# SIPA Sentinel

**May 2004**


**SIPA has a mission:**

- **to aid public awareness of how the investment industry operates;**
- **to provide guidance to those who have a complaint about investments with a bank, broker, financial advisor, or other seller of financial products;**
- **and to pursue improvement of industry regulation and enforcement.**

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**Small Investor Protection Association - A voice for the small investor**

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## Welcome new members!

You should receive your membership card and your User Name and Password to enable you to access the Member's Pages of SIPA's website at www.sipa.to.

## SIPA Sentinel

The SIPA Sentinel is a newsletter for members. It contains material we hope is of interest. Members are welcome to submit comments for including in a future issue.

From time to time SIPA will be including articles that offer opinions on subjects related to investing and the regulatory system. These are meant to help increase investor awareness, and SIPA may not share these opinions.

## SIPA Inc Five Year Review ~ the Small Investors' Perspective of Investor Protection in Canada

The SIPA Report will be available to members on the SIPA website. The report is about 100 pages including an appendix of small investor voices. A copy of the executive summary:

### Executive Summary

**Until recently the public perception was that the investment industry is well regulated and the regulators provide investor protection that will protect the small investor from wrongdoing. More recently the public is becoming aware of widespread industry practices of wrongdoing that are creating a negative impact on all investors.**

**The small investor voices included in this report are excerpts from the many communications received since SIPA was founded in mid 1998. These voices are representative of the hundreds of voices that have been heard and come from all walks of life including doctors, lawyers, health care workers, teachers, widows, and seniors. From all these voices a composite small investor perception of the investment industry has evolved.**

**Regulators are challenged to balance the needs of investor protection with the need to promote market efficiency, but the Canadian public does not understand how the regulatory system works. There is great disparity across the country and amongst the dealers, mutual fund companies, insurance companies and banks. There is pervasive non-compliance with the rules. Regulators appear largely ineffective in dealing with those engaged in wrongdoing. Investors do not know where to turn. The Wise Persons Committee Report issued in December 2003 calls for a Canadian Securities Commission to provide consistent regulation for all Canadians and a united Canadian voice in the global marketplace.**

**The lack of investor awareness is acknowledged. Attempts at investor education will not resolve the underlying problem, of investor losses due to industry wrongdoing, faced by small investors. The small investor needs to become more aware of how the industry operates and is regulated. However, Canadians are busy with earning a living and participating in family life. The investor trusts his advisor and trusts our Government to provide industry regulation and control. Government has a responsibility to protect small investors as consumers and that responsibility can no longer be deferred.**

**The investment industry tends to follow widespread practices that are contrary to the rules and regulations and not in the best interests of small investors. Some of these practices are being exposed in the United States. Canadian investors are becoming aware that these same issues are prevalent in Canada. There is an appalling abuse of small investors who are financially uneducated. The leaders of the industry should have at least some knowledge of the cavalier attitude towards small investor life savings. It is irresponsible to ignore this situation or worse to condone it. Our Canadian society is based on trust and that trust is being betrayed by the investment industry.**

**The primary complaint of the small investor is that he is encouraged to place his trust in his advisor but his advisor often seems more motivated by commission generation than providing a capable professional service to the clients depending on him. Fiduciary duty is breached on an alarmingly regular basis and sometimes fraud is an issue. This results in the serious degradation of small investor savings with the resultant negative impact on lifestyle. The regulators receive large numbers of complaints but are reluctant to reveal information. The public has a right to know when this information could help them to ward off destruction of their life savings.**

**Investors have found it takes time to determine how complaints are dealt with, and it is difficult to get an appropriate response from industry participants. Industry sponsored dispute resolution mechanisms do not provide appropriate means for small investors to have their disputes resolved. Investors who make a complaint are stalled and encounter delaying tactics. Ultimately, they find that civil litigation is the only viable alternative and often this is not an option possible for the small investor who has lost everything. Most seniors do not have the requisite resources of money, physical and mental stamina, and time to pursue lengthy legal battles.**

**Investor losses are estimated to amount to billions of dollars. The BCSC alone estimates $100 million annually in 'reported losses' in British Columbia. Many small investors are not even aware when they have had a negative experience as a direct result of industry wrongdoing. Industry has failed to provide all investors with meaningful statements on a timely basis. Many that are aware of a problem are reluctant to proceed with a complaint. Often, they are misled when industry participants provide false or misleading information.**

