SIPA Sentinel

April 2008

SIPA has a mission:

- to aid public awareness of how the investment industry operates;
- to provide guidance to those who have a complaint about investments with a bank, broker, financial advisor, or other seller of financial products;
- and to pursue improvement of industry regulation and enforcement.

Small Investor Protection Association - A voice for the small investor

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

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

Dr. Al Rosen is recognized as one of Canada's leading forensic accountants and is an expert witness for many of the major securities lawsuits. Those with e-mail have already received a request for support but this issue is worth repeating. Please write your Member of Parliament and express your concern. If you need help please contact me. The following are Dr. Rosen's comments:

WHY IFRS IS A HUGE MISTAKE FOR CANADA

1. Extensive, needless power is being given to corporate management to permit them to:
A. not measure and report self-dealing executive transactions; hide cash inflows and outflows; utilize undisciplined "fair values", have "secret reserves"; reverse write-downs; hide losses; not describe methodology that is vital for investors' decisions; and much, much more.
B. paint whatever "pretty picture" that management chooses to report, so as to deceive investors into providing more capital, including money to what are really defective companies.
C. spread out corporate losses over several years, again to mislead investors; and similar.
2. Prosecutions of executives who promote misleading financial reporting will become extremely difficult. Rules cannot be pointed to in Court as having been violated, because the IFRS rules are too general and permissive. Accordingly, investors are unlikely to be able to recover money that was swindled from them.
3. Given Canada's deficient record of not prosecuting (and leaving discipline up to U.S. regulators and courts), suspect management has nothing to lose by taking advantage of

weak IFRS. One trick after another will be utilized in certain companies, as we have recently noticed across Canada.

4. Claimed benefits of IFRS (e.g., lower cost of capital, comparability across countries, etc.) are false, and almost universally so. Greater reporting uncertainty leads to higher costs of capital. Management choice destroys comparability among companies, and leads to uncertainty.

5. Downplaying of income and cash flow within IFRS leads to Ponzi frauds, and huge investor losses. Canada has seen too many Ponzis in the past 10 years.

6. The role of auditors in Canada will quickly diminish from the perspective of investors. Auditors simply will not stand behind their "audited" figures. Yet, they will charge companies for pointless tasks, and give unwarranted assurance.

7. IFRS, when matched up against our Canadian financial scams of the past 25 years, would have allowed the scams to go undiscovered for perhaps 4-8 years longer. Considerably more losses would have been borne by investors from the time extensions.

8. In essence, IFRS contains many words and sections that Canada rejected 15-30 years ago as being too loose, and promoting financial shenanigans. Loopholes that were plugged are wide-open under much of IFRS.

9. IFRS foolishly assumes 100% management honesty.

10. Much, much more of deficiencies of IFRS can be cited. Also, conversion costs will be major, pointless expenditures.

Overall, it is astounding that IFRS has been promoted by Canada's auditors. The clear losers of IFRS are investors, and eventually the average Canadian, who will lose jobs because inadequate equity capital will exist for deserving companies to expand plants and provide services.

The limitations of IFRS are really quite staggering. Hence, the politicians must act and swiftly. Investors have no choice but to get the attention of their elected officials.

ASSET BACKED COMMERCIAL PAPER (ABCP) DEBACLE

The ABCP financial fiasco created by the investment industry could lead to calamity. It's affecting not only small and large investors including pension plans, but is having a collateral effect on many businesses and organizations that were led to believe ABCP was a secure short term investment. It has also impacted share values of many firms.

ABCP is meant to be a liquid investment vehicle that pays a slightly higher rate of return than Treasury Bills and GICs. Institutions and pension plans invested in these to improve returns. Unfortunately the industry packaged some loans, including sub-prime mortgages, for which there was risk of default. Some of these packages were backed by banks and some were not. This latest crisis has focused attention on the industry and regulatory failure resulting in increased awareness for Canadians.

Industry cobbled together the Montreal proposal to resolve the crisis but the court approval required all investors to be consulted and required a majority vote for final approval. The intent was to convert these short term investments to long term investments but investors must agree to forego any legal action against those responsible for this debacle. It seems that the crisis will be resolved as the retail investors will be bought off by returning 100% of their investment. Otherwise there could be financial calamity.

