June 20, 2007

John Stevenson
Secretary, OSC
20 Queen St. W.
19th Floor
Toronto, Ont.
M5H 3S8

Comments on Consultation Paper NI 31-103

Thank you for allowing me (and others) to comment on the CSA Proposal for NI 31-103. In essence, my view is that, while the proposed reforms regarding registration are worthwhile, they rather miss the "larger issue" of what the project had originally intended. Specifically, I was a member of one of the six working groups that offered input on the OSC's so-called Fair Dealing Model (FDM). The CSA mandate to harmonize, streamline and modernize the securities industry, while obviously laudable, does nothing to address the three primary objectives set out in the FDM, namely: improving cost, conflict and compensation transparency (notwithstanding modest references in part 6), achieving clarity when opening accounts (notwithstanding part 5; division 2) and standardizing meaningful performance reporting. The discussion paper for NI 31-103 is virtually silent on these critical issues and that is a shame. My comments pertain generically to the issues raised in parts 5 and 6 of your paper.

Before going into more specific comments, please allow me to add my voice to the growing number of stakeholders who would like to have single national regulator. To be honest, I would like to go further than even the most ambitious proposals I have heard to date. Specifically, I believe that a single regulator should govern securities, mutual funds, insurance and all other financial instruments. As it now stands, whenever one regulator "raises the bar", those who are governed by that regulator are able to (and likely to) simply recommend those product solutions that are governed by lower standards of competency, ethics and disclosure. *This arrangement does absolutely nothing to protect consumer interests.* All referenced enclosures are being noted in **bold type** for easy reference. These enclosures are included in order of reference at the back of this document. I am enclosing an as-yet unpublished article entitled **"One Set of Rules, Please"** to add clarity to these concerns.

To get a slightly more detailed view on what I think should be done going forward, please refer to my article "**The Changing SRO Landscape**"

I would like to add that it has long seemed to me that there are multiple sets of rules regarding disclosure as they pertain to different stakeholders and that the industry clearly paints advisors as being the "bad apples" when often, it is the member firms, their SROs and product manufacturers that are far more culpable. I have particular concerns regarding consistency and fairness as they pertain to:

a) executives and advisors at the same firm; and
b) differing advisor approaches within the same firm.

I have submitted these concerns to Richard Corner of the IDA (See letter Dated **February 2, 2007**), but he has merely deflected them back to me and requested that I take these matters up with my employer. This, to me, is a massive cop-out. The problems identified below are systemic (i.e. as far as I can tell, they pertain to the entire industry). Getting one firm with two-dozen advisors to change its policies while doing nothing to change the rules for dozens of firms with (collectively) thousands of advisors completely misses the point that the industry has systemic biases that need to be addressed. Specifically, re: a) above- if an advisor is *required* to disclose that opinions expressed are not necessarily shared by the firm, why are CEOs not *required* to make a reciprocal disclaimer? When at Assante, my CEO, Joe Canavan made comments that I strongly opposed. I have no quarrel with his expression of opinion, but I find it offensive that he would not abide by the same rules that he imposes on his representatives. Similarly, re: b) above- I have been required to use a specific **Disclaimer** by my current CEO, Mario Frankovich in relation to public presentations I give. I note, however, that no other advisor at my firm (all other advisors seem to favour active management) has been required to make this disclosure. Why, given that the wording chosen *by my firm* clearly acknowledges that neither side of the debate can score an "unchallenged victory", do proponents of one side of the debate have to make disclosures that proponents of the other side do not have to make? My simple view is that it clearly ought to be both or neither. Given my preference for more disclosure as opposed to less, I recommend that *all* advisors be required to make disclosures using language similar to what is found in the attached disclaimer.

Without being unduly prescriptive (i.e. respecting that there are a number of stakeholders that also have legitimate interests that need to be reflected in the final document), I am enclosing five additional articles that speak to my desire for clear, consistent rules that apply to everyone in the industry. My view is that disclosure obligations ought to shift more to product manufacturers (i.e. mutual fund and insurance companies) to the greatest extent possible. There are two basic reasons for this:

1. As with cigarettes, it is the product manufacturer, not the advice-giving intermediary that bears primary responsibility for the risks and limitations associated with the product.
2. As in other professions, consumers are entitled (rightly or wrongly) to "opt out" of the use of an advice-giving intermediary. For those people who choose to work through a discount brokerage (for instance) there should still be disclaimers and disclosures being made. After all, many of the risks being borne are directly attributable to the *product*, not the *advice*. Indeed, people choosing to invest on their own are expressly choosing to forego advice altogether.

The five final attachments **An Inconvenient Truth, Calibrating Disclosure, What's an Appropriate Level of Disclosure?, Facts Evasion** and **Selective Disclosure** all deal with the topic of disclosure in some manner or another. I believe they are relatively self-explanatory, so I will not speak to them other than to request that you give them careful consideration.

Should anything in this correspondence prove to be unclear or incomplete, please do not hesitate to contact me, as I would be delighted to explain my positions and/ or expand upon them if need be.

In closing, I'd like to wish you success in bringing together what must surely be an enormous and challenging task and to assure you that I look forward to reading the finished product.