**The impact on victims of investor losses due to wrongdoing can be devastating. It is not only the financial loss; it is the sense of betrayal the victim feels when his trusted advisor has caused the loss of life savings. The victims lose their money, their hope, and their future. Many suffer from Post Traumatic Stress Disorder. They experience depression, difficulty sleeping, stress on relationships, loss of trust in others, loss of hope, and too often thoughts of suicide.**

**Small investors need regulators to provide investor protection that is fair and available to all Canadians. History shows that self-regulation has failed to provide adequate investor protection. Industry sponsored agencies or agencies that employ mainly industry staff will not provide fair and objective investor protection. The Government must now act to afford consumer protection for the small investor. Government should heed the call for a Canadian Securities Commission and a Canada Securities Act; and enact legislation for a national authority to provide investor protection for all Canadians. As the Wise Persons Committee Report states and is so aptly named "It's Time".**

## Investor Advocate Jim Roache Speaks Out

This issue we have an article written by investor advocate Jim Roache. Jim is a former journalist and for several years operated a website that was critical of the investment industry and how small investors are treated. Jim experienced a dispute with a major brokerage firm but was able to resolve his dispute a couple of years ago. Good for Jim!

## Another Canadian Bull Market – Why???

By Jim Roache, MBA

Jim Roache, MBA - Ottawa

In recent years, it has become the mantra of the financial services industry that any whiff of scandal is unacceptable because it will result in a lack of investor confidence. There is widespread espousal of the belief that if market anomalies – deliberate or inadvertent – go unchecked, Canada will lose the ability to attract foreign capital and to grow its economy. Lip service is paid to the avowed objective of maintaining an orderly financial marketplace where breaches of Criminal Law, the Securities Act, the policies of the regulatory agencies and industry convention are kept to an absolute minimum.

We have laws, policies, regulations, rules and voluntary standards in place purportedly to ensure economic growth and prosperity, especially for those willing to undertake the risk of placing capital in the hands of managers who pledge to fulfill the legitimate expectations and protect the legal and ethical rights of investors.

We have security commissions, self-regulatory agencies, ombudsmen and, in extremis, the police - or the police in tandem with the regulators - to protect a free economy which by definition requires universal trust and confidence as the key element to continued shared prosperity. Such is the general consensus.

Why then, so soon after any number of wholesale scandals from Bre-X to Nortel, so soon after a drastic bear market that whipped out millions in personal savings, so soon after all our safety mechanisms have proven totally inadequate in times of crisis, and in light of similar catastrophes south of the border, are investors back into the markets in record numbers plowing record amounts of money into stocks with insane P/E Ratios and mutual funds which rarely if ever even match the market Indexes....and this while banks and their investment subsidiaries see their profits soar almost as fast as personal debt? I have an MBA, but I must have missed a few very important classes!

Investors would have to have been holidaying on another planet for the last decade not to know that the stock market is no place for anyone who is not an insider to put their money. I know of four suicides myself. During the time when I was an investor advocate – so dubbed by the media – I was in contact with literally hundreds of people coast to coast who had been financially seriously damaged or totally ruined by the financial services system.

I use the term system deliberately. Too many times I was told that what happened during the decade – to the markets themselves, to shareholders, to employees and to creditors – was the work of “a few bad apples”. It was even suggested by business reporters that I should not be individually critical or dome businessmen and senior finance executives because “they were nice people”.

Initially, I thought that the problems, which need no detailed recounting here were, in fact, brought about by the behaviour of a relatively few people who had failed to study or absorb the moral, ethical or religious content of their formative years. I simply could not allow myself to believe that a whole system and the mechanisms put in place purportedly to police it was corrupt. Inept maybe – corrupt – I just could not make that leap from everything I had been conditioned to believe about Canada to what I was seeing unfold right before my eyes.

A conversation with a senior reporter from the Financial Times of London changed everything for me. It was at a time when a well-known Canadian bank CEO had “washed up” on the shores of the British Isles. In anticipation of what to expect, he was interested in (possibly) doing a feature on what had gone so wrong for so many investors in Canada under the executives tenure and why. The second part of his inquiry was most interesting.