Ken Georgetti, president of the Canadian Labour Congress wrote an article about ABCP entitled *"FINANCING THE BANKER'S FUNERAL: What the ABCP Swindle Means for Working Canadians"*. He writes *"Working Canadians have suffered enormously from greedy Bay Street bigwigs, but most aren't aware of it. Their pension funds will take a huge hit after dodgy credit investments (once billed as secure) blew up last Summer."*

This article indicates that many heads of large organizations representing ordinary Canadians are becoming more aware and increasingly concerned about the attitude of the investment industry and the failure of the regulatory system. They recognize that not only small investors are having their savings decimated by industry greed and wrongdoing, but pension funds are also being eroded. Ken concludes his article stating: *"Canadians must turn over a new leaf, and demand stronger laws for corporate accountability. Main Street shouldn't suffer for the duplicity of Bay Street. The dodgy debt littered through the world financial system is an ongoing problem that needs closer government regulation. As an earlier generation recognized during the Great Depression, our economy can't be sabotaged by ruthless speculators and pocket-suffers. Believe it: a more sane economy is possible. Meanwhile, we need a public inquiry into this mess. We also need government intervention to recover the ill-gotten gains by the invisible billionaires."*

A Toronto Star editorial captures the essence of this latest financial fiasco.

ABCP a wake-up call

April 14, 2008

Asset-backed commercial paper, or ABCP. Even the name of this type of financial instrument was fashioned to create the impression of solid and secure value, which we now painfully know was never justified.

Yet rating agencies endorsed ABCP with ratings far higher than it deserved. Brokers flogged it to unsuspecting investors as a safe investment that would earn more than truly safe instruments like government treasury bills. And companies and banks that issued ABCP saw an opportunity to raise low-cost money through risky vehicles.

It is hard to blame investors who got badly burned by this scheme for thinking of it as a tacitly contrived, greed-driven financial conspiracy operating on a grand scale.

But a more useful and productive interpretation of the ABCP debacle would be that it reflects the kind of market failure that occurs in the absence of proper regulatory *oversight. Had regulators ensured a proper assessment of these instruments, their use never would have become as widespread as it did.*

Another lesson that has emerged from the ABCP crisis is that regulations of the various parts of the financial system must be knitted tightly together because distinctions among the players – bond and stock issuers, banks, brokers, security exchanges and rating agencies – tend to blur in highly integrated financial markets.

But co-ordinated regulation is especially difficult in Canada, where the constitutional division of powers over financial matters is poorly suited to the complexities of modern finance. At a time when the world's seven richest countries are looking for ways to collaborate in strengthening regulatory oversight of integrated, international capital markets, Canada is the only country that does not have a national *securities regulator; instead, it has separate provincial regulators.*

Federal Finance Minister Jim Flaherty has said, with some justification, that these provincial securities regulators deserve some of the blame for the ABCP problems in Canada. One more reason why this country needs a national securities regulator.

DID ABCP IMPACT BANK SHARES?

During the last year the value of bank shares dropped between 23.2% to 47.7%.

In recent months there has been some recovery in share prices as the ABCP crisis seems to be on the verge of being resolved. As a result of the extreme drop in bank share prices, and dividends remaining unchanged, the dividend rates are higher than normal, with the Bank of Montreal currently highest at 5.6%. While there is no guarantee that the banks will not reduce the dividend rate, by retaining their rates they will encourage long term investors to hold their shares as this will help to maintain share price.

Bank share prices are still well off their highs, ranging from -11.7% for the Bank of Nova Scotia to -30.7% for the Royal Bank and -32.5% for the Bank of Commerce. The ETF (Exchange Traded Fund) that tracks financial shares also dropped 25.9 % and is still off its high by -14.3%. The following chart shows the highs and lows of the past year for bank stocks and the share price and dividend rates at April 28, 2008.

	Hi	Lo	% Loss	Apr 28	Div
Nova Scotia	$54.67	$42.00	23.2%	$48.30	3.90%
Montreal	$71.88	$41.89	41.7%	$50.25	5.60%
CIBC	$107.45	$56.25	47.7%	$72.54	4.80%
National	$66.50	$43.60	34.4%	$52.13	4.80%
Royal	$69.08	$42.82	38.0%	$47.89	4.20%
TD Bank	$77.10	$58.57	24.0%	$66.12	3.60%
XFN (ETF)	$57.02	$42.26	25.9%	$48.85	2.80%

WHAT DO POLITICIANS SAY ABOUT THE ABCP DEBACLE?

