SIPA Sentinel

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Small Investor Protection Association - A voice for small investors

CANADIANS LOSE BILLIONS EACH YEAR DUE TO INVESTMENT INDUSTRY FRAUD

Canadians are losing tens of billions of dollars from their retirement savings each year due to unbridled fraud and wrongdoing by the regulated investment industry. In this issue we provide a victim statement and examine why this is happening and what needs to be done. In a society that is based on trust it is difficult to stomach the laissez-faire attitude of regulators.

VICTIMS ARE DAMAGED FAR BEYOND THE FINANCIAL LOSS

The public is generally not aware of the risks they face in dealing with the investment industry until they or a family member become a victim. SIPA has heard hundreds of stories of the life-altering tragedies that continue to occur year after year. The stories are similar. Here is one recently received by SIPA that fairly represents what victims face.

> ”A number of years have gone by since I first woke up and found myself in the middle of a nightmare. My first reaction was shock and disbelief. I could not believe it. I made up many excuses for my advisor's behaviour and held tightly to the belief that this would soon be all straightened out and surely was just a big misunderstanding. Gradually, the reality of the situation began to sink in and I experienced an emotion I was mostly unfamiliar with ... fear. Crippling, gut wrenching, fear. I had no idea who I could trust. I was in unfamiliar territory and had to scramble to get my bearings, keep my wits about me and learn as much as I could, as quickly as I could.
>
> If you are or have been a victim of financial assault, you know this impacts you on many levels. The stress impacts you physically, emotionally and spiritually. I experienced a constant level of distraction as the situation consumed me. I experienced hurt, a sense of betrayal, anger, a desire for retaliation, embarrassment and shame. It impacted my family and my relationships. I lost confidence in myself and ability to assess situations and people.
>
> As my journey continued and I spoke with many in the system, my hope that if I articulated the situation clearly, the checks and balances I believed to be in place, in what I thought was a well-regulated industry, would surely rectify, restore and make the situation right, faded. I discovered advisors do not have to act in their clients best interests and regulators do not restore or fix errors clients experience. I also discovered I was not alone. This was happening from coast to coast. In fact, some cases read like a script, almost identical in the deceptive tactics used to: gain trust, access to funds and to ultimately deceive. I felt re-victimized by the very system I was led to believe was there to protect me. I found myself at a crossroad and had to make a choice, was I going to let this make me bitter or better?
>
> A righteous anger led me to speak out, in comment letters to the regulators, to government officials, to the media. I invite you to join me and make your voices heard. Here is a video I did https://www.youtube.com/watch?v=TYu_td_bvs8

Please consider doing one too and adding your voice to mine and submitting it here. Get in touch with SIPA and ask how you can help. Maybe you are a creative person. Consider participating in SIPA's video contest.

I have come out of this journey a changed person. I am stronger, wiser and more compassionate. I am more assertive, I ask more questions and I am not afraid to take a stand.

If change is ever going to happen, in this deeply entrenched system, it will only come about if we stand together for it. Won't you join me?"

Sincerely,
DM

WHY ARE SO MANY CANADIANS LOSING THEIR RETIREMENT SAVINGS?

For some time SIPA has been trying to alert the Canadian public about the deception that is practiced by the investment industry and the regulators. In the midst of all of the issues currently being discussed, studied, talked about or monitored we believed there must be one fundamental reason why so many Canadians are losing so much of their savings and suffering in their retirement rather than enjoying the golden years.

It is no secret that investors trust their Financial Advisor. It seems common knowledge that mutual funds have high fees that are not disclosed. So why are so many losing so much?

SIPA found a common factor amongst all the investors interviewed by SIPA who experienced significant life-altering loss when they placed their trust in a Financial Advisor. When the Advisor was registered with the regulated industry the common factor was leverage, either through margin loans, mortgage or bank loans, or a combination of both. This coupled with inappropriate investments including mutual funds or segregated funds inevitably resulted in significant loss.

All of the victims placed complete trust in their Financial Advisor and believed he had a fiduciary duty. They were not aware that he was simply a sales person without legal requirement to look after their best interests. There is no doubt that some of these sales persons would do their best within the system to not harm their clients, but the investment industry is based upon sales and the commission incentives encourage action that is detrimental for investors.

