move, and in line with similar initiatives already undertaken in the United Kingdom and Australia. Unfortunately, however, the FCA's mandate was always extremely limited, as were the resources put at its disposal. Recently, according to the *Financial Post Business Magazine*, the FCA has been largely reduced to checking whether the banks are cashing government cheques and whether branches carry enough pamphlets publicizing the role of the FCA. The *Post* suggests that the government should get rid of the FCA as presently constituted and "combine all financial services regulators into a single entity, similar to the Financial Services Authority in the U.K."

Though the *Post* goes on to suggest that a single financial services regulator "is a pipe dream for now", determined national governments in both the U.K. and Australia have achieved just that, and in situations of divided jurisdictions every bit as complicated as Canada's.

The CCSI proposal above, however, does not ask for a single national financial regulator in the short term. Instead, it suggests four specific, practical and short-term measures that would ensure the current regulatory regime becomes considerably more effective in bridging the unacceptable gap. Though the ultimate goal should continue to be one national financial services regulator and one single avenue of information and redress for all consumers and investors, these four measures will in a very short time have an enormous effect in alleviating a very real crisis for Canadian investors, and the very real danger that the reputation of Canadian financial services will be irreparably damaged. The latter danger is neither fanciful nor exaggerated. As David Dodge put it, Canadian financial services are being increasingly regarded as better suited to the "the Wild West" than a serious world power.

2. Who we are

We are a collection of groups and individuals concerned with the welfare, not only of consumers and investors, but also with the health, integrity and stability of the Canadian financial services industry as a whole.

SIPA acts as a voice for small investors throughout Canada and has over 500 members in nine provinces from Nova Scotia to British Columbia. The United Senior Citizens of Ontario (USCO) represents Canadian seniors and has 300,000 members in Ontario.

Together we represent several hundred thousand actively engaged and knowledgeable voters; but more importantly we are known and trusted by a much larger group of consumers and investors as representing their best interests in a climate where they have few places to turn for reliable unbiased information and redress for investment losses caused by malfeasance. We also affiliate with other organizations, such as Canada's Association for the Fifty Plus (CARP), for specific projects. Some of our joint initiatives and publications are listed below.

The commitments we are seeking from the political parties prior to the January 2006 General Election are not new, but they have become more urgent with time. Similar requests have been made in a variety of forms and venues, and there is a great deal of documentation available exhaustively justifying the need for these commitments and providing blueprints for how they might be implemented in practice.

3. What we are asking of the political parties

The explicit commitment, with an implementation timetable, to;

1. ***Create an independent Federal Consumer Council on Financial Affairs (CCFA) with statutory authority -- and its own budget -- to represent the investor and consumer point of view to governments (federal and provincial), regulators, law enforcement bodies, financial institutions and voters as a whole.*** It should have the power to investigate and independently publish its findings, possibly modeled partly on the very successful Financial Services Consumer Panel in the UK.

2. ***Establish a totally independent body for setting accounting and auditing standards is a necessity, to place Canada on side with our trading partners.*** New balanced rules, and enforcement thereof, are required to minimize the extensive financial abuse that is occurring in Canada. The current standard-setters appear to have long ago abandoned public and investor interests.

3. ***Since regulators have limited resources to unearth illegal and unethical conduct in the accounting and securities fields, make a commitment to pass a comprehensive Whistleblower Protection Act to protect all Canadians***. It should be drafted and implemented both to protect those reporting abuses and to aid the regulators in unearthing market and competition irregularities.

4. ***Create a division within the proposed CCFA to provide a one-stop mediating and remedial service for all consumer redress concerns, whether in investment, banking services, real estate or insurance.*** Such a body can mediate concerns consumers have with provincial as well as federal bodies, even if it cannot directly impose solutions on non-federal bodies. However, it can exercise its power to at least publicize abuses and draw them to the attention of police and other law enforcement agencies.

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List of Publications and Initiatives

THE SCORPION AND THE FROG – A consumer view of Canadian financial services and ways to transform them - A report prepared for the Consumers Council of Canada for presentation to the Office of Consumer Affairs, Industry Canada by David Yudelman, 2001

SIPA Inc, Five Year Review – the Small Investors' Perspective of Investor Protection in Canada - A report prepared by SIPA to brief Canada's leaders on the plight of investors and recommend Government action to provide investor protection for Canadians. February 27, 2004

Comments on the Fair Dealing Model of the Ontario Securities Commission - An analysis of the client/representative relationship that occurs in the context of internal account reviews and whether the client/representative relationship in this context is objectively impaired relative to the factors that constitute fair dealing. Dr. Pamela Reeve. August 9, 2004

GIVING SMALL INVESTORS A FAIR CHANCE: Reforming the Mutual Fund Industry - Carp's Report and Recommendations – In partnership with Small Investor Protection Association (SIPA). September 2004.

It's a Matter of Trust – SIPA Inc submission to Standing Senate Committee on Banking, Trade and Commerce. February 14th, 2005.

Elder Financial Abuse - Submission to the Senate Committee on Banking, Trade and Commerce. Patricia Cosgrove. April 2005.

OSC Town Hall Event – Transcript of the Town Hall Event. May 31, 2005

Reduced Limitation Periods – CARP, SIPA and USCO associated to address the unfairness to aggrieved investors of reduced limitation periods with a joint press conference in July 2005, and a meeting with the Ontario Attorney General's staff to protest the reduction from six years to two years in August 2005.

The Worst is Yet to Come – The $20 billion deception that dwarfs the tax debate. .A report on business income trusts by Accountability Research Corporation. November 16, 2005.