



**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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## SIPA Sentinel

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

## FINANCE MINISTER'S RESPONSE TO SIPA'S INCOME TRUST SUBMISSION

The following is Finance Minister Flaherty's response to SIPA's February 1, 2007 submission:

*March 8, 2007*

*Mr. Stan Buell  
President  
Small Investor Protection Association*

*[stanbuell@rogers.com](mailto:stanbuell@rogers.com)*

*Dear Mr. Buell:*

*Thank you for your correspondence of February 1, 2007 regarding the Tax Fairness Plan for Canadians announced on October 31, 2006.*

*I understand the concerns expressed to me concerning this decision. This decision, while regrettable, was necessary. We were seeing a very troubling trend of acceleration of conversions to income trusts in 2006. In some cases, it was done purely to avoid paying corporate income tax. If left unchecked, this would have resulted in millions of dollars in less revenue for governments across the country to invest in the priorities of Canadians, including more personal tax relief. It was important to act decisively to address what had become a clear danger to our economic productivity as a country.*

*We believe all Canadians should pay their fair share of taxes, including corporations. We do not believe ordinary taxpayers should pay more because corporations were not paying their fair share.*

*Our Tax Fairness Plan restores balance and fairness to the federal tax system by creating a level playing field between income trusts and corporations, and will deliver more than \$1 billion of new tax relief annually for Canadian seniors and pensioners.*

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*Measures in the Tax Fairness Plan include:*

- \* A distribution tax on distributions from publicly traded income trusts and limited partnerships. Distributions of existing income trusts will not be affected by this tax until 2011.*
- \* A reduction in the general corporate income tax rate of one-half of a percentage point as of January 1, 2011. As of 2011, the federal general corporate income tax rate will be 18.5 percent.*
- \* An increase in the Age Credit amount by \$1,000, from \$4,066 to \$5,066, effective January 1, 2006.*
- \* A major positive change in tax policy for many seniors and pensioners: permitting pension income splitting, beginning in 2007.*

*The proposed new distribution tax will not punitively tax income trusts. Recognizing that many Canadians have savings invested in income trusts, existing income trusts will not be subject to the new measures until their 2011 taxation year. This four-year grandfathering period is both reasonable and appropriate. A grandfathering period longer than four years would continue to provide income trusts with an inappropriate tax advantage relative to their competitors and retain the unlevel playing field that currently exists between income trusts and corporations. In addition, under the new measures, income trust distributions will be treated as dividends eligible for the enhanced Dividend Tax Credit. Together, these measures will help remove the existing tax distortion in favour of trusts relative to corporations and let the underlying economics, and not the tax rules, determine business decisions. There will not be any additional government revenue generated from the corporate sector.*

*The increase in the Age Credit amount and allowing pension income splitting will help many of the most vulnerable Canadians, and many investors. The \$1,000 increase in the Age Credit amount will provide tax relief to low- and middle-income seniors, and increase the income level at which the credit is fully phased out, from \$57,377 to \$64,043. The pension-income-splitting measure will allow Canadian residents who receive income that qualifies for the Pension Income Tax Credit to allocate up to one-half of that income to their spouse or common-law partner, thereby significantly reducing the tax on that income. This is a significant and positive new step that will directly benefit thousands of pensioners and seniors across the country. It will strengthen our social security system even more.*

*The Tax Fairness Plan builds on steps taken in Budget 2006, in which we delivered significant tax relief for Canadians, with 29 tax cuts amounting to \$20 billion in tax relief over the next two years. We believe that tax relief is one of the keys to ensuring the Canadian economy remains strong and competitive. Families and businesses still pay too much tax in this country, and our Government will continue to reduce the tax burden on Canadians.*

*By introducing our Tax Fairness Plan we are acting in the national interest to ensure a stronger, more productive economy in the future. We are significantly enhancing the incentives to save and invest for family retirement security.*

*Thank you for communicating your concerns.*

*Sincerely,  
James M. Flaherty*

## MORE ON INCOME TRUSTS

Untold numbers of investors are losing their savings when they blindly place their trust in an industry that is self regulated and has at best a cavalier attitude towards small investors and their savings. It is not necessary to become a financial expert but everyone should learn the basics of investing so they understand the types of products, the inherent risks and how the industry operates and is regulated.