The fact that regulators condoned the use of unregulated business titles such as "Financial Advisor" and "Vice President" stood out. The Canadian public was being misled by the industry and its regulators while they believed the regulators would protect investors. These unregulated titles lead the public to believe they can place their trust and their savings with a "Financial Advisor" and expect that their best interests will be safeguarded.

In Canada the public, and some financial journalists, seem to be unaware of this great deception, but in the U.S.A. this topic is on the table. Even President Obama has talked with the AARP about this issue and he supports the Department of Labor proposal to have fiduciary duty mandatory for all those dealing with retirement savings.

SIPA supports this need for fiduciary duty and continues to recommend that all those individuals and firms who provide financial advice or sell investment products be held to fiduciary accountability. In fact that is a requirement of the various Securities Acts for Portfolio Managers and Advising Representatives but not for a “Dealing representative – A sales person.”

Unfortunately, “Financial Advisors” are registered as a “Dealing representative – A sales person.”

FIDUCIARY DUTY

So what is Fiduciary Duty?

> A **fiduciary duty** is a legal duty to act solely in another party's interests. Parties owing this duty are called **fiduciaries**. The individuals to whom they owe a duty are called **principals**.

The investment industry is strongly opposed to being subject to fiduciary duty and object to any move towards establishing fiduciary duty for those who provide advice or sell products. Even in the USA the industry is opposing Fiduciary Duty but we are hopeful that the Department of Labor will prevail and provide some US commentary below.

There are those who are proposing a best interest standard instead of a fiduciary standard but SIPA is opposed to this because best interests is not well defined in law but fiduciary duty is well defined and established in the courts. Knowing how the investment industry is able to work wizardry with words we believe a simple best interests standard would be difficult to manage. For example the industry believes an Advisor is not an Adviser. Seriously.

The USA is calling for Fiduciary Duty

Recently the Public Investors Arbitration Bar Association (PIABA) has produced a report. It is available at: https://piaba.org/system/files/pdfs/PIABA%20Conflicted%20Advice%20Report.pdf

The Executive summary states:

> No national standard exists today requiring brokerage firms to put their clients' interests first by avoiding making profits from conflicted advice. In the five years since the passage of the Dodd Frank Act, inaction by the Securities and Exchange Commission (SEC) on a fiduciary standard has cost American investors nearly $80 billion, based on estimated losses of $17 billion per year. Amid encouraging recent signs of possible action from the Department of Labor and the SEC, there is a compelling case to be made for a ban on conflicted advice in order to protect investors.
> In the absence of such a standard, brokerage firms now engage in advertising that is clearly calculated to leave the false impression with investors that stockbrokers take the same fiduciary care as a doctor

or a lawyer. But, while brokerage firms advertise as though they are trusted guardians of their clients' best interests, they arbitrate any resulting disputes as though they are used care salesmen.
A review by the Public Investors Arbitration Bar Association (PIABA) of the advertising and arbitration stances of nine major brokerage firms – Merrill Lynch, Fidelity Investments, Ameriprise, Wells Fargo, Morgan Stanley, Allstate Financial, UBS, Berthel Fisher, and Charles Schwab – finds that all nine advertise in a fashion that is designed to lull investors into the belief that they are being offered the services of a fiduciary.
For example, Merrill Lynch advertises as follows: "It's time for a financial strategy that puts your needs and priorities front and center." Fidelity Investments appeals to investors with these words: "Acting in good faith and taking pride in getting things just right. The personal commitment each of us makes to go the extra mile for our customers and put their interests before our own is a big part of what has always made Fidelity a special place to work and do business."
Nonetheless, all nine brokerage firms using the fiduciary-like appeals in their ads eschew any such responsibility when it comes to battling investor claims in arbitration. Adding to the confusion is the fact that five of the eight brokerage firms – Ameriprise, Merrill Lynch, Fidelity, Wells Fargo, and Charles Schwab – have publicly stated that they support a fiduciary standard. But these firms are every bit as vociferous as the other four brokerages in denying that they have any fiduciary obligation when push comes to shove in an arbitration case filed by investors who have lost some or all of their nest egg due to conflicted advice.
In this atmosphere of misleading advertising and a complete disavowal by brokerage firms of the same ad claims in arbitration, investor losses will continue to mount at the rate of nearly $20 billion per year until the SEC and DOL prescribe the long-overdue remedy: a "fiduciary duty" standard banning conflicted advice.

