SIPA
SMALL INVESTOR PROTECTION ASSOCIATION

A Voice for Small Investors

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Ms Marsha Manolescu, Senior Policy Advisor
Alberta Finance and Enterprise
522, 9515 – 107 Street
Edmonton, Alberta T5K 2C3
Fax: (780) 644-7759
E-mail: marsha.manolescu@gov.ab.ca

Mr. Francois Bouchard
Directeur, Direction de l'encadrement du secteur financier
Ministère des Finances Québec
8, rue Cook, 4e étage
Québec (Québec) G1R 0A4
Fax: (418) 646-5744
E-mail: francois.bouchard@finances.gouv.qc.ca

Request for Comments : Consultation Paper December 20, 2010 Consultation on Possible Options for the Incorporation of Individual Representatives of Registered Dealers and Advisers in Canada http://www.finance.alberta.ca/publications/other/2010-1220-consultation-incorporation-dealers.pdf

Thank you for the opportunity to submit our comments on behalf of small investors. We are concerned about the industry proposal to allow representatives to be incorporated at a time when the rest of the world is concerned about the lack of investor protection and the need for establishing a fiduciary responsibility for those who handle Canadians' savings and investments.

The recent financial market meltdown vividly illustrated how Canadian investors are not protected when they place their trust in an investment industry that appears pre-occupied with increasing their incomes that are unrelated to the performance of Canadians' investments. Few Canadians were spared in this most recent debacle. Many who had felt secure with their retirement savings were shocked to realize the impact on their retirement security either through the losses in their investments or the deterioration of their pension plans.

This has resulted in a new awareness for many Canadians and has precipitated recognition of the weakness of our regulatory system and the legislation for the industry with regard to investor protection. The fractured approach to regulation in Canadian provides little comfort and seems embarrassingly out of step with the rest of the world. The United States is moving towards holding all sellers of financial products to a fiduciary standard. In the past stockbrokers were held to a lesser standard of suitability while financial advisers were held to a fiduciary standard. In Canada the less stringent suitability standard applies to all. As a result "Advisors" are held to the lesser suitability standard.

In Canada we have dealers representatives who call themselves financial advisers but there is no legal requirement for them to put their clients' interest first. In fact regulation is failing to properly protect Canadians and the regulators are largely unable to provide restitution to investors who have been wronged by industry even when the regulators find they have been guilty of breaching the rules and/or committing fraud.

While a recent initiative labeled the Fair Dealing Model offered some hope that the Investment Industry Regulator Complex was recognizing global developments and intending to treat investors fairly, this initiative was gutted and watered down to the Client Relationship Model which seems regressive compared to developments in other western countries.

Fraud is abdicated to our criminal justice system which fails to recognize the damage done to Canadians by white collar crime and too few resources are allocated to fight this blight on our society. Instead aggrieved investors are directed to the civil court system to seek redress. With our current regulations and legislation the civil system is a process that is totally unsuitable for victims of a life-altering experience such as losing your savings due to wrongdoing, particularly seniors whose remaining time is too limited to waste on an extend legal battle which can take ten or more years to reach a final conclusion. It is not only the financial loss that impacts on Canadians and radically change their lifestyle but it is the breach of trust that completely and utterly destroys their lives.

To accept representatives incorporating is tantamount to throwing investors to the wolves if this in fact limits "Advisors" exposure to accountability and does not include a provision for fiduciary responsibility with appropriate mandatory protection mechanisms.

There are already problems related to the proliferation of titles and holding perpetrators accountable for their wrongdoing. It is difficult to see any benefit for investors form this initiative but as pointed out by other investor advocates it will make a bad situation even worse.

While there is talk of improving financial literacy, improving investor education, and even a national securities regulator, these initiatives are not new. The fact remains that Canadians are losing in excess of an estimated $25 billion per year due to fraud and wrongdoing and this will continue unless and until the investment industry culture changes, or legislation is enacted that provides remedial investor protection and punitive penalties for the perpetrators of fraud and wrongdoing, and a robust enforcement process is put in place. We believe incorporation for dealers representatives will do nothing to improve the situation for investors.

It is not enough to pay lip service to investor protection or to perpetuate the illusion that the regulators are protecting investors. There is an abundance of evidence that the current regulatory system is failing investors. Victims of investment fraud and wrongdoing need above all else restitution. Letter of reprimand, fines that may or mat not be collected, and jail sentences that may or may not be served do little to help the victims who are devastated by this life-altering event when their trust has been breached.

Any initiatives that at first blush appear to provide some hope for investors gets abandoned or watered down due to the magnitude of response from well funded industry associations that are able to lobby Government to impact any initiatives that may be taken to improve the situation for investors and provide protection for their savings and retirement security.

There is no independent Government sponsored Investor Protection Agency. For the better part of a decade SIPA has been recommending an agency charged with investor protection that is not an industry organization or funded by industry.