Dr. Al Rosen of Accountability Research Corporation has been writing articles to alert investors about the risks associated with investing in income trusts because of the lack of meaningful disclosure and the creative accounting that misleads investors. We have featured a number of Dr. Rosen's articles to help make investors aware. The following article was published in Canadian Business.

### ***Detecting crookery***

***Al Rosen***

*From the February 12, 2007 issue of Canadian Business magazine*

*Over the past eight years I have avoided turning this column into an endless series of accounting lessons on how financial statements can be cooked. I fear now that this was to the detriment of investors. I originally believed that the perpetrators of the scams would stop performing certain tricks once they were exposed. Sadly, this was not the case.*

*The situation really came into perspective when I saw the old "pro forma" financial reporting chicanery at the heart of the 2000–2001 tech meltdown get dusted off and used for many income trust scams.*

*Unfortunately, Canadian investors have not understood the main reason for the continued unravelling of many trusts. Unmistakable blame should be placed with certain underwriters, accountants, lawyers and regulators who promoted and allowed misleading distributable cash and yield figures that routinely misrepresented the ongoing costs of these businesses.*

*The lack of willingness of regulators and SROs to clean up these recycled shenanigans once and for all means that it's back to teaching investors how to protect themselves. This column—the first in a small series this year—serves as an introduction for subsequent articles.*

*Step 1 in protecting your investments involves actually reading quarterly and annual financial reports. By doing this, you will quickly learn that financial statements can be at great odds with what someone has told you about a company. And, of course, after careful analysis you will also find that the financial reports of many companies are frequently incomplete and sometimes quite misleading.*



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*Step 2 involves understanding the type of company you are analyzing. You must recognize that you have a better chance when a company follows U.S. or international accounting rules, and is regulated by the U.S. Securities and Exchange Commission. Canadian regulators are simply too feeble and have a long history of letting down investors.*

*Step 3 requires learning the nature of the company, especially its sources of revenue and income, including the countries of origin. Many corporate collapses have involved financial institutions (e.g., Canadian Commercial Bank, Northland Bank, Principal Group, Standard Trust, Confederation Life) and real estate operations (e.g., Bramalea, O&Y Real Estate Investment Trust, Castor Holdings). Monitoring cash inflows is vital, but financial statements can hide or obscure them. Likewise, the financial statements of resource industries can be of limited use because accounting doesn't focus on valuing the assets in the ground.*

*Step 4 involves developing a skeptical attitude in general. Canadian regulators rarely prosecute financial reporting misrepresentations. Corporate managers know this better than anyone. They also know the specific tricks available under loose accounting rules that can be used to mislead investors.*

*Unlike the rest of the industrialized world, Canada has foolishly allowed its auditors to direct and influence the writing of auditing and accounting rules. This has resulted in the current financial reporting process being skewed in the interests of corporate issuers, instead of addressing the needs of investors.*

*Even worse, successful Canadian court cases against directors, officers and auditors are negligible. One reason is that the auditor-influenced rules are too weak to secure convictions. The fact that an annual report has been audited and approved by a provincial securities commission must be ignored; virtually all of Canada's major financial failures over the past 25 years had financial statements that passed regulatory oversight.*

*Step 5 involves recognizing when something is too good to be true. An investment that boasts of tax efficiencies or superior returns must be viewed with a critical eye. Likewise, large gains in reported sales or income should have a good explanation. Any unexplained or windfall results could be a warning sign of financial games being played with your money.*

## **DECEIPT & BETRAYAL**

For many years we have stated that wrongdoing in the investment industry is widespread and that the industry is covering up the magnitude of this problem. The public is being deceived by the industry when it creates products to provide an illusion of a safe investment with a good return, and when the public is told the industry is well regulated and consumer/investors are protected. The public is persuaded to place their trust in the industry but too often that trust is betrayed.

For those who have failed to believe that wrongdoing is widespread and the industry is covering up, the recent IDA leak of ComSet data should convince them otherwise. Robert Kyle, who runs a website [www.investorvoice.ca](http://www.investorvoice.ca) discovered the data through the IDA website and promptly published it on his website.