SIPA also did similar research to see if the same misleading advertising was occurring in Canada.

It shows that the same factors prevail in Canada. The industry and its SROs are deceiving the Canadian public with advertising and misleading titles that lead Canadians into believing they are dealing with a Financial Adviser who will look after their best interests

It is time to end the pretence. The outdated transaction based model does not reflect client expectations or the wealth management industry's desire to be seen as a respected profession. It is an advice based industry. Bottom line it is time to stop trying to fit a square peg into a round hole. Canadians believe they are dealing with a fiduciary. Industry advertising and titles reinforce that perception. Common sense and decency tell us that a person handling another person's savings needs to be held to the highest standard. They need to be fiduciaries.
http://www.sipa.ca/library/SIPAsubmissions/720_SIPA_Report_Deception_20150505.pdf

Stephen G. Blum comments on Fiduciary Duty

Steven G. Blum has been teaching in the Department of Legal Studies and Business Ethics at the Wharton School of Business of the University of Pennsylvania since 1994 and has been a visiting professor at the ALBA Graduate Business School in Athens, Greece since 1996. Mr. Blum has taught in Wharton Executive Education programs, lectured and consulted widely, and frequently leads seminars and educational forums. He has led training sessions for a number of Fortune 100 companies as well as organizations of lawyers, physicians, accountants, and other professionals.

> “In three decades as a lawyer, it never occurred to me that professional duties precluding taking advantage of clients are a limitation on my freedom. Quite the contrary, in licensing a profession or vocation the proper authorities have a responsibility to impose appropriate duties. Proscribing conflicts-of-interest, hidden overcharges, or otherwise taking financial advantage is surely part of a proper regulatory function.”

> “For years the Department of Labor has urged that those who advise on tax qualified retirement accounts should owe their clients that higher level of competence, care, know-how, and loyalty. President Obama has now added his voice to those efforts. Indeed, from where I sit, the idea of imposing the same high duty on those handling people’s retirement money as is expected of doctors, lawyers and other “true professionals” cannot possibly be controversial. All that is being proposed is that the money guys be held to the same higher standard that any professional must uphold to keep the public safe from exploitation.”

> ”An NPR report quoted Kenneth Bentsen Jr., president and chief executive of the Securities Industry and Financial Markets Association, as saying, “This re-proposal could make it harder to save for retirement by cutting access to affordable advice and limiting options for savers.” The argument seems to be that this industry cannot afford to serve retirement savers unless it is free to take them to the cleaners.”

Barbara Roper Consumer Federation of America comments on Fiduciary

Barbara Roper is director of investor protection for the Consumer Federation of America (CFA), where she has been employed since 1986. CFA is an alliance of approximately 300 pro-consumer organizations, which in turn represent more than 50 million individual consumers. She states:

> “The problem with the SIFMA and FINRA alternative "best interest" standard isn't just that it is weaker than what DOL has proposed. It is also weaker than the standard that Congress mandated in the Dodd-Frank Act. FINRA goes to some lengths in its letter to explain why the Dodd-Frank limitation on conflicts is too rigorous. In our view, it calls into serious question FINRA's willingness and ability to enforce a fiduciary standard under securities laws, despite their long-touted support for such a standard. We expect this from SIFMA, which is after all "the voice of the securities industry." We didn't realize FINRA was also vying for that title.”

Ron Rhoades wants DOL to ignore Industry groups' alternative standards

Ron Rhoades is Assistant Professor of Finance at Western Kentucky University and his comments are excerpted and re-printed from Wealth Management.

http://wealthmanagement.com/industry/finra-sifma-best-interest-standards-dont-go-far-enough

FINRA, SIFMA 'Best Interest' Standards Don't Go Far Enough

Ron Rhoades wants DOL to ignore Industry groups' alternative standards. The definition of a "best interests" standard for advisors that would allow for investment-related fees and some conflicted selling as long as they are disclosed to the customer are "misleading and ineffective," he says.