Sincerely,
BURGEONVEST SECURITIES LIMITED

John J. De Goey, CFP
Senior Financial Advisor

Encl.

One Set of Rules, Please

The business of giving financial advice is ridiculously fragmented in the eyes of many (including yours truly). Many people who want to give advice get into the business (and are subsequently regulated) not on the basis of the advice they give, but on the products they are licenced to sell. Talk about putting the cart before the horse. If ever the business of giving financial advice is going to be seen as a true profession, regulation needs to put the emphasis squarely on advice; not products.

Products don't hurt consumers. Bad advice implemented through inappropriate product use hurts consumers. And as the saying goes, "there's only one consumer", anyway. It seems to me that the most sensible way of dealing with the interminable industry wranglings about who regulates who, how they do it and what can be done to make it better, it is the consumer that usually ends up drawing the short straw.

As an example, whatever opinion you might have about the value of advice, it should be obvious that advice had some value and costs something. As such, products with advice should always cost more than the same products purchased without any associated advice. As such, if a person wanted to buy stocks through an advisor, they should be able to do so. If they wanted to forego the services of an advisor, they should be able to not only forego those services, but also the associated costs. That's currently the basic set up as it pertains to securities, but often not the case as it pertains to mutual funds.

Most reasonable people would agree that there should be a level playing field among advisors so that consumers can make apples-to-apples comparisons regarding both products and services. However, if we're talking about insurance, there is simply no mechanism for consumers to go the do-it-yourself route. Simply stated, if a person wanted to 'shop the market' for say a $500,000 joint and last to die Universal Life policy, that person (or couple) would be forced to work through a qualified insurance agent. Who comes up with these ridiculous rules, anyway?

People are able to represent themselves in court without using a lawyer. They can file their own taxes without using an accountant. They can buy and sell property without using a realtor. They can buy and sell securities without using a broker. But when it comes to insurance, well, there's a situation where anyone can see that a qualified insurance agent is an absolutely essential part of the equation.

Of course, you'll likely know why there's a double standard- insurance "professionals" simply don't want banks and others encroaching on their turf. Never mind that there's no other line of "professional" work that enjoys a comparable competition-exempt status from people who want to do things on their own. Insurance people can lobby to protect their interests, so they do. Who cares if the position is nonsensical so long as it works?

Obviously, the advisors giving the advice and/or placing the products in question should be suitably qualified. As such, if banks (as one example) wanted to be able to sell insurance, they would need to be able to assure their clientele that the advice being given is coming from a reputable and qualified source. Similarly, anyone who wanted to get

insurance without using an intermediary ought to be able to do that, too (and save the associated commission costs along the way). As the financial services industry fumbles toward professional status, there are a number of consumer questions that should have transparently obvious answers no matter what. These include:

- Is the advisor qualified to offer advice?
- What are the real and perceived baises in the recommendations?
- What is the cost of this advice (i.e. how much could I save if I purchased the product without the advice)?

The last question is likely the most important. Too often and for far too long, many "professional" advisors have implied that qualified financial advice is "free" simply because a client might not receive a direct bill. It is time for the industry to remove the systemic biases caused by embedded-compensation products that allow less than scrupulous advisors to fudge the facts in order to make a sale while masquerading as independent professionals.

John J. De Goey, CFP is a Senior Financial Advisor with Burgeonvest Securities Limited (BSL) and author of *The Professional Financial Advisor II.* The views expressed are not necessarily shared by BSL.

The Changing SRO Landscape

Consumers ought to care very much about their money- how it is invested and how the people investing it are regulated. In November, 2006, the Ontario Securities Commission (OSC) held its annual "Dialogue with the OSC" at the Toronto Convention Centre. One of the main topics of discussion was Self-Regulatory Organizations (SROs) and their role going forward.

The securities industry, like many others in Canada and abroad, has opted to regulate itself. In other words, member firms have decided amongst themselves that they would agree on the salient points of disclosure, best practices, compliance, audit and so forth among each other in order to forego potentially draconian (and bureaucratic) oversight from government. The good news is that a reliance on an SRO structure can indeed be more responsive and flexible. The bad news is that, although responsiveness and flexibility are good, they are only useful if the people in charge feel compelled to act on whatever deficiencies are unearthed.

Consumers should care because the industry "foxes" have secured a role as the collective gatekeepers of the collective consumer "henhouse". Many observers, myself included, remain doubtful as to the responsiveness of SROs when complaints pit consumer interests against those of member firms.

It should also be noted that the alternative of potentially draconian government intervention has a number of flaws of its own. In fact, a panel discussing the matter of SRO evolution noted that countries like Great Britain have taken different approaches, but not necessarily with better results. Members pointed it out that in 2001, the UK founded the Financial Services Authority (FSA), an integrated regulator for banking, brokerage and insurance that has caused significant upheaval.

As such, some panelists, like Stephen Luparello, a Senior VP at NASD noted that the mood surrounding SRO appropriateness is one of "skepticism, cynicism and reluctant resignation", even though many continue to feel it is superior to direct government oversight. Paul Bourque, Senior VP of Member Regulation at the Investment Dealers' Association (IDA) added that credibility is needed in order to maintain the privilege of an SRO arrangement. Bourque cited investor protection, enforcement, stable funding and a process of open consultation as being necessary. Market efficiency was also cited.