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A recent article by Gary Norris on the canoe.money.ca website states *"The Canadian securities industry's self-regulatory organization is being defied by an investor advocate who is a longtime critic of, as he sees it, letting the foxes regulate the henhouse in the investment business. ... At issue are the names of 2,800 stockbrokers in a database of IDA registrants involved in client complaints between October 2002 and June 2005."* Norris also writes *"those totals are impressive - 177 in January alone, or eight every working day, including 36 civil claims and three criminal charges. ... For all of 2006, the IDA reported 1,932 complaints through ComSet plus 616 via other channels ... the association currently has 108 disciplinary cases underway."*

Another article by David Clarke in the Investment News states *"A tussle has erupted over what to do with complaints against more than 2,000 brokers that the Investment Dealers Association of Canada inadvertently posted on its website. Investor rights activist Robert Kyle, who discovered the list on the IDA's website, deliberately posted it to his own website, investorvoice.ca., where it remains. ... Now he has received a letter from the IDA's lawyers, Toronto-based Borden Ladner Gervais LLP, which said, "You must immediately remove from your website the information relating to IDA members and brokers."*

Clarke also quotes Kyle as saying *"the data has been lodged in the Superior Court of Justice of Ontario in Toronto since Jan. 24" — in a case involving TD Waterhouse Canada Inc. of Toronto, a subsidiary of Toronto-Dominion Bank."*

Clarke also states *"The IDA says that 87.6% of its registered representatives have had zero "events" reported on ComSet since mandatory reporting began in October 2002. Of 3,929 reported complaints registered with IDA members over the two-year period through February 2006, 463 remain outstanding. Only 15 individuals on the ComSet database have been charged with a criminal offense."*

This means that 12.4% of registered representatives have had "events" reported, or more simply you have a one in eight chance that your registered representative has had an "event" reported. Now this does not mean that all investors are at great risk of losing their savings, but it certainly illustrates that wrongdoing is widespread. This data was accumulated over just a few years and may not include all complaints.

The regulators have never made this information available to the public. This really demonstrates that the industry and the regulatory system have been covering up so that investors have been unable to carry out due diligence when they are searching for a financial advisor. This is an additional risk faced by investors who use advisors.

It is time that the public demands action from the Government to clean up the investment industry and regulatory system. Its time that Canadians have an Investor Protection Agency with the power to investigate and order restitution. It must be independent from the regulators and not controlled by the investment industry. Self regulation is not protecting investors.

Wrongdoing is widespread and the public is not aware of the extent because the regulators are failing to disclose information. However, there are signs that this will change. The fact that the IDA is collecting data and that some CSAs are making data available is encouraging.

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The BCSC is one of the CSA's that is more forthcoming with information. They are the only regulator that provides an alphabetical list of disciplined registrants and they also provide a list of those who have not paid the fines levied. The BCSC Annual Report provides statistics on complaints as detailed below:

*"The BCSC 's process for dealing with misconduct starts with the intelligence and assessment branch of our enforcement division. This team receives complaints and referrals from investors, securities industry participants, other regulatory and enforcement agencies, and BCSC divisions that monitor market conduct and disclosure.*

*Last year, we handled 230 complaints. Many of these represented multiple violations, including:*

- ? 85 related to unregistered activity*
- ? 62 related to illegal sales of securities*
- ? 47 related to fraud*
- ? 45 related to registrant misconduct*
- ? 59 related to director and officer misconduct*
- ? 54 involving civil disputes outside our mandate"*

L'Autorité des marchés financiers is one of the more advanced regulators and are actively handling complaints. Their latest annual report indicates the number of complaints below:

*"L'Autorité a reçu 1 056 plaintes entre le 1er avril 2005 et le 31 mars 2006. Certaines des plaintes analysées ont été transférées à un service de l'Autorité ou à un organisme d'autoréglementation."*

The Saskatchewan Financial Securities Commission Annual Report for 2005-2006 indicates the number of complaints below:

The SFSC "Assisted consumers in resolving disputes with financial services businesses by responding to 172 complaints."