Industry groups like the Securities Industry and Financial Markets Association, as well as Wall Street's self-regulatory agency the Financial Industry Regulatory Authority, have argued the proposal would put an unfair burden on advisors working with smaller investors, like those looking to roll over 401(k) plans into brokerage-held Individual Retirement Accounts.

“I urge policy makers, such as those in Congress and in our regulatory agencies, to not be fooled by these 11th-hour attempts to deter the expansion of true fiduciary duties,” Rhoades writes in his 65-page comment letter supporting the DOL's fiduciary proposal.

Rhoades contends the current suitability standard under which brokers operate is “nebulous and amorphous with respect to its content and parameters,” adding that it permits the “conflict-ridden sale of highly expensive, tax-inefficient and risky investment products, leaving the customer with little or no redress.”

Many of the proposed alternatives to the Labor Department’s fiduciary requirements, including those offered by FINRA and SIFMA, center on increased, simplified disclosures to customers. But Rhoades argues this is not enough to protect consumers.

THE REGULATORS SHOWS WHY THE FIDUCIARY STANDARD IS ESSENTIAL

A review of some of the evidence provided by the regulators indicates the fraud and wrongdoing that occurs on a regular basis across Canada.

- misrepresented the know-your-client information on the account opening and loan application documents of 25 clients
- misrepresented, failed to fully and adequately explain, or omitted to explain, the risks, benefits, material assumptions, costs and features of a leveraged investment strategy
- obtained and maintained eight (8) blank pre-signed account forms in respect of five (5) clients
- maintained and, in some instances, used to process transactions, 136 pre-signed blank or partially completed forms in respect of 69 client accounts
- made unauthorized transactions in a client’s account
- having recommended and acquired securities that were unsuitable for a client’s investment objectives for the purpose of generating commissions; having recommended and substituted bonds in a client’s portfolio for the purpose of generating commissions
- involved in the false endorsement of a client signature and misrepresentations regarding the holdings and activity in two client accounts
- admitted that he made improper use of client funds and that he forged copies of client documents and signatures

- forged copies of cheques and client signatures to facilitate the unauthorized transfer of client funds into his personal brokerage account

It is apparent that forgery and fraud are systemic and these practices continue unabated as the firms are not held accountable for the actions of their representatives. The penalties levied are small fractions of the ill gotten gains and fines are often not collected. It seems these actions are more to create the perception that the regulators are doing their job.

The solution is to hold the firms accountable and responsible for repaying investor losses due to the wrongdoing. Instead victims must resort to civil litigation and the firms spend millions on legal fees each year to delay and defend actions that appear indefensible.

Forgery and fraud are rampant and provide sound argument that a fiduciary responsibility is necessary to protect investors.

FROM THE REGULATORS

MFDA August 11, 2015 (Toronto, Ontario) – The Mutual Fund Dealers Association of Canada ("MFDA") commenced a disciplinary proceeding in respect of Joseph Daniel Laurie (the "Respondent") by Notice of Hearing (the "Notice of Hearing") dated March 10, 2014.

... In particular, the settlement agreement concerns allegations that:
i) between 2005 and 2011, he misrepresented the know-your-client information on the account opening and loan application documents of 25 clients, thereby engaging in conduct unbecoming an Approved Person and failing to observe high standards of ethics and practice in the conduct of business, contrary to MFDA Rules 2.2.1 and 2.1.1;
ii) between 2005 and 2011, he misrepresented, failed to fully and adequately explain, or omitted to explain, the risks, benefits, material assumptions, costs and features of a leveraged investment strategy that he recommended and implemented in the accounts of 25 clients,

IIROC August 13, 2015 (Vancouver, B.C.) – On July 28, 2015, a Hearing Panel of the Investment Industry Regulatory Organization of Canada (IIROC) accepted a Settlement Agreement, with sanctions, between IIROC staff and Amandeep Gill. Mr. Gill admitted that he was involved in the false endorsement of a client signature and misrepresentations regarding the holdings and activity in two client accounts.