A couple of panelists noted that merging certain SROs was a laudable "aspirational" goal that was worth taking a fair degree of "execution risk" in raising the bar to increase the quality (but not the cost) of regulation. As a result of hearing the panelists speak, I came away with four basic personal conclusions:

1. raising the bar > status quo
2. sooner > later
3. SRO > government mandate
4. consolidated > fragmented

My sense is that reforming the self-regulatory framework in Canada is akin to reforming the constitution of Canada. It is a tedious, complex and potentially frustrating undertaking that is by no means guaranteed to be successful. However, the rewards are potentially enormous. Merging various disparate SROs would allow for an organization that has deeper and broader staff capacity and is better able to attract, retain and challenge people who are concerned with the public interest and how to attain it.

It seems there's a consensus that, to date, all regulators have failed to properly manage investor expectations regarding restitution and recourse. Merging various SROs might help. To that end, the IDA's Bourque mentioned that finding members for an Investor Advisory Committee would be particularly challenging because it is difficult to find consumers who are: "able, informed and constructive".

John J. Goey is a Senior Financial Advisor at Burgeonvest Securities Ltd. and author of The Professional Financial Advisor II. The views expressed are not necessarily shared by Burgeonvest.

February 2, 2007

Richard Corner
VP, Regulatory Policy
Investment Dealers Association of Canada
Suite 1600
121 King St. W.
Toronto, Ont.
M5H 3T9

Dear Mr. Corner,

Thank you for your e-mail earlier this week where you encouraged me to seek formal interpretive guidance regarding how the IDA's rules apply to specific situations. There have been a number of occasions in the past two years where I have felt member firms have been inconsistent in their interpretation and enforcement of industry standards. Given that I have been at two different member firms in the past 24 months, I cannot help but fear that my concerns are systemic in nature and that a large number of member firms engage in activity similar to what I have experienced and believe to be inappropriate.

My understanding is that the IDA has a general rule in section 29.1 that discourages conduct "unbecoming" to the industry. Furthermore, my understanding is that the IDA would like to foster the notions of fairness and evenhandedness- both within and amongst member firms. To that end, my questions are as follows:

What is the IDA's position in regard to disclaimers and disclosures as they apply both to individual advisors at a firm and to the firms themselves? Specifically,

- *i) May member firms require that different advisors use different disclosures?*
- *ii) If yes, what is the basis for these differences?*
- *iii) Are member firms required to disclaim their own opinions?*
- *iv) If yes, where does this occur; if no why doesn't it occur?*

I would prefer to avoid forwarding specific examples, but will be happy to provide them once I've received your responses if further investigation seems warranted. On the other hand, if the responses you provide demonstrate that the conduct I have noticed is acceptable to the IDA, then you will not hear from me again on these matters. I look forward to hearing from you.

Sincerely,

BURGEONVEST SECURITIES LIMITED
John J. De Goey, CFP
Senior Financial Advisor

DISCLAIMER

The opinions expressed are those of the author and not necessarily those of Burgeonvest Securities Limited. The opinions and generalizations by the author concerning professionalism within the financial services industry reflect the lack of homogeneity among numerous providers of financial services from differing industries (insurance, banking, financial planning, and investment) and with differing standards of conduct. For advisors who are regulated by the Investment Dealers Association of Canada, some of these generalizations about professionalism are not accurate.

In respect of opinions relating to Modern Portfolio Theory and passive versus active management, an attempt has been made to discuss these complex academic issues in simple terms. As such, the depiction does not fully reflect the breadth and depth of opinion and evidence regarding these topics, nor can it be expected to.

Everyone's investment and retirement plans must be created to satisfy their particular situation. Therefore, it is recommended that the reader accept the information in this book as general in nature and consider getting advice from lawyers, accountants, financial planners and other related professionals.

An Inconvenient Truth

A couple of weeks ago, my wife and I had the privilege of hearing former U.S. Vice President Al Gore give his famous powerpoint presentation on global warming to a packed house at Toronto's Hummingbird Centre. This week, three academics released the second edition of a paper that shows Canada having the highest mutual fund costs on earth. It can be downloaded at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=901023 if you're interested.

So how are those two little nuggets connected? Easy – they both deal with inconvenient truths. Gore's message is that the evidence showing the linkage between carbon dioxide emissions and climate change is irrefutable. Similarly, essentially every *credible* study I have seen over the years shows that mutual fund performance and mutual fund cost are correlated – NEGATIVELY. In other words, there is no longer any real doubt that the more mutual funds cost (in aggregate), the worse they perform (in aggregate). There will always be exceptions, but the general causal relationship is beyond dispute. To make matters worse, Canada's fund costs are now widely accepted as being the highest on earth. Let's put those two little factoids together, shall we?

1. The more mutual funds cost, the worse investors do (you get what you don't pay for); and
2. Canada mutual funds cost more than those offered anywhere else in the world.