The Finance minister seems sincere in his efforts at establishing a national regulator. There is no doubt the Expert Panel will support this concept as did the Wise Persons Committee in 2003. Will the investment industry be able to stall this initiative? In an April 12th Globe and Mail article entitled *"Regulators share blame for ABCP collapse, Flaherty says"*, Kevin Carmichael writes:

"Federal Finance Minister Jim Flaherty signalled that provincial securities regulators deserve blame for the collapse of Canada's asset-backed commercial paper market, and said they and the firms they oversee will be subject to scrutiny as he pushes Canada's financial services industry to upgrade its standards.

'The financial institutions aren't just the banks,'' Mr. Flaherty told reporters in Washington, where he is attending a meeting of the 185-member International Monetary Fund.

"We had various entities selling asset-backed commercial paper to people. We have a number of investors in Canada who feel they have not been well treated and didn't know what they were buying, or were misled on what they were buying and have been through a difficult process...So we need to look at those institutions as well and who's regulating them and are they disclosing properly and is their due diligence being done by them with respect to the products they are selling.''

Mr. Flaherty is using the G7's push for better financial regulations to back his lobby for a single national securities regulator, suggesting today that the ABCP mess might have been avoided had there been one overseer of the securities industry rather than 13.

"There's no confusion, it's the provincial securities regulators,'' Mr. Flaherty said when asked if there was uncertainty over who was responsible for the ABCP market. "We have the banks of course, but the banks were only part of that process and most of it was relegated to entities that are under the supervision of provincial securities regulators.''

Finance Critic John McCallum called for a Commons Finance Committee Inquiry into ABCP which took place mid April, and recently wrote an article for the Financial Post with his views on the latest financial crisis. He writes about regulatory capture which we characterize as "industry/regulators". The article is reproduced in its entirety:

The ABCP crisis: Canadians want answers

The asset-backed commercial paper (ABCP) crisis raises a simple question that is important to all Canadians:

Q. Can individuals make investment decisions with confidence in the financial system?

Alberta farmer Murray Candlish, testifying before the finance committee in Ottawa last week, explained how he had invested his life savings in ABCP because he was told that such an investment was "as safe as the Canadian banking system." Now, he says, "our dreams are slowly disappearing." Murray Candlish was in the wrong place at the wrong time. What happened to him could have happened to just about any one of us.

That is why, in a rare display of non-partisanship, the finance committee of the House of Commons agreed to make this issue its top priority. In coming weeks, we will have hearings on two issues:

1. *Why did this crisis happen?*
2. *And who, if anyone, is responsible?*

More important, we will also investigate what legislative or regulatory changes are needed to restore Canadians' faith in their capital markets and make sure such a crisis does not happen again.

While it would be naïve to think that legislation can abolish fear and greed or rule out future financial crises, we should spare no effort to improve the system.

Regulations of the Office of the Superintendant of Financial Institutions (OSFI) encouraged banks to offer conditional liquidity facilities to back up ABCP markets, as opposed to the unconditional facilities that are the international standard. It is alleged that these conditional facilities, while sufficient to allow the issuance of ABCP, offered no protection at the moment of crisis, quickly undermining confidence in the market. It will be interesting to hear the response of the finance minister and OSFI to this concern.

At the provincial level, we must inquire why regulators allowed ABCP products to be sold without disclosure or effective liquidity backup, despite warnings to the contrary from the Bank of Canada, and whether it is true that they have been very slow to respond to citizen complaints.

For decades, economists have studied the phenomenon of the "captured regulator" -- whereby regulators become subservient to the industries they are supposed to regulate. A subtle form of capture occurs when a chummy atmosphere develops, leading to undue deference to the industry on the part of the regulator. To what extent, if any, have federal and provincial regulators become captured by the financial services industry? And to the extent capture has occurred, what can be done about it? Do the agencies mandated to protect individual investors or ensure they are provided with adequate information have sufficient clout and independence? Or have these agencies been "captured"?