IIROC August 24, 2015 (Montréal, Québec) — Following a disciplinary hearing held on September 10 and 26, 2014, October 3, 2014 and November 6 and 7, 2014, in Montréal, Québec, a Hearing Panel of the Investment Industry Regulatory Organization of Canada (IIROC) found that Steve Duchaine was liable of the violations alleged by IIROC, namely: having misrepresented to several clients that the principal amount of a corporate debenture was 100% guaranteed at maturity, when it was in fact a non-guaranteed debenture; having recommended and acquired securities that were unsuitable for a client's investment objectives for the purpose of generating commissions; having recommended and substituted bonds in a client's portfolio for the purpose of generating commissions, preferring his own interests ahead of the client's; having executed transactions in clients' accounts, charging commissions that were not within the bounds of good business practice; and having tried to forge a client's signature to complete an application form.

August 25, 2015 (Toronto, Ontario) – The Mutual Fund Dealers Association of Canada ("MFDA") today announced that it has issued a Notice of Settlement Hearing regarding the presentation, review and consideration of a proposed settlement agreement by a Hearing Panel of the MFDA's Atlantic Regional Council.

The settlement agreement will be between Staff of the MFDA and Michael Edmund Duhan (the "Respondent") and involves matters for which the Respondent may be disciplined by a Hearing Panel pursuant to MFDA By-laws. The proposed settlement agreement concerns allegations that, between 2005 and 2014, the Respondent obtained and maintained eight (8) blank pre-signed account forms in respect of five (5) clients, contrary to MFDA Rule 2.1.1.

IIROC August 27, 2015 (Toronto, Ontario) – A hearing has been scheduled before a Hearing Panel of the Investment Industry Regulatory Organization of Canada (IIROC) in the matter of Norman Robert Todd Armstrong. The hearing concerns allegations that Mr. Armstrong made unauthorized transactions in a client's account and that he refused and failed to attend and give information in respect of the IIROC investigation into his conduct.

IIROC August 28, 2015 (Toronto, Ontario) - IN THE MATTER OF Brian Anish Kumar - Settlement Accepted August 28, 2015 (Toronto, Ontario) – On August 19, 2015, a Hearing Panel of the Investment Industry Regulatory Organization of Canada (IIROC) accepted a Settlement Agreement, with sanctions, between IIROC staff and Brian Anish Kumar. Mr. Kumar admitted that he made improper use of client funds and that he forged copies of client documents and signatures. Specifically, Mr. Kumar admitted to the following violations: a) Between February 2013 and April 2014, Mr. Kumar made improper use of $1,450,980 in client funds by transferring these funds from the brokerage accounts of four clients into his own personal brokerage account without the clients' consent or authorization, contrary to IIROC Dealer Member Rule 29.1; and b) Between February 2013 and April 2014, Mr. Kumar forged copies of cheques and client signatures to facilitate the unauthorized transfer of client funds into his personal brokerage account, contrary to IIROC Dealer Member Rule 29.1. Pursuant to the Settlement Agreement, Mr. Kumar agreed to the following penalties: a) A permanent prohibition on registration with IIROC; and b) A fine in the amount of $50,000.

September 2, 2015 (Toronto, Ontario) – The Mutual Fund Dealers Association of Canada ("MFDA") today announced that it has issued a Notice of Settlement Hearing regarding the presentation, review and consideration of a proposed settlement agreement by a Hearing Panel of the MFDA's Prairie Regional Council.

The settlement agreement will be between Staff of the MFDA and Joanne Elizabeth Williamson (the "Respondent") and involves matters for which the Respondent may be disciplined by a Hearing Panel pursuant to MFDA By-laws. The proposed settlement agreement concerns allegations that, between September 2006 and December 2013, the Respondent obtained, maintained and, in some instances, used to process transactions, 136 pre-signed blank or partially completed forms in respect of 69 client accounts.

THE OSC OVERRULES IIROC HEARING PANEL – IT'S ABOUT TIME

Earlier this year IIROC staff appealed a decision of the IIROC Hearing Panel to the OSC for review. The OSC agreed with IIROC staff and increased the penalty. James Langton wrote an article for IE disclosing this action.

An investment advisor has been suspended for two years after IIROC staff appealed the decision to the OSC

By James Langton | June 24, 2015 14:15

The Ontario Securities Commission (OSC) has overruled an Investment Industry Regulatory Organization of Canada (IIROC) hearing panel and imposed a two-year suspension on an investment advisor after finding that the panel was too concerned about the impact of a suspension on the rep and her clients and not concerned enough with ensuring investor protection.