In essence, the facts point to an exceedingly bleak outlook unless there's fairly drastic and immediate change. To hear Gore talk about climate change, one is left with a clear impression that he is right in his view that global warming is a moral issue as much as it is a political or economic issue. To my mind, the same can be said for mutual fund costs. In my opinion, it is immoral that companies charge what they do without even acknowledging the causal relationship between cost and performance.

I can't even begin to count the number of advisors I have met over the years who say something to the effect of: "it doesn't matter what the product costs; what matters is the product's performance AFTER the costs have come off". This might be true if there was a reliable way of identifying those funds that buck the trend and outperform in spite of their cost. Unfortunately, no one has yet discovered a reliable way to do that.

To me, "logic" like that is simply an offensive form of willful intellectual misrepresentation. Imagine if you had a family physician that said: "it doesn't matter how much you smoke, just be sure not to get cancer" (as if the two were somehow not related). Here's the news: smoking causes cancer, CO_2 emissions contribute to global warming and mutual fund costs hurt performance. These fact patterns and causal relationships may not be pretty, but they are demonstrably true in a statistically significant, academically robust sense.

The fact that "big money" doesn't like this kind of disclosure should come as no surprise. Big oil doesn't care much for Al Gore's truth telling. Big tobacco never seemed to have much time for those Surgeon General Reports that came out in the 1960s, either.

As with climate change, I think the poor disclosure regarding mutual fund costs is a moral issue. If it were up to me, politicians should force the financial services industry to take a page from the tobacco industry's playbook. The front cover of the prospectus for every mutual fund, exchange traded fund, hedge fund and principal-protected note should carry a series of bold disclaimers about the importance of cost so that the industry would no longer be able to pretend that the facts were other than what they are. Remember – the mutual fund industry that tries to hide the evidence about cost and performance is the same industry that purports to be committed to full, true and plain disclosure.

John J. De Goey, CFP is a Senior Financial Advisor with Burgeonvest Securities Limited (BSL) and author of *The Professional Financial Advisor II.* The views expressed are not necessarily shared by BSL. **www.johndegoey.com** www.burgeonvest.com

Calibrating Disclosure

The financial services industry is still looking for the "Goldilocks" level of disclosure- not too much; not too little. How much disclosure is required before making a product and advice based decision, anyway? What if some product recommendations might, due to compensation considerations, lead advisors to recommend products that lead to self-serving outcomes?

Over time, the public's views have evolved about the risks and limitations associated with certain products in particular. Take cigarettes, for example. For many years, people throughout the world denied there was any threat to the health of smokers at all. Then, in the 1960s, evidence began to surface that cigarettes might be both addictive and carcinogenic. Product manufacturers denied this, of course. They disclosed nothing of these newfound risks. Professional advice giving intermediaries (physicians) were uncertain of where to draw the line regarding suitable disclosure levels. Ultimately, public policy makers intervened and solved the problem for them all. Do you see the dilemma?

I ask this because of a couple of things that are now coming to the forefront of the financial services industry. They are: the "value proposition" of certain financial products and the price of the associated financial advice.

Let's look at the products first. Around the time when evidence started to come out that cigarettes caused cancer, evidence also began to appear that perhaps stock picking was a nebulous value proposition. Throughout history, there have been stock pickers who have beaten their benchmarks. However, the number of these outperformers has never been appreciably different for the number one might expect through random chance. Perhaps chance was the only thing driving these "superior results", not causal, value-adding research, insight and shrewdness.

For forty years, the debate has raged. Throughout that time, social scientists have been able to run more and better tests, with better controls for survivorship bias, mandate consistency, start and end date bias and other material factors like costs, bid-ask spreads and taxes. Both sides of this debate have scored points over the years, but neither has scored a decisive, unequivocal victory.

Were you aware of this? Did you know that there's every bit as much evidence in support of simply buying a cheap, tax effective asset class-tracking product as compared to a product with a stock-picking approach for the same asset class mandate? The evidence is far from unequivocal either way, so either approach should be up for consideration. Again I ask you- were you aware of this? What's that you say? Your advisor never told you that buying a product that simply tracked a benchmark was an option?

When you go to a wedding out of town, you might order a rum and cola and the bartender might ask you if you want Coke or Pepsi. However, if you invest your life savings for retirement your advisor almost certainly won't ask you if you want to use products that

typically get returns consistent with a benchmark minus a small cost or products that can vary significantly (either better or worse than the benchmark), but which have been shown to collectively do worse than the benchmark-based products over statistically significant time horizons. Why do people ask about the mix in your cocktail, but not about product decisions that involve your life savings? Just how much disclosure and consent is the right amount, anyway?

Let's move on to the question of advice. Suppose you went to Canadian Tire to buy a muffler. The muffler on the shelf has a price of $69 and has a little ticket at the front of the shelf you can take to the checkout to have a sales representative bring the exact same make and model to your car. Do the good people at Canadian Tire need to go out of their way to explain to you that, although the muffler costs $69, it will cost you more if you want someone from the store to install it for you. Parts and labour are sold separately- and the $69 covers the cost of the part only. Seems a bit silly, doesn't it?

To my mind, this level of disclosure is totally unnecessary simply because it is entirely self-evident that the price of the muffler on the shelf is for the muffler only. Obviously, the world would be a pretty tedious place if every sales representative had to disclaim every last detail of every product available for sale.