## **RESOLVING DISPUTES – IS JUSTICE AVAILABLE TO ALL?**

As many aggrieved investors can attest, it is not easy to resolve a dispute with the investment industry. The regulators direct investors to try to resolve their dispute with the firm and this can lead to management, compliance officers and even ombudsman. There is also industry sponsored arbitration that can provide an arbitrary resolution but does not provide justice. The legal system is complex, costly and time consuming. Victim's rights have been eroded by the reduction in limitation periods to two years in most provinces. A recent editorial in the Toronto Star summarizes the justice issue, and quotes Court Chief Justice McLachlin's presentation to Toronto's Empire Club. These words provide optimism that something can be done.

### ***THE HIGH COST OF JUSTICE – (Toronto Star Editorial)***

*Supreme Court Chief Justice Beverley McLachlin has delivered a sharp warning about the high cost of justice in this country that should shake policy makers and the legal establishment into action.*

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*In a speech last week, McLachlin noted that while the rich can afford to hire lawyers and the very poor can apply for government-funded legal aid, most other Canadians struggle to obtain justice.*

*Even though most disputes are settled out of court, they can still be expensive, and those that do wind up in court can be ruinous.*

*As the Star's Tracy Tyler recently reported, a three-day civil trial can cost more than \$60,000. McLachlin described the options for most working people with legal problems as "grim".*

*They can "use up the family assets in litigation; become their own lawyers; or give up," McLachlin told her audience at Toronto's Empire Club. "The result may be injustice."*

*Chilling words, those. And sadly accurate. Moreover this problem does not end there.*

*Many people who choose to represent themselves tie up the system because they are ill-prepared to navigate legal procedures. Judges who try to help them risk being seen as biased. And when costs deter people from pursuing groundbreaking cases – Charter of Rights and Freedoms cases spring to mind – the courts miss out on trying issues that can push the law in new directions.*

*As McLachlin warned, "the most advanced justice in the world is a failure if it does not provide justice to the people it is meant to serve."*

*Her troubling appraisal bolsters Ontario Chief Justice Roy McMurty's view that access to justice is the most critical issue facing the legal system.*

*Some "modest progress" is being made McLachlin notes.*

*Some lawyers offer free, or 'pro bono', services to clients who cannot afford to pay. People who represent themselves in court can turn to special clinics for guidance.*

*Class actions and rule changes allowing contingency fees in more cases also are helping more people bring lawsuits.*

*There needs to be more innovative thinking on these lines. Governments, judges and lawyers, the people who administer the system, must put their heads together to find ways to make the courts more accessible.*

*And of course, Ontario and the other provinces must review eligibility and funding for their legal aid program, with a view to expanding access.*

*"Whatever our political persuasion or our particular conception of justice, there can be no doubt that Canadians today expect a just society", McLachlin reminded her audience.*

*"They expect just laws and practices. And they expect justice in their courts."  
To which we might add: Without going broke.*

## SIPA letter to the Editor Toronto Star



### Golden years spent fighting for justice

TheStar.com - opinion - Golden years spent fighting for justice - March 13, 2007

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#### The high cost of justice

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Editorial, March 11.

Your editorial that quotes Supreme Court Chief Justice Beverley McLachlin shows that there are learned people who understand that access to justice is being denied to many and that Canada is not the just society that many of us wish it to be.

Seniors who have been financially victimized often lack the resources, stamina and time to undertake civil litigation that is generally long and arduous. Large companies vigorously defend situations that, to many of us, appear to be morally indefensible.

Defence strategies of delay and legal manoeuvring run up costs and consume time with the result that seniors have little hope of reaching a successful conclusion in court. So many settle for pennies on the dollar.

I have spoken with hundreds of victims of white-collar crime who have been virtually robbed of their savings by the investment industry when rules are broken with impunity and at times fraud and forgery perpetrated.

One victim, a widow, lost \$1.5 million. The facts seem evident that there was abundant wrongdoing. However, the pursuit of the case was costly and time-consuming. She settled out of court for one-third of what she lost because she felt she could survive on that and wanted to enjoy some of the rest of her life.

In the case of Armand Laflamme, who lost his life's savings, it took 10 years to gain a Supreme Court decision. The initial lower-court decision in his favour was appealed. He was 61 when he started and 71 when he finished.

However, he looked much older, as litigation is stressful for most seniors. He lived only a few years longer. From 61 onwards, he spent most of the rest of his life fighting for justice rather than being able to enjoy his golden years.

Is this a just society?

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Stan Buell, President, Small Investor Protection Association, Markham