The OSC found that the IIROC hearing panel "erred in law and proceeded on an incorrect principle" when it decided that a suspension was not warranted in the case of Lucy Marie Pariak-Lukic, a rep with your CFO Advisory Group Inc. in Stoney Creek, Ont. Pariak-Lukic was found to have sold off-book investments to clients without ensuring that they qualified for prospectus exemptions, which the IIROC hearing panel found amounted to "conduct unbecoming" and violated the public interest.

However, the IIROC hearing panel didn't levy a suspension against Pariak-Lukic. Rather, it ordered a $50,000 fine, $45,000 in costs, six months of close supervision by her firm, and that she re-take the Canadian securities course and the conduct and practices handbook exams.

IIROC staff appealed the decision to the OSC, asking for a suspension as well, and the provincial regulator has now ruled in their favour. In addition, rather than sending the case back to the IIROC hearing panel to reconsider its sanctions decision, the OSC simply imposed the two-year suspension itself, citing the need to "avoid the unnecessary cost to the parties of a further hearing".

In the IIROC staff application for a review of the hearing panel decision, it was argued that the penalty the hearing panel imposed failed to place sufficient weight on the principle of general deterrence; overlooked evidence in determining the appropriate penalty. Furthermore, the application stated that the IIROC hearing panel made mistakes in finding that Pariak-Lukic derived no personal benefit from the investments and by considering the "trauma" Pariak-Lukic suffered due to her participation in the IIROC hearing as a factor in assessing sanctions, among other things.

According to the OSC decision, Pariak-Lukic argued that the IIROC hearing panel's approach to suspensions was appropriate and that IIROC staff is wrong to argue that a suspension is the only way to achieve general deterrence. She also argued that it is unfair for IIROC staff to suggest that the panel erred by overlooking evidence; that it was a key observation of the panel that she received no personal benefit from her clients' investments; and that the panel appropriately considered the impact, trauma and anxiety the IIROC proceeding against her, and the spectre of a suspension that hung over her head for almost two years, had cause. She also said that the OSC should give the IIROC hearing panel's decision a high degree of deference and that it is consistent with other previous decisions in similar cases.

Although the OSC found that the IIROC hearing panel did not overlook material evidence and did not err by failing to impose a suspension solely because Pariak-Lukic may have received a personal benefit from the securities she sold, it did find that the panel should not have considered the impact of facing a regulatory hearing as a factor in determining sanctions.

"In my view, the panel's assessment of the effect of the proceeding on Pariak-Lukic, some of which was speculative on the part of the panel, should not have been a factor in the panel's determination of the appropriate sanctions to impose on Pariak-Lukic, particularly in light of both her breaches of the [Securities] Act ... and the significant losses suffered by her clients," the OSC decision said. "I find that the panel's apparent consideration of the effect of the IIROC regulatory proceeding on Pariak-Lukic, particularly in the absence of evidence to that effect, constitutes an error of law."

The OSC also found that the IIROC hearing panel "failed to adequately address the issue of general deterrence and appeared to be more concerned about the consequences of a suspension on Pariak-Lukic and her clients' continuing ability to rely on her than it was on investor protection and market integrity."

Ultimately, the OSC ruled that the IIROC hearing panel erred in law and that the sanctions it ordered are inconsistent with the OSC's decisions and that the hearing panel's perception of the public interest conflicts with the OSC's view. Furthermore, the OSC ordered that Pariak-Lukic be suspended from the industry for two years.

Reprinted from Investment Executive on the web

IS THE OSC FAILING INVESTORS?

Following the Go Public exposure of the way Financial Advisors are incapable of treating investors fairly, the OSC announced a mystery shopping program to study the activity of “Financial Advisors”. Two years later it seems there has been no development made public. James Langton has written yet another excellent article in the Investment Executive. Let us hope he continues to have the freedom to print the truth. Certainly there are those in the industry that want to see it cleaned up and would welcome the imposition of a fiduciary duty. Although it would not eliminate all the fraudsters it would provide better service for investors and enable industry representatives to be proud of a service which is essential for investors.

