SIPA
SMALL INVESTOR PROTECTION ASSOCIATION

A Voice for Small Investors

April 26, 2011

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Re: OSC Draft Statement of Priorities

Dear Sir;

We are pleased to offer our comments on the OSC Draft Statement of Priorities. The Statement of Priorities states:

"In undertaking policy and rule development as well as compliance and enforcement programs, ***a foremost priority of the OSC will be the protection of investors.***
*The interests of investors are at the core of everything that the OSC does. The need to assist and protect investors is even more critical given the increased availability of complex products, greater reliance on the exempt market for distribution; and potential intermediary conflicts of interest in the distribution of products****. The OSC will work with added vigour to help investors get a fair deal."***

These words are encouraging but in words Rex Murphy might use "*Or is it just posturing and little more than a perfumed phrase?"*

Given that Ontarians and Canadians generally:

- Live in a trusting society
- Trust that professionals including doctors, lawyers, accountants will give them sound professional advice that is in their best interest
- Trust that Government Services will give sound advice that is in their best interests
- Trust that business will treat them fairly, honestly and in good faith
- Trust that Government will ensure that organizations dealing with the public will be properly regulated so that they deal fairly, honestly and in good faith with the public.

Why then should the public not believe that a "Financial Adviser" providing them with advice on their life savings, and working in an investing environment regulated by a Government agency would be any less trustworthy?

Indeed the public is told that the Canadian financial services are well regulated and that investors are protected. Marketing materials tell the public they can trust the industry to help them save for their future retirement security.

Yet Canadians are losing in excess of an estimated $20 billion per year due to fraud and wrongdoing by the regulated investment industry. A recent study by FAIR Canada indicates investor losses due to fraud and wrongdoing by the regulated industry are much greater than that due to the unregulated fraudsters with their Ponzi schemes and other imaginative scams.

Numerous case studies vividly illustrate the impact on investors when our systems fail to provide proper investor protection:

The widow Sara worked in a family business with her husband for 25 years. They operated a profitable business and had a modest home and modest savings. Her husband was diagnosed with terminal cancer and soon passed on. The business and the home were sold. The proceeds and their savings were placed with an "Adviser" recommended to them. The "Adviser" was the Toronto Branch Manager and a Vice President with one of the largest and well known investment firms. He offered to look after her investment and she placed her trust in him. Within a few years her total investments of $ one million were gone. (Over a period of 15 years several other investors also lost their savings under similar circumstances.)

Engineer Peter was a builder and developer. He built his business over 15 years. He never took a holiday but was quite successful, building himself a lovely home, raising a family, and invested in GICs. He was worth several million dollars. In the course of business he met the president of an investment dealer who was also on the board of an industry regulator. He convinced Paul that he should be investing and that he would look after Paul's account. Paul trusted his new "Adviser"; after all he was the president of the firm and was also a director for the regulator. Paul was led to believe that things were going well and decided to take a long holiday in the Caribbean with his family on a yacht. He thought "Why didn't I do this earlier?" After a couple of months in this idyllic environment he received a telephone from his broker saying that everything was lost. He strapped a 50 lb anchor to his waist and prepared to jump overboard. His family saved him.

The widow Marjorie had invested with an investment firm that was a member of OBSI. She trusted her "Adviser" completely and knew little about investing. When she noticed the value of her account diminishing she raised the alarm. Months went by and her account continued to deteriorate until she lost $130,000. She made a complaint to OBSI. They found that there was wrongdoing but decided she knew there was a problem after she lost $30,000. They decided the firm should reimburse her for the $30,000 loss but said she should have taken action to mitigate the loss and held her responsible for $100,000.

The common element in each of these case studies is that the investors trusted their "Adviser" and believed they could rely upon them to look after their investments. They were not aware that investment is a Buyer Beware environment or that the "Adviser" does not have a legislated fiduciary duty.