While the Ombudsman for Banking Services and Investments (OBSI) should provide a good service for investors, OBSI is a prime example of how a good initiative (a national ombudsman) gets bastardized by the Investment Industry Regulator Complex when the industry persuaded Government to accept their offer to convert the industry's Canadian Banking Ombudsman to OBSI. In spite of a series of well meaning Ombudsmen, Mike Lauber stated his intention was *"to make clients whole"*, the industry created mandate limits the role of the Ombudsman and industry attitudes towards dispute resolution are embedded in the mandate.

We continue to believe OBSI can be an important national organization to assist investors wioth dispute resolution provide some fundamental changes are made. We are hopeful that the OBSI initiative of having Lighthouse review OBSI will result in improvements that will be consistent with developments in the rest of the western world.

The national ombudsman service would have been a very positive move for Canadians had not the industry retained its governance and control of the mandate. The intent appears to be to maintain the illusion that investors are well protected in Canada yet the records show that limits to OBSI's mandate prevents the Ombudsman and staff from providing the service that the public rightfully expects.

As long as the regulators and industry funded organizations are captured by the industry Canadians will find no relief form the current situation of Caveat Emptor. In 1999, Robert Goldin wrote a book entitled "Investor Beware". Unfortunately little has changed since then.

We recommend that any proposed changes regarding representatives' incorporation be deferred until such time as Canada's approach to investment regulation (will a national regulator be established?) is resolved, rather than introduce changes that can only complicate the process of evolving a new regulatory system that truly seeks to provide nationally a consistent appropriate investor protection and hold the perpetrators of fraud and wrongdoing accountable.

All of Earl Jones victims trusted him. No one gives their money to someone who they do not trust. As long as Canadians continue to trust we must try to create a regulatory system for an industry so they are worthy of that trust.

Specifically our response to the six questions is:

1. *Should governments allow a broader range of registered dealers and advisers to redirect remuneration to a non-registered corporation?*

At present the practice varies by province and by regulator. This is a question that should only be answered in the context of a national regulatory system. To implement changes at this time does not seem appropriate. There is a world wide move to improve investor protection and I do not see how expanding the practice of incorporation to enable so called "Advisors" to avoid taxes will help the small investor.

2. *Should governments allow individual representatives of registered dealers and advisers to incorporate?*

Not at this tiime. See response to Question 1

3. *If yes to question 2, which incorporation option would in your view be the most effective and balanced alternative?*

The response was No.

4. *Are there other provisions or options that should be considered to ensure that the use of a corporation continues to preserve the registrant-client legal relationship for both firms and individual sales representatives and provides for proper oversight of individual sales representatives by their registered dealer and adviser?*

There is an international move to impose a fiduciary relationship on Investment Advisors. The Investment Executive reports:
" The group of state and provincial securities regulators called upon the U.S. Congress to support implementation of regulatory reform, strengthen state-federal collaboration, and impose a fiduciary duty on all financial professionals when providing investment advice about securities, among other things.

FAIR Canada is a national non-profit organization dedicated to putting investors interests first. Last year a conference on fiduciary responsibility brought together representatives from across Canada and the United States. There was consensus that to protect investors it is essential to impose fiduciary relationships so that the investment industry will put clients' interests first rather than have a loosely defined lesser responsibility of suitability. FAIR Canada has endorsed putting clients' interests first.

We believe that in this age of proposed transparency and disclosure and the new POS product disclosure for mutual funds, there should also be a POE (Point of Engagement) disclosure for Financial Advisors that will provide qualifications, background, and responsibilities that would clarify whether or not the "Advisor" has responsibility to put the clients interests first and whether or not there is discretionary authority amongst other things. These are issues that consistently arise in investment disputes.

5. *Do you have any concerns or comments about potential income tax consequences or regulatory obstacles regarding each option?*

Reducing tax obligations for high earners by allowing incorporation for the primary purpose of reducing tax will shift the load to ordinary tax payers.

Any increase in complexity will increase the regulatory burden and divert resources from regulation and enforcement which should be the regulators primary functions.

6. *Do you have any concerns or comments about the potential impact of the incorporation options on investor protection?*

We are concerned about the negative impact on investor protection. Incorporation normally reduces personal liability which is not what is needed. The present legislation fails to hold Advisors responsible and as a result many systemic practices are the direct cause of investor loss. What is needed are measures to ensure accountability.

We believe the Client Relationship Model needs further review to assess required disclosure prior to appointment to determine whether incorporation in itself would be detrimental to client interests. The failure to proceed with the Fair Dealing Model (the nomenclature itself provided optimism) and downgrading it to a Client Relationship Model (an accurate description but with no indication of intent) should give cause for re-examination of the Investment Industry Regulator Complex.

We trust you will find our comments helpful in addressing investor concerns regarding any changes that could reduce accountability before fiduciary relationships are legislated. We remain hopeful that the legislation for a national regulator will include such legislation and that provincial regulators will continue to introduce changes that will be consistent with the objectives of a national regulator to minimize the stress during the transition period.

Yours truly,

Stan I. Buell, P.Eng.
President