Regulation: Findings are a mystery
No results from project launched in 2013

By James Langton | August 2015

Here's a mystery for you: why has it been more than two years since securities regulators began touting their plans for a "mystery shop" of financial advisors, but they still have yet to publish their results?

The Ontario Securities Commission (OSC) first signaled its plans to examine the quality of advice being provided to Canadian investors with a mystery shopping exercise in April 2013. Now, more than two years on, and despite repeated promises of publishing results along the way, the regulator still has not revealed its findings. According to the OSC's director of communications and public affairs, Jill Homenuk, the regulator now expects to publish its report on the research "later this summer."

In the meantime, investor advocacy groups, such as the Canadian Foundation for Advancement of Investor Rights (a.k.a. FAIR Canada), are pressing the regulator to reveal what the research found. Although FAIR Canada lauds the regulator for engaging in this kind of original research, and calls on the OSC to do more of it, the advocacy group also says that the results from the inaugural mystery shopping are "long overdue."

At the same time, the results of research commissioned by the Canadian Securities Administrators (CSA) into mutual fund fee structures also appear to be behind schedule. After a halting start to that research project - largely due to the fund companies dragging their feet when the regulators asked for extensive sales data from those companies - a report on that research was hoped for by last June. Now, the OSC states, the results of this research also are expected "later this summer."

Once again, late data from the fund industry is being cited as the cause of a delay in this project. Although the OSC said in March that York University finance professor Douglas Cumming (who has been commissioned to perform this research for the CSA) had received enough data from the industry to allow him to complete his study, the regulator now says some of the data was received as recently as May. This, in turn, has delayed Cumming's analysis.

These delays are important because both of these projects - the mystery shopping to examine the quality of advice and Cumming's research into the impact of mutual fund commission structures on fund unit sales - could provide key evidence as the regulators weigh some major policy decisions.

For example, the CSA is considering whether to impose a "best interests" standard on financial advisors and whether to ban trailer fees or otherwise intervene with fee structures.

Furthermore, an expert panel in Ontario is now studying regulation for financial planners.

Overdue research inevitably delays decision-making, thus risking the loss of momentum in reform efforts - if that hasn't already happened.

"More data is good," says Neil Gross, executive director of FAIR Canada. "And we want the research to have rigour - just not rigour mortis."

Indeed, why a mystery shopping project should take more than two years to complete is hard to understand. Such projects haven't been this difficult for other regulators.

For example, when the U.K.'s Financial Services Authority (FSA) launched a mystery shopping exercise to examine the provision of financial advice in 2006, that research was carried out between January and April of that year, and the FSA reported its results four months later.

Similarly, when the FSA sought to assess the quality of advice in the wake of reforms that included raising proficiency standards and banning third-party commissions in the U.K. in 2012, the regulator carried out mystery shopping between March and September of that year and reported results by February 2013.

Regulators in Australia also have carried out a couple of major "shadow shopping" exercises in that country that were completed in about 12 months - from the initial announcement of the project to the publication of results.

Somehow, Canadian regulators have taken more than twice as long to do the same kind of research. After first announcing an intention to undertake mystery shopping in the spring of 2013, the OSC issued a request for proposal to carry out the research in mid-July of that year.

And, in August 2013, the minutes from meetings of the OSC's Investor Advisory Panel (IAP) show that OSC executives were briefing the IAP on the "extensive research" being done on the use of mystery shopping by other regulators to "gain insight and knowledge" into those regulators' experience with the technique.

The OSC's field research was launched in the ensuing months. In fact, the OSC reported, it began its mystery shopping exercise in the fiscal year ended March 31, 2014. And, in a report on the project's progress for that year, the OSC noted that it was aiming to release the results by the end of 2014. Clearly, that did not happen.

Then, in April of this year, the Investment Industry Regulatory Organization of Canada (IIROC) indicated in its strategic priorities report that the mystery shopping results would be published by June. Now, IIROC says, there is no planned release date for the report and, as mentioned above, the OSC says "later this summer."

Explaining the delay, Homenuk says: "As this is a joint initiative involving the OSC, IIROC and the [Mutual Fund Dealers Association of Canada], we're taking the time necessary to review the results thoroughly and develop a detailed action plan."