In part, Canada's financial system is based on self-regulation. Given the ABCP crisis, is the amount of self-regulation appropriate? How were these products determined to be suitable for retail investors? Canadians need to hear from the national organization and trade association of the securities industry, the Investment Dealers' Association.

On what basis did ABCP secure a triple-A credit rating from a Canadian rating agency, but not from anyone else? Indeed, when global rating agencies refused to grant a rating to Canadian ABCP, why did everyone appear to ignore this red flag? Would a single securities regulator have helped much in this case? Perhaps, but a single regulator is not a panacea. The U.S. and the U.K., both subject to single regulators, seem to have actually fared worse than Canada.

Subject to the limitations of the committee process, the Liberal party will leave no stone unturned to get answers to these and other questions, with a view to restoring transparency and public confidence in Canada's financial markets.

John McCallum, National Post
Thursday, April 17, 2008

CLASS ACTIONS ARE BECOMING MORE COMMON

Although class actions have been active in Canada for some time, investors may not be sufficiently aware of how they can participate. Klein Lyons is one of the law firms active in class action suits. The following interview with David Klein is reproduced here to provide answers for questions you may have. Klein Lyons have offices in Vancouver and Toronto and additional information is available on their website.

The Role of Class Action Law in Canada: An Interview with David Klein
A class action is a lawsuit that groups people with a common claim together against the same defendant. Class action lawsuits allow people whose voices might otherwise go unheard to fight together for a common interest. Full Disclosure *recently spoke with David Klein about class action in Canada.*
Class actions are a relatively new area of law. How long have they been around?
In 1995, British Columbia became the third province in Canada to permit class actions. Quebec, in the late 1970s, was the first province, followed by Ontario in 1993. The US has allowed class action suits since 1976.
How long have you been involved in class action litigation?
I've been involved in class actions since they first became possible in BC on August 1, 1995.
Are there many lawyers involved in class action law?
In Canada, there's a limited number of lawyers who have this expertise. There are only

about 20 lawyers across Canada whose primary practice involves representing plaintiffs in class actions.

Are class actions in Canada and the US similar?

While there are many similarities between the two, it's become more difficult to certify class actions in the US. There's currently a tendency to pursue individual lawsuits there.

What are some of the differences between class actions and regular lawsuits?

Class action cases are generally more complex, in terms of both legal issues and factual issues. Also, because about half of the suits involve a defective product, there's a greater use of consumer protection and product liability law. Because many of the suits involve medicine or science, we spend a lot of time analyzing and gaining an understanding of medical and scientific issues. Class action suits are expensive to conduct and also take a long time to resolve. The average length of a class action is three to six years, about twice as long as other court cases. One of the reasons for this is that a class action suit must go through a certification process, which can take up to two years. Another reason is that the fact patterns are more detailed, often with millions of pages of documents.

So, obviously, you can't have just one lawyer working on a class action suit.

No, it's never a one-person job. We usually have two to four lawyers working on a case and often have co-counsel arrangements with other law firms. We call this "team lawyering."

What are some advantages of class actions?

Most class actions are social justice cases on behalf of people who have been seriously harmed or deceived by marketers. Class action litigation has created access to the judicial system for thousands of people, especially in cases that are too expensive for them to pursue on their own. Class actions have become the key to the courthouse.

Read more about class actions at www.kleinlyons.com/class/faq.php

INVESTMENT BENCHMARKS – HOW DO YOUR INVESTMENTS COMPARE?

Some fund investors say their investments are going nowhere. Others say after many years they have no more than the money they put in. You need to know the annualized rate of return on your account, and how that compares to the market. Since January 1, 2004, the TSE index has a cumulative gain of 69.5%. Have you done as well?

Measure your investments against a benchmark. The Toronto Sock Exchange index is a good starting point as a reference benchmark. There are ETFs that track the TSX for investors who prefer not to invest in individual shares but want to invest in equities and are reluctant to invest in funds.

	Apr 30	2007	2006	2005	2004	2003
S&P/TSX	13,937	13,853	12,908	12,272	9,246	8,220
Return Rate	0.6%	7.3%	14.5%	21.9%	12.5%	