This seasoned journalist did not want to know what was wrong with the financial services sector in Canada. He wanted to know why so many Canadians could be so ignorant, so gullible or so greedy as to be drawn into such a clear web of deception in the months previous and, when the inevitable happened, plead ignorance. He asked me – don’t you people know that the Canadian stock markets are the most manipulated and controlled in the civilized world and that the only reason any experienced foreign investor puts money into Canada is to launder it??? I was “gob struck” – to use their term - by what he said, and he was gob struck that I was gob struck.

When I explained that Canadian "outsiders" were, as he observed, "ignorant, gullible and greedy" and conditioned to be that way by multi-million dollar advertising campaigns in all major media and by government and institutional propaganda, he was not impressed. That our industry insiders are crafty, conniving and corrupt by any civilized standard was not news to him? He said that was not a story – nothing new – it is common knowledge, he said, that the deck is stacked by insiders here to the point at which anyone with common sense would simply vote with their investment dollar by moving it elsewhere. But we don't.

He hoped there might be a story in that because he simply could not grasp how a whole highly-educated population could be taken in en masse. That we had been was not the story – people in Europe know this is the wild west and "colonials" are idiots. How it could possibly happen he felt might be media fodder and instructive to local investors as to what to look for from the new man in town. Our recent history merely confirmed his dismissive impression of us and he saw no value in doing a story stating the obvious. It was a stereotypical snub, but it rankled all the more because he was – I was forced to admit – absolutely right! I couldn't answer his question then – he didn't do the story – and I can't answer his question now.

Not only are you just as well advised to go to a casino or to buy a lottery ticket as to buy a stock – if you are an "average" Canadian, but you had better realize that if you are defrauded in the stock market, there is no help to be gotten – not from your government, not from the police, not from the regulators and not from the civil courts --- except in highly unusual circumstances and at great expense over a number of years – if at all.

If you buy a home or an automobile, you get a warranty – a contract between the manufacturer or seller and you. It is enforceable.  If you buy a stock, you get a New Client Account Agreement subject to a Know Your Client rule. It is not enforceable. And for many people – especially in the case of RSPs – there is much more on the line than there is with a house or car. Your standard of living and quality of life until the day you die is on the table.

Yes, there is tax deferral, but the rule of thumb in investing is look at the risk-return, not simply the tax implications when considering where to put your money. To do otherwise is a mugs game. Why defer taxes and find yourself partially stripped or even totally devoid of resources after the fact?

But most investors are as hypnotized as a viper by a skilled snake charmer when dealing with the minions of the financial services industry. The only difference is they know more tricks than any snake charmer and they are the deadly ones not the poor snake turned sitting duck – most Canadian investors.

What is that reporter thinking now? What is he saying to others now? "There they go again – feeble minded colonials". So I have a question for those of you who still have investments placed with Canadian institutions – especially if you were given an acid bath over the last decade – WHY? Why so counter-intuitive? Why are the Indexes soaring in the face of grossly inflated P/E Ratios? Why are bank profits soaring as consumer credit grows to insane levels and interest rates can turn on a dime and bankrupt thousands? If he weren't right in his assessment of us, I wouldn't care even a little about what a British financial reporter thinks. But he is right – apparently.

I would like to know why you are doing what you are doing. You could have pleaded ignorance during the last bull market. But you only get one free pass. Inquiring minds need to know – what on earth are you thinking????

Your turn – why do I want to know??? Well, SIPA and a number of journalists and investor advocates have tried to alert, warn and educate investors about the built-in systemic dangers in financial services for years. We have used every means at our disposal. The media has been full of horror stories that should logically have investors running for the exits. Instead people behave like lemmings and stampede into yet another inevitable bear market. We who have tried and failed to stop this madness need to know whether there is something else we can do or whether we should simply walk away? So…please tell me!

## OMBUDSMAN FOR BANKING SERVICES AND INVESTMENTS

We have received complaints about OBSI. The main complaints are: it takes a long time to get a final report, and the results tend to show an industry bias.

We have also had a complaint that one of the banks included the OBSI report in their Statement of Defense. OBSI says "you and (the bank) are able to deal with OBSI in a complete and open way without the risk that you may prejudice your legal rights. … the parties agree that the files of OBSI and the discussions between you, (the bank) and OBSI as part of the review process are confidential and will not be used in any subsequent legal or other proceedings." SIPA wrote to OBSI for clarification of why this happened. OBSI investigated and responded saying it should not have happened. The bank in question also advised SIPA it should not have happened. But it did.

In a recent complaint to OBSI, a senior had lost almost 50% of the value of their RRSP while depending upon a bank owned brokerage for advice. OBSI investigated and found no fault on the part of the bank.