GORDON PAPE IS A WELL KNOWN WRITER AND DESCRIBES THE IMPACT OF LEVERAGE – WHY DO REGULATORS ALLOW THIS PRACTICE TO CONTINUE?

Based on a true story: How bad financial advice can cost you everything

Encouraging people to borrow to invest (known as leveraging) is common among financial advisers. What people are rarely shown is the downside risk.

By: Gordon Pape Building Wealth, Published on Fri Jan 16 2015

This is a true story. The people involved — we'll call them Bob and Brenda — are still fighting for compensation years after the fact.

It happened back in 2007-08. With Bob approaching retirement, the couple went to an adviser for help in rationalizing their finances. The adviser reviewed their assets and recommended opening a home equity line of credit for several hundred thousand dollars, with the proceeds to be invested in mutual funds. He presented some very persuasive numbers to show how lucrative such a strategy would be in a rising stock market.

That advice was bad enough but then he went a step further. He suggested that Bob cash out his pension plan, taking a lump-sum payment and investing it as well. The payoff, the couple was assured, would be much greater than the monthly pension Bob was to receive at retirement.

You can guess how the story turned out. The couple was almost wiped out in the crash of 2008-09. They were left financially devastated with a home that was mortgaged to the hilt and no pension income to see them through their senior years.

They sought compensation from the adviser's employer, with no luck. Now they are consulting with a lawyer with a view to taking legal action.

Unfortunately, this scenario happens too often in the financial industry. Most advisers are conscientious and try to do the best they can for their clients. But, as with any other business, there are a few bad actors that take advantage of unsuspecting clients in order to collect more sales commissions and mutual fund trailer fees.

Encouraging people to borrow to invest (known as leveraging) is one of the most common ploys. The adviser prepares a spreadsheet showing how effective leveraging can be in building personal wealth and the figures are compelling. For example, suppose you borrow $100,000 using a home equity line of credit at prime plus half a per cent, which would be 3.5 per cent today. The interest cost would be $3,500 a year, which is tax deductible because the money is used to invest.

The adviser will then go on to illustrate how much profit can be made assuming various rates of return — most of which are usually unrealistically high. An 8 per cent annual return on $100,000 would generate $8,000. Subtract the after-tax interest cost (let's say $2,100) and the borrower comes out ahead by $5,900 a year. The higher the projected rate of return, the better the numbers look.

What people are rarely shown is the downside risk. Leveraging is a two-way street — it can produce significant gains when the markets run in your favour but create unacceptable losses when stocks go south.

The leveraging ploy has been plaguing the industry for years. Now, rather belatedly, regulators are trying to introduce measures to curb it and other questionable practices. In the U.S., the Financial Industry Regulatory Authority (FINRA) has published a set of priorities for 2015 that says the "central failing" of advisory firms is not putting clients' interests first.

"The harm caused by this may be compounded when it involves vulnerable investors (e.g., senior investors) or a major liquidity or wealth event in an investor's life," FINRA says in its annual letter to broker-dealers. "Poor advice and investments in these situations can have especially devastating and lasting consequences for the investor."

Right. Just ask Bob and Brenda about that!

"FINRA believes that firms best serve their customers — and reduce their regulatory risk — by putting customers' interests first," the letter says. "This requires the firm to align its interests with those of its customers."

The ultimate solution is to impose a fiduciary responsibility on financial advisers. This would require them to place the clients' interests before their own, just as lawyers must do.

Generally, Canadian financial advisers are not in a position of fiduciary responsibility vis-à-vis their clients. But the Investment Funds Institute of Canada (IFIC) says there are situations in which a fiduciary duty might be deemed to apply.

"The sort of adviser-advisee relationship that would likely be found not to be fiduciary in nature would be one where the client simply placed orders with a discount broker who then carried out the requested transaction," says a Q&A on Fiduciary Duties and Financial Advisors published on the IFIC website. "On the other hand, an adviser-advisee relationship that would likely be found to be fiduciary in nature would be one where an elderly, unsophisticated client placed his or her retirement savings in the hands of an investment adviser to invest as the adviser deemed necessary to achieve certain investment objectives for the client (e.g., to provide income through retirement)."

That last comment certainly sounds like it would fit Bob and Brenda. Perhaps they'll win their fight yet.

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