Here's where these two little tales intersect. It has come to my attention that when advisors recommend or write about stock-picking products that involve advisor compensation, compliance departments do nothing to force them to disclose that they involve commissions as a result of the client buying those products. To this day, most mutual fund consumers cannot do a reputable job of explaining what the products cost- or how much of that cost goes to their advisor. A large percentage still think that both the product and the associated advice are free. Advisors seem content to do nothing to correct any misconceptions that may have taken hold.

Meanwhile, advisors who recommend asset class products need to make these disclosures all the time. When they sell the product they obviously have to make the disclosure, since the products involve no embedded compensation. In other words, they're going to have to hand their clients a bill. There's no way for these advisors to pretend that advice is "free". What's particularly curious is when these advisors write articles about these asset class investment products. These products are like the mufflers we considered earlier. They're products, pure and simple. Obviously, anyone who needs help with how to use these products would be expected to pay for it. Advice is not free.

Astonishingly, compliance departments around the country seem determined to force advisors to mention that muffler installation costs money- even if they only write about the mufflers. Meanwhile, the competing products, where many advisors pretend that advice is free (it most certainly is not) are not forced to disclose anything. If both were forced to make the disclosure, it wouldn't be a big deal. If neither made the disclosure, it would be no big deal. Reasonable people can disagree on the appropriate level of "Goldilocks Disclosure", but surely there ought to be one standard that everyone adheres to.

What really gets me riled is that there seems to be a severe double standard here. One set of advisors is being forced to make disclosures, while the other is not. To make matters much, much worse, the advisors who never pretended that financial advice is free are being made to make additional, self-evident disclosures, while those that do pretend that financial advice is free are allowed to perpetuate their little self-serving misconception all they want.

What's an Appropriate Level of Disclosure?
The problem with the social sciences is that few things can be proven with absolute certainty. For instance, there are countless studies pointing to the fact that cigarettes cause cancer. This causality is widely and generally accepted today. However, it was not always so- and when the evidence linking cigarette smoke to cancer began to show up in research papers, there were significant members of the medical community whose first reactions were ones of denial.

Suppose you were a physician in the 1950s that did not disapprove of cigarette smoking. In fact, suppose you actively encouraged it (as some did) as a benign means of relaxation. As time goes on, evidence mounts that your paradigm is incorrect and your view shifts from being in the majority to being in the minority. Would you continue to cling to your position?

The dilemma that professional physicians faced was one of grave consequence. As the primary advisors regarding their patients' health and welfare, there was an obligation to alert patients of any material risks associated with consumption of the product. On the other hand, the evidence (in the early days at least) was not definitive and there was a professional reputation to protect. What should a professional, client-centred physician do? What would a patient whose health is on the line want the physician to do?

The idea of being a STANDUP advisor hinges on the twin pillars of research (which should be dispassionate and rigourous) and disclosure that should be compulsory. One pillar is never enough. Physicians learned this first hand a generation or two ago. Those who tried to deny the evidence were seen, with the benefit of hindsight, as being "less than professional".

Regarding the carcinogenic effects of cigarettes, everyone knows of someone who has been a chain smoker for over half a century, yet who has never had even the slightest hint of cancer in their system. Winston Churchill was supposedly one such person. Alternatively, everyone knows of someone who has encountered cancer at an early age in spite of a generally healthy (and possibly exemplary) lifestyle. Mario Lemieux springs quickly to mind. In short, there are exceptions in both directions. There are instances where one might expect something to occur where it does not and others where one would normally anticipate no consequences, yet consequences crop up nonetheless.

The main point, however, is that those exceptions do not disprove the general rule. Just because it is possible to smoke ceaselessly and not get cancer doesn't mean smoking is advisable. Similarly, just because it is possible to contract cancer even without smoking does not mean that one should feel certain that it couldn't happen to them. Given that the linkage is compelling, but not absolutely definitive, is the statement "cigarettes cause cancer" a matter of fact or a matter of opinion? Once again, accepting that the social sciences always allow for at least a modest amount of uncertainty, I believe that most reasonable people would be comfortable saying that the carcinogenic impact of cigarettes is now a generally accepted fact. Looking back on the past half-century, it should be

obvious that the medical profession could have been and should have been more forthcoming about the harmful effects of cigarettes. Have we learned, as a society?

The next question becomes one of drawing the line. Given that most people agree that more should have been done to alert the general population sooner, what has society decided regarding the proper role of professional intermediaries like physicians? Specifically, should they have simply disclosed risks once they became aware of them, or, given that cigarettes are not only carcinogenic, but also highly addictive, should they have played an active role in encouraging and helping their patients kick the habit? In other words, is mere disclosure even enough- or were physicians, through their Hippocratic Oaths, required to actively engage in the constructive modification of their patients' behaviour? A moral dilemma, to be sure.

Financial advisors and the companies they work for simply cannot have it both ways. Either markets or efficient or they are not. Similarly, the issue in question is either a matter of fact or a matter of opinion. Irrespective of where the advisor might come down personally on the matter of opinion, the existence of contentious "evidence" (or the lack of unequivocal evidence either way) ought to be disclosed at the outset. Alternatively, if this really is a question of fact, then surely the side that is shown to be wrong needs to stand down (the antithesis of standup).