OSC Key Regulatory Priorities for 2011-12

- *Better demonstrate our commitment to investor protection*

Will the OSC demonstrate their commitment by requiring industry registrants to provide disclosure of the Agency relationship that exists between the Client, "Adviser", and firm as a mandatory "Know Your Adviser" form? This information is essential for investors to be properly advised prior to making a commitment to place their trust in an "Adviser" who may be mis-representing himself and the firm. Will the OSC also require registrants to provide product disclosure at the Point of Sale and not allow reliance upon deemed disclosure or the need for clients to request disclosure?

- *Identify and address investor protection issues to help retail investors get useful and un-conflicted advice in their interactions with market participants.*

  One of the main issues is that investors are not being told it is a "Buyer Beware" investing environment. Investors believe they can trust their Adviser and many believe the industry has a fiduciary responsibility. The OSC has a choice to either 1. inform investors that it is Buyer Beware and not allow the industry to use false or misleading advertising and titles that mislead investors, or 2. ensure that the industry does have a clear cut fiduciary responsibility and not rely upon such nebulous standards as suitability

- *Simplify its messaging and use a variety of tools (e.g. social media, focus groups, etc.) to communicate more effectively with retail investors.*

  To communicate effectively the OSC should clarify the message so there is no doubt in the minds of investors or registrants. As long as investors and the industry believe in different rules of engagement, investors will continue to see their savings unfairly eroded.

- *Address investor engagement and the role of shareholder activism through greater interaction with investors.*

  Investor advocates and small investors are more than willing to participate. The OSC Investor forum held half a decade ago attracted a crowd way beyond the expectations of the experts that organized the forum. Investor advocates have given freely of their time. It would seem appropriate that the OSC Investor Advisory Panel approach could be used more extensively.

- *Continue its focus on issues relevant to investors who own securities (shareholder rights).*

  It would seem that the focus on issues needs to be improved rather than just continued. The OSC should set some concrete objectives and new well defined strategies that can be measured.

- *Continue to support investor education through the use of monies received through enforcement proceedings to support the Investor Education Fund.*

  The Investor Education Fund will not help with financial literacy as long as investors are misled into believing they can place their trust in the industry and that regulators will provide protection in the event that things go wrong. The first step is to have proper disclosure to raise awareness of the true situation so investors can see the need for financial literacy in a Buyer Beware environment.

- *Investigate mechanisms to return recovered funds to investors who have suffered losses through frauds, scams, etc.*

  In 1999 SIPA suggested that the OSC should seek a change in mandate to enable them to order restitution to victims when registrants have been found guilty of breaching the rules leading to investor losses. Some other provinces are able to order restitution and in some cases to directly reimburse victims of the investment industry. It would seem appropriate that the OSC should without further delay take action to initiate the power to order restitution.

- *Strive to modify market behaviour by making use of the full set of regulatory tools available to take action against those who engage in activities that are adverse to investors' interests or raise market integrity concerns.*

  To modify market behaviour the OSC will have to implement significant penalties that will discourage cheating investors so that perpetrators and their firms will have to disgorge all profits, fully reinstate their victims and pay punitive damages. Minor penalties and lack of jail time has not discouraged the continuance of perpetrators preying on small investors.

- *Continue to refine processes to reduce timelines for completing investigations and bringing regulatory proceedings forward.*

  When investigations are carried out and rule breaches are found the investigation should be expanded to determine if there are systemic practices and additional victims who may not be aware of these issues. In fact the regulators should contact all clients to alert them to these issues. As long as investors believe they can trust their Adviser it is improbable that they will be in a position to alert the regulators of wrongdoing. Often initial industry response suggests nothing is wrong and investors are again misled.

- *Focus on improving the timeliness of adjudicative processes.*

  The OSC should set targets for timeliness rather than simply make general statements. The Statement of Priorities seems particularly weak in this aspect. Without measurable objectives and timelines it will be impossible to determine if there is any improvement over time.