OBSI did not agree that a risk profile of 20% low risk, 60% medium risk and 20% high risk is not appropriate in this case although experts considered it inappropriate. SIPA disagrees with OBSI. RRSPs are generally considered as funds for retirement and should not be exposed to excessive risk. It seems totally unacceptable that a full service brokerage could allow an RRSP to deteriorate by almost 50%.

OBSI seemed to justify the failure of the RR to mitigate the loss by saying "At no time when you raised your concerns with (the RR) did you request that he sell your mutual funds and invest them in bonds or GICs, or even switch them to lower risk mutual funds, because you were overly concerned with your portfolio at the time." They recognize that the investor had been concerned but seem to suggest that the investor is responsible for taking action to protect his account and that the brokerage does not have responsibility. SIPA does not agree with that position. In fact there is court precedent (LaFlamme vs Prudential Bache) that indicates the brokerage retains fiduciary responsibility for the account until it is closed or transferred.

OBSI closes by saying "Although it is unfortunate that you experienced losses in your account, given the results of our investigation we are unable to recommend that (The bank owned brokerage) provide you with the compensation requested."

Given that the account when transferred in was composed of approximately 50% bonds and cash and 50% in equities, it is hard to accept that capable management of the account could reduce it by 50%. It appears that the bonds were sold and mutual funds were purchased. This is not an uncommon move as it certainly increases the earnings for the RR and the brokerage. Bonds are not a big earner for the companies, but mutual funds provide commissions and trailer fees.

It may well be that if seniors receive this type of treatment with this bank owned brokerage they would be well advised to cash out or transfer their account to avoid risk of loss without hope of restitution.

## GOVERNMENT MUST ACT TO PROVIDE INVESTOR PROTECTION

On January 26, 2004, the following e-mail was sent to the Prime Minister:

This message is copied to some concerned Canadians, and others

Dear Prime Minister

The investment industry, the regulators, and the government have failed the small investor.

Small investors have placed their trust in the industry and that trust has been betrayed. Many small investors have lost all of their life savings. They have also lost their hope for the future and their trust in our society.

Is Canada no longer a just society?

There are fundamental issues that have not been acted upon. There have been numerous studies, task forces and reports. Yet investor protection is lacking.

The Industry Canada sponsored 1998 Stromberg Report "Investment Funds in Canada and Consumer Protection" identified issues and proposed solutions. Industry and regulators failed to act.

The Wise Persons Committee Report of December 2003 "It's Time" reviews securities regulation and strongly recommends action. IT IS TIME for government to act because industry and regulators have failed to respond. Canadians need investor protection. The present regulatory system fails to protect the small investor.

An article in the New York Post January 25th has captured the situation in the United States and this applies equally to Canada:

***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.***

***"Whether you are talking about research or mutual funds or specialists, there has been a failure to properly question behavior that they know about before anyone else. Everyone of those issues was understood by the industry and not responded to."***

***Spitzer, 43, a graduate of Princeton University and Harvard Law School, where he was editor of the Law review, sees the solution in leadership.***

***"I don't pretend to have any answers beyond the platitudinous observation that those who are in charge of the SROs have to be willing to rock the boat and have to*** **be willing to play the role of prosecutor or the system will fail," he said.**

This is a message our leaders in Canada need to hear.

Yours truly
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## NESBITT BURNS MANAGER FINED

The Toronto Star article by Stuart Laidlaw April 29th, 2004 states "John Dunn was fined $100,000 yesterday plus $15,000 in costs by the Investment Dealers Association for failing to properly manage accounts at the Nesbitt Burns Inc. office he once ran." The article describes how an investor from Mississauga specified he did not want to invest in high-risk stocks but ended up heavily invested in Tee-Com Electronics. The Star states Tee-Com was "considered a high-risk investment by Nesbitt's research department".
The Star reports that one investor lost $452,412 "when the stock collapsed in the spring of 1997. ... Tee-Com was removed from the Toronto Stock Exchange in May, 1997."
The Star reports that Dunn's assistant manager, and a third accused were fined "for recommending inappropriate investments and failing to exercise due diligence."

This situation is yet another illustration that self-regulation does not provide protection for small investors. When a manager, an assistant and another accused are all involved, it suggests there are systemic problems in the investment industry. Rogue brokers? Yeah, right!