Furthermore, if market efficiency is merely a question of opinion, then surely everyone is entitled to their own. All correspondence ought to carry a disclaimer that others in the organization do not necessarily share the opinions expressed. I know of entire organizations that have expressed opinions in favour of active management exclusively, yet have not disclaimed their opinions. On the other hand, when advisors express within those organizations opinions in favour of an efficient/ equilibrium paradigm, the organizations steadfastly maintain that a disclaimer is required. This attitude of "do as I say, not as I do" surely has no place in an industry that aspires to be a true profession. These organizations have also been known to thwart the career paths of those people who happen to disagree.

For anyone to disagree with another by clinging to an "opinion" out of self-interest (whether it is held by a majority of people or not) is no excuse for denying factual evidence. Just when does an opinion cross the line to become fact, anyway? If 99% of the world's population continued to say that the sun revolves around the earth, would that constitute ipso facto evidence of that being the case? Surely, we have come far enough as a society to know that saying something is so doesn't make it so and that questions of empiricism should never be reduced to something as juvenile as a popularity contest.

According to many in the industry, there is now sufficient evidence to allow fair-minded observers to conclude that markets are sufficiently efficient that it is improbable that one could "beat them" through security selection or market timing as a matter of fact. If this is true, one could argue that suggesting markets are inefficient is just as offensive as saying cigarettes are not in any way linked to cancer.

Most FSPs think, talk and act like sales agents. A small, but growing segment of the FSP population wants the industry to transform itself into a profession. We are a nation with a strong rights tradition. Our constitution guarantees the right to thought, belief, opinion and expression. As a result, even holocaust deniers are entitled to express their views, no matter offensive others find them. Like Rosa Parks, people who believe in the Efficient Market Hypothesis (EMH) are increasingly coming to demand that their rights be recognized. The financial services industry, long steeped in a culture of sales, is clearly uncomfortable with the minority that uses a professional paradigm and expresses its views based on minority rights. I know of some firms that even force EMH FSPs to use disclaimers that are more boldly worded than those used by other FSPs in the same firm.

> The whole difficulty about recognition turns on the question of whether it means acquiescence, acceptance, or approval. When a majority grants a minority rights; is it required to acquiesce, accept or actively approve of the practices of this group? (Michael Ignatieff, The Rights Revolution, pg. 87).

Making recommendations that are not based on research is bad enough. But surely one ought to be allowed to advise based on academic research. If the recommendations that are made do not involve an alternative interpretation (where one exists), the "advice" can quickly become a sales pitch. Similarly, if there is a level of disclosure regarding the pros and cons of one approach or product without a similar degree of disclosure about something that is in direct competition, then how is a consumer supposed to make an informed decision about which way to go?

I happen to believe that the weight of the evidence rests squarely in favour of markets being sufficiently efficient that it is ill advised to try to "beat" them through security selection. Other advisors see it differently. Given that the evidence is not definitive, both views are defensible. As it now stands, most consumers (indeed most advisors) are totally unaware of the very real merits associated with investment products designed to capitalize on market efficiency. They ought to be made aware and can still choose products designed to capture and exploit inefficiencies if that is their wish.

A critical aspect of real professionalism is that practitioners do not impose their personal views on others. Different people may look at the same information and come to totally different conclusions. And everyone is entitled to his or her right to be wrong. However, any professional offering advice based on information that is either not fully understood or not fully agreed upon ought to disclose the things in dispute in a manner that allows the consumer to make an informed choice.

Unilaterally espousing only one paradigm is the height of arrogance. It would be disingenuous of any genuinely dispassionate advisor not to at least portray all possible interpretations and alternatives fairly. Advisors are allowed to (indeed expected to) advocate for one position over another, but should do so only after giving all viewpoints a fair hearing.

Advisors should be allowed- even encouraged- to advocate for either market efficiency or market inefficiency. However, they should also be required to disclose the evidence regarding both options before doing so. The final choice should rest with the consumer.

That's why the problem is so insidious. The financial services industry has effectively brainwashed advisors into believing that fundamental and technical analysis add value. Given the presumptuousness of the "education", advisors then quickly dismiss all alternative explanations regarding the behaviours of capital markets. The Symbionese National Army would be proud.

Teaching only one side of any contentious issue is not education it is indoctrination. To make matters worse, current teaching methods and course material allow for paradigms to continue to hold sway long after they ought to be able to do so by taking a condescending view of alternative explanations in a self-perpetuating (and self-serving) dismissal of anyone who dares to challenge the prevailing model.

Even the gambling industry is getting into the disclosure game. I've heard radio ads by provincial lottery and gaming corporations that explain how anyone's experience at slot machines is a random and unrelated event, so that things like the last time it paid off or the last time someone else won are totally irrelevant to your success. In my view, active managers ought to run similar ads. The media is full of stories about how certain products or strategies are somehow "better" than others, when in fact, the outcomes they are championing are nothing more than random occurrences. Nassim Nicholas Taleb's excellent book "Fooled by Randomness" ought to be required reading for everyone earning a living as a financial journalist.

Where does FSP Loyalty Lie?