- *Focus compliance efforts on higher risk areas and potential abusive practices affecting investors.*

  These higher risk areas and potential abusive practices should be identified and proposed actions outlined so that performance can be measured. Investor advocates and groups representing investors could be helpful in identifying these risks and practices.

  In general the priorities need better definition and defined objectives with timelines. Repetition of vague objectives will do little to provide a better investing environment for investors and registered representatives. Continuance of the current system enables unregistered fraudsters to operate with relative impunity. It's time to recognize the fundamental issues and take appropriate action rather than fiddling with details that do little to change the major weaknesses that cause widespread investor loss.

In SIPA's submission to the OSC February 14, 2010 we stated

> *"SIPA's top priority with regard to investor protection is restitution. The OSC should have its mandate revised, if necessary, so they can provide*

> *restitution as other provinces have already done. It should be able to not only order, but also pay the restitution as does the Autorité des marchés financiers in Québec."*

In the United States a 2010 study sponsored in part by the Certified Financial Planners Board of Standards Inc., the Consumer Federation of America, the Financial Planning Association, the National Association of Personal Financial Advisers and the North American Securities Administrators Association Inc. found that more than 60% of investors surveyed operated under the false notion that their brokers and insurance agents are held to a fiduciary standard. I have no doubt a study in Canada would have similar findings.

In a recent talk to RPAC Glorianne Stromberg said:

> *"The hot button issue in the financial services industry today is whether everyone who gives advice or holds him or herself out as giving advice to their clients, has or should have fiduciary obligations. I think such persons do have fiduciary obligations to their clients – i.e. the obligation at all times to act for the sole benefit and interests of the person with whom you have a relationship who has placed their confidence and reliance that you will act in good faith and in their best interests – and that if there is any doubt, it should be removed by clear and unequivocal legislation."*

Although fiduciary duty for Investment Advisers may be considered arguable by some, it should be made absolutely clear by the regulators that anyone providing financial advice or holding themselves out to be financial advisers (by their titles) should be held accountable to a fiduciary standard along with the firm they represent.

So what will the OSC do to *"help investors get a fair deal"* ?
A good start would be to clarify this financial adviser responsibility and either ensure advisers are held to a fiduciary standard or make it clear that it is a "Buyer Beware" investing environment. To do less is neither treating investors fairly nor providing a fair deal.

The SOP states *"Our Vision is to be an effective and responsive securities regulator – fostering a culture of integrity and compliance and instilling investor confidence."* What does that really mean? Will it translate into positive action or will it be simply creating a perception that will help to instill investor confidence?

The SOP states *"The OSC's mandate is to provide protection to investors from unfair, improper or fraudulent practices."* Does that mean something will be done about the misleading marketing and the false titles? Does that mean they will alert investors by telling them it is Buyer Beware rather than misleading investors to believe they are protected? Or will action be taken to hold "Financial Advisers" to a fiduciary accountability?

Although the language of the Statement of Priorities may give investors a warm and fuzzy feeling there are no specific real objectives, or outlines of measurable actions to be taken, or results expected. There is no indication of any change to the organization to provide an office

with responsibility for investor protection. What real changes will occur? Or is it simply words, and more of the same can be expected?

The OSC is to be commended for establishing the Investor Advisory Panel. Although the panel has no authority and there is no requirement for the OSC to take action on anything they might recommend, the panel is offering some valuable input to the OSC for consideration.

It is recognized that previous action was taken with regard to a "Fair Dealing Model" and a "Point of Sale Disclosure document", but as is often the case, these initiatives have been watered down and delayed to erode any of the apparent advancement that involved individuals had hoped would be implemented.

Recently Ed Waitzer wrote in the Financial Post:

> *In January 2004, the Ontario Securities Commission released a concept paper advocating a "fair dealing model." The paper acknowledged that the regulatory regime -- regulating dealers and their representatives through the products they sell -- was based on the outdated assumption that transaction execution is the primary reason people seek financial services. Recognizing that most customers are seeking advice, the concept paper proposed changing the regulatory framework to focus on the Advisery relationship.*
>
> *Financial professionals and salespersons in Canada are allowed to call themselves Advisers, irrespective of their professional designation. Few, however, are compensated directly for their advice. Instead, they are paid commissions to sell specific products. Addressing the conflicts of interest that result from commission-based compensation, the paper proposed that retail clients should be entitled to rely on objective advice that is in their best interest and, when there are conflicts of interest, they should be clearly disclosed so that the client can understand the conflicts and how they may affect the advice given.*
>
> *In September 2004, the proposal was swept into a broader project of the Canadian Securities Administrators (CSA) and rebranded as the "client relationship model." Last month, the Investment Industry Regulatory Organization of Canada (IIROC) published its proposed reforms to establish requirements for the client relationship model. They specifically avoid imposing a duty on firms and their representatives to act in the best interest of clients, focussing instead on improving compliance with the existing "suitability" standard and improving disclosure with respect to conflicts of interest and performance reporting. IIROC noted that part of what influenced its thinking was an effort to harmonize with existing and proposed CSA standards (and other standards applicable to firms not under its jurisdiction).*

This is a most unfortunate regressive development which does nothing to improve investor protection. There are numerous issues that should be addressed to provide some degree of protection for investors including more transparency and disclosure, and making the industry accountable for their actions. The current suitability standard does little to help investors when

the industry apparently believes that *"everything on the shelf is suitable".* Allowing sales people to mislead investors by the use of misleading titles and not requiring qualification standards is unfair and unacceptable.

When it seems the rest of the world is trending towards separating advice from sales and introducing fiduciary standards for all those providing advice it seems regressive and unacceptable that regulators permit the investment industry to rely upon ill defined arguable standards of suitability and false and misleading titles for sales persons.

It is also unacceptable when regulators allow exemptions from rules so that toxic products can be sold to unsuspecting investors.

No amount of investor education or financial literacy can compensate for deceiving the public into believing they are protected by the regulators when the environment is really Buyer Beware and the victims are themselves responsible for trying to seek justice and restitution.

At the Ontario Bar Association (OBA) "Access to Justice Summit" a few years ago. The OBA lawyer leading the Civil Workshop stated *"The civil system was not designed to provide justice; it was designed to resolve disputes."* So it seems the small investor who has been wronged has minimal chance of ever seeing justice. What is needed is a tribunal that can investigate and provide fair and timely resolution of disputes.

In the United States, Dalbar's 2010 Investor Statement Preferences study identifies the elements of the investor statement that are deemed most valuable by customers. *"Second only to the counsel of financial professionals, the statement is the most powerful tool in influencing behaviour among financial services clients. It is the most widely read, the most frequently sent, and quite often the only personalized written communication received by clients."*

Dalbar's Investor Statement Preferences study identifies the importance of the elements in investment and benefit statements and found:

- *As in the past, the overall rate of return in the account is the single most important statement item, with over half of the respondents considering this to be critically important*
- *Total of fees charged was the second highest rated item investors want on their statement*
- *Sections that summarize various aspects of the statement are most critical to understanding.*
- *Over half of investors consider statement messages from their financial adviser to be important*

"The financial services industry as a whole needs to pay attention to investor's demand for rate of return data", says Jody Bullen, Director at Dalbar. In the Mutual Fund Statements study released in Q3, 2010, Dalbar discovered that only 23% of the firms tested displayed the rate of return period ending figures; the figure was much lower in the Brokerage industry, with only 6% of the firms offering rate of return details to their clients.

The situation in Canada is probably not significantly different. Investors are being misled by lack of disclosure in client statements. Without proper disclosure of annualized rates of return the investor is not in a position to evaluate whether or not he is being treated fairly and is dependent totally upon his Adviser. Failure to hold Advisers or those who hold themselves out as Advisers is unconscionable.