Have you ever heard the phrase "the client comes first"? It is everywhere in the financial services industry. No company would ever claim *not* to put their clients first. The same goes for FSPs. Have you ever heard tobacco companies use that kind of terminology? In the minds of many observers, embedded compensation does more to skew priorities rationales and loyalties than anything else in the business. Most consumers are unaware of the fact that the very large majority of mutual funds sold are recommended because they carry the component of embedded compensation.

If embedded compensation were eliminated, FSPs would be free to align their words and their deeds. Many adamantly believe in market inefficiency and would no doubt continue to recommend products that seek to capitalize on it. There are other observers, however, that think product recommendations would change drastically. Of course, this is also a matter of opinion. Since it hasn't been tried before, no one really knows for sure what is likely to happen.

Let's put it this way. If a person could make money by recommending product A and having product A pay a commission through the cost of the product or make money by recommending product B by receiving no commission and sending the client a bill instead, which option would the person doing the recommending choose? Today, a very

large proportion of the total FSP population uses option A. Not surprisingly, research consistently shows that most consumers have no idea about how (or how much) these people are being paid. I seems the people doing the recommending like it like that.

The use of actively managed mutual funds and the hiring of a conventional stockbroker both pre-suppose the same thing- that it is possible to reliably outperform markets over long time frames through security selection, market timing or both. By acknowledging that this is not a reliable value proposition, many financial advisors would find it nearly impossible (having spent their entire lives being wedded to the notion of purposeful security selection) to justify their own existence.

Still, if we are to believe FSPs and the firms they work for when they say "the client comes first", then this ought not enter into the equation. Security selection (whether done at the micro level by a conventional broker or at the macro level by a mutual fund manager) generally costs about 1% per year. Holding FSP compensation (and all other factors) constant, that's an obvious opportunity to increase client returns by 1% a year. Similarly, there's an opportunity to find a "price point" where both the FSP and the client are better off- at the expense of the people doing the stock picking.

Where does Causality Lie?

This brings us to the never-ending debate about causality. The debate lies at the heart of the market efficiency conundrum. The issue is not what happened, but whether what happened happened for a reason or not. Just because a black cat crosses your path does not mean that you'll have something bad happen to you that day. And if something bad happens to you that day, it won't necessarily be because a black cat crossed your path. Just because two sequential events occur does mean one caused the other.

While the previous example is obvious, let's think about cigarettes and cancer again. Just because you smoke doesn't mean you'll get cancer and just because you don't doesn't mean you won't. The same goes for stock picking. Just because someone "beat the market" this year doesn't mean that person will do it again next year. And just because someone "beat the market" this year doesn't mean he was shrewd or insightful. It might just be (in fact, it will almost certainly be) because that person was just lucky that year. Throwing darts at the stock pages will result in some people doing better than the market on some occasions, but that doesn't make it a sensible thing to do.

The industry is full of disclaimers that past performance is not necessarily indicative of future performance. Even if a manager had a very long track record of consistently beating the market, it wouldn't necessarily be due to superior security selection. If the Fama/ French three factor model is correct, then one could theoretically divide the market for any asset class into small and large cap "buckets" and into value and growth "buckets". Having done that, one could simply discard the large cap and growth buckets and throw darts at the small cap and value buckets. The expected outcome would likely be one of "outperforming" the market, but it would likely have everything to do with overweighting small cap and value stocks and nothing to do with the individual securities chosen by the intrepid dart-thrower.

Facts Evasion

History is full of examples where people in a position of power refuse to acknowledge scientific evidence because it suits them not to. In the fullness of time, society often comes to recognize not only that these empirical explanations exist, but that they also have considerable merit.

Back in 1610, the Catholic Church was not very happy about Galileo's view that the universe (as was understood at the time) was heliocentric. They did lots of nasty things to him simply because his scientific findings didn't fit neatly into their stated paradigm.

In the 1960s, there were a number of physicians that had to re-consider their stated view that cigarettes were benign products in light of new evidence being brought forward by a number of Surgeon General's reports.

Society in general and governments in particular came to terms with the linkage between cigarettes and cancer not by banning the products, but by moving to impose a high degree of mandatory disclosure (made by product manufacturers, not professional intermediaries) to alert product users of the risks they were subjecting themselves to.

More recently, Prime Minister Stephen Harper has even come to acknowledge the connection between fossil fuel consumption and climate change. Some evidence is just too hard to deny.

The financial services industry is in a similar situation. There's a systemic and ongoing denial of evidence that pervades. Independent research convincingly shows a clear causal linkage between high investment product costs and poor performance most of the time. As John Bogle says: "you get what you don't pay for".

Corporate interests can speak glowingly of their deep and abiding respect for their clients' welfare while simultaneously manufacturing products that might underperform. Once clients figure out that certain segments of society may be less than forthright, attitudes often change. A simple way to think of this is by using the acronym STANDUP- Scientific Testing And Necessary Disclosure Underpin Professionalism.

As with cigarettes, there are anomalies. In other words, just as there are chain smokers who never get cancer and non-smokers who do, there are also cheap products that lag their benchmarks and expensive ones that don't. If one accepts these exceptions, the causal (negative) linkage between cost and performance is undeniable.