Regulators should make it mandatory that client statements provide essential information including annualized rates of return and comparison benchmarks.

Regulators assigning fines, which may never be collected, to perpetrators of fraud and wrongdoing does not help victims. They want and need restitution. We had recommended to the OSC in 1999 that they seek revised legislation that would enable them to order restitution.

If the OSC means *"In undertaking policy and rule development as well as compliance and enforcement programs, a foremost priority of the OSC will be the protection of investors."* then a good place to start would be to seek a mandate that enables ordering restitution, a power that exists in several other provinces already. Why shouldn't Ontario investors be entitled to the same treatment?

While there are many ongoing discussions for the last half century, it would seem that there are some issues that could be resolved very quickly if the OSC really wants to *"help investors get a fair deal".* Some issues for consideration are:

- Holding perpetrators accountable whether or not they remain registered or move to other jurisdictions.
- Enabling the OSC to order restitution to victims of fraud and wrongdoing whenever the perpetrators are found guilty of breaching the rules that contributed to or led to the victim's loss.
- Holding the investment industry accountable to a fiduciary standard rather than transaction based ill defined suitability standards.
- Exempting victims of investment fraud and wrongdoing from the limitations period in the same way that the OSC obtained exemption from the limitations period.
- Prohibiting the investment industry from using false or misleading advertising in the same way as the Business Brokers Act prohibits other businesses from using false or misleading advertising.
- Prohibiting the use of fancy misleading titles such as "Investment Advisor" or "Financial Consultant" for any person that does not have a fiduciary duty to clients.
- Making it mandatory for the investment industry to provide POS Disclosure for all products prior to the sale. Deemed disclosure, web based disclosure, and requested disclosure are neither appropriate nor acceptable for small investors.
- Making it mandatory for the investment industry to provide Point Of Engagement Adviser Disclosure prior to opening accounts for clients.
- Making it mandatory for firms selling products to provide regular client statements that are easily understood by average Canadians and that provide the annualized rate of

return for the account compared to an appropriate benchmark, the total fees collected by the firm in dollars and percentage of assets, and a clear statement of the net cash value of the account.
- Enabling the OSC to prohibit the sale of toxic products that have not been scrutinized by the OSC.
- Prohibiting exemptions for selling new products without proper disclosure and regulatory approval.
- Prohibiting the industry from holding clients responsible for mitigation of loss for situations created by the industry.

So what will the OSC do to *"help investors get a fair deal"?*

The SOP states *"Our Vision is to be an effective and responsive securities regulator – fostering a culture of integrity and compliance and instilling investor confidence."* What does that really mean? Will it translate to positive action or will it be simply an illusion to create a perception that will help to *"instill investor confidence"*?

The SOP states *"The OSC's mandate is to provide protection to investors from unfair, improper or fraudulent practices."* Does that mean they will do something about the misleading marketing and the false titles? Does that mean they will alert investors by telling them it is Buyer Beware rather than misleading investors to believe they are protected? Do they think it's fair that there is no requirement for client statements to disclose the investor's annualized rate of return?

Our closing statement for our last response February 14, 2010 to the request for comments on the Statement of Priorities remains valid today:

> *"There are many issues that need to be addressed; but unless investor protection includes provision for restitution when preventative measures fail and fraud and wrongdoing result in investor loss, the other issues seem remarkably less important for consumer/investors."*

The most important issue for aggrieved investors is restitution.

For those investors who have not lost their savings the most important issue is disclosure. That includes disclosure on the Adviser and firm (POE Adviser Disclosure), disclosure on the product (POS Product Disclosure), and ongoing transparency and disclosure (Client Statements).

We hope the Statement of Priorities is indicative of good intent on the part of the OSC but believe it needs better definition to iterate concrete actions and expected deliverables that can be measured rather than vague motherhood statements.

Yours truly

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President