In fairness, the financial services industry has never suggested otherwise and full disclosures are filed with regulators. The problem, as many see it, is that the industry doesn't disseminate information on the subject at all. It's not that the industry lies, it's just that it fails to spread the whole story. Over the years, a number of proposals have been put forward to improve the transparency of various investment products and services. None seem to have worked.

Many material investment considerations have not been disclosed in a manner that is consistent with the approach chosen for the tobacco industry- even though the industry is highly regulated and disclosures are being made.

Perhaps we could learn from this. What if we put prominent disclosures about the risks and limitations of investment products on the fronts of prospectuses for every mutual fund, segregated fund, hedge fund and principal-protected note in Canada?

Oh sure, big finance will complain. In the end, however, legislators have a duty to protect the public interest - it should not matter whether the stakes are quantity of life or quality of life. People's lives are being threatened.

John J. De Goey is a Senior Financial Advisor with Burgeonvest Securities Limited (BSL) and author of *The Professional Financial Advisor II.* The views expressed are not necessarily shared by BSL. www.burgeonvest.com www.johndegoey.com

Selective Disclosure

Although the evidence is far from unanimous, there are many learned experts who believe markets are highly efficient- and certainly efficient enough that it does not make sense to try to exploit whatever mispricings might still exist. For them, fundamental and technical analysis, market timing and similar methods seem nearly useless. Although it is certainly possible to be successful using those techniques, it is far from probable. Curiously, relatively few advisors mention this to their clients.

How, exactly, can you honestly expect someone to choose an option if the person doing the choosing isn't even aware that the option exists? To my mind, the financial services industry has been doing exactly that pretty much from day one. By cherry picking what advisors are taught- and by extension, what kind of recommendations are ultimately make- the industry has been getting what it wants (higher corporate profits) for years.

Many- perhaps even most- advisors have no idea about how much evidence there is in favour of market efficiency- or how rigourous and compelling that evidence is, accepting that there are anomalies involved. To those advisors that are oblivious to the facts, there is an unchanging paradigm of stock picking that explains their world and there's no need for them to think critically about alternatives.

Indeed, the Canadian Securities Course (CSC) devotes less than one page to the concept of market efficiency. The other many hundreds of pages imply (note: not necessarily demonstrate) that those techniques remain useful. In contrast, most MBA finance courses devote about 15% to 25% of their content to dealing with the subject.

The difference, it would seem to me, is that University courses have a mandate to offer a balanced position on subject matter that is in factual dispute. The CSC, in contrast, has no such mandate. The course is designed by the industry and for the industry to prepare future Investment Advisors to do business.

Why not show some natural curiosity and see what you're missing? Why not do a Wikipedia search on Eugene Fama, the Efficient Market Hypothesis and William F. Sharpe, among others? I often wonder what most advisors, if given a choice between enshrining either genuine truth or personal profit in their practices, would choose.

Although readers likely know that I favour the paradigm of market efficiency, they may not know that I also allow my clients to invest 100% using active managers if that is their wish. I have strong views, but respect those people who have equally strong views that are not in accordance with my own. Denying my clients of their right to be wrong is not a practice that I can condone- after all; it's my clients' money.

This brings me to a recent situation that I found myself in. I was preparing to give a presentation to a large number of consumers and submitted my slideshow for compliance approval. Part of my talk was to compare and contrast active management and passive management, including the importance of disclosure.

In the end, I was required to insert a disclaimer that read (in part): "Debate regarding market efficiency, the usefulness of fundamental and technical analysis, active vs. passive management and the efficiency of fee payments is ongoing. To date, neither side of these debates has been able to claim unchallenged victory."

I'm fine with that passage. My concern is that pretty much every presentation ever given in the history of the Canadian financial services industry has been given *without* that kind of disclaimer. To me, that silence is the antithesis of meaningful disclosure. It's willfully not talking about material facts because bringing those facts to someone's attention might cause them to actually think critically and question their pre-existing beliefs. By remaining silent on the matter, member firms and their advisors imply that the issue either isn't an issue at all or at the very least that it isn't very material- simply because it is not mentioned.

I have never seen or head tell of a compliance department insisted that an advisor, in publicly espousing the virtues of security selection and/ or market timing, include a reference in the material's disclaimer that evidence in favour of active management is not definitive. Advisors favouring active management are simply silent on the matter- and no compliance department that I am aware of has ever required that such an advisor either disclaim his views as being uncertain at all. Virtually everyone in the business acts as though active management is unequivocally sensible management.

To my mind, this practice is not only presumptive; it is also manipulative and hypocritical. It presumes that there is no need to disclaim the fact that active alternatives might not always be best. It manipulates people by causing them to think there is no dispute surrounding the validity of active management. And it is hypocritical because the industry has been built on the principle of the client coming first through the use of full, true and plain disclosure. Proponents of active management don't disparage; they simply dismiss.

Perhaps, instead of comparing and contrasting the two approaches, I should have confined my comments to the strict benefits of a passive approach and said nothing about active. That's what active management proponents do all the time and it seems to work for them. It's as if to suggest that by talking only about the benefits of one approach, there would be no need to disclaim the uncertainty surrounding both.