SIPA Sentinel

March 2014

Small Investor Protection Association - A voice for small investors

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

BORROWING TO INVEST IS NOT IN YOUR BEST INTEREST

SIPA continues to make investors aware that borrowing to invest is not in investor's best interest. There are many ways of borrowing to invest usually called leveraged investing:

- Mortgaging your home to raise cash
- Obtaining a cash loan
- Agreeing to buy into a "Leverage Plan"
- Opening a "Margin Account" rather than a "Cash Account" (A margin account allows you to borrow against your invested assets whereas a cash account does not provide this option)

Whichever way you borrow to raise cash to give to your "Advisor" (cum sales person), unfortunately in many cases it is just that as the money is lost and you don't get it back. It is particularly high risk when you place borrowed money (bank or mortgage loan) in a margin account. This risk is similar to that of some leverage plans. Of the many hundreds of victims of significant investment loss that SIPA has spoken to, almost all had leveraged investments. Losing all or nearly all of your savings is a life-altering event.

Margin accounts are normally opened for clients because the representatives know that the easiest way to increase the amount of money they manage (Assets under Management) is to have their clients borrow. If they can convince a client to borrow money or use margin to increase the dollars invested, the representative has just increased his income from that account. This is a powerful initiative for a commission based industry.

We strongly recommend that small investors do not use borrowed money for investing. This is only for sophisticated investors who can afford the risk of substantial loss.

Here is what Barbara Shector writes in the Financial Post:

"IIROC puts heat on dealers to protect clients who borrow to invest"

Canada's investment industry regulator said Wednesday it has uncovered a growing number of cases that involve "inappropriate" borrowing by retail clients to pay for investments in stocks and other securities.

Costly advice case study: 'Leveraging was new to me'

They didn't finish high school and had never heard the word 'leveraging' before, but when this couple's advisor suggested they could pad their retirement by borrowing more money than they had ever seen, they jumped in — and lost.

The cases unearthed included "several situations where clients were not provided with sufficient information to properly understand the risks associated with such strategies," the Investment Industry Regulatory Organization of Canada said.

As a result, IIROC is stepping up efforts to make sure dealers and advisors provide clients with the information they need to make informed investment decisions based on an understanding of the risky nature and the potentially high costs of such strategies, also known as leveraging.

The regulator issued fresh “guidance” Wednesday that “makes it clear that IIROC-regulated firms, as part of their supervisory framework, must have sound policies, procedures and controls in place when borrowing-to-invest strategies are recommended by the firm and its registered representatives.”
The guidance — an explanation of rules that often proceeds enforcement action by the regulator — also reminds advisors of their obligations to ensure “suitability” for a particular client when they recommend or become aware that such a strategy is being used.

In addition, advisors must ensure the risks are fully explained and that clients are aware of the potential impact of borrowing-to-invest strategies based on the clients’ financial situation, risk appetite and ability to withstand loss.

“The use of borrowed money will magnify losses in situations where the value of the investments decline,” IIROC said, adding that the issue falls under its “investor protection” mandate because investors must pay back the borrowed money, plus interest, whether the investment makes money or not.

Do It Yourself Investing (DIY Investing)

Many small investors that have become aware of the challenges of dealing with an investment industry where the regulators condone the use of false titles (allowing sales persons to call themselves “Financial Advisors” when they are only registered as “Dealer’s Representative” and not as an “Adviser”). These representatives do not have a legal obligation of fiduciary duty or even to look after clients’ best interests. Because of this lack of legal obligation these sales people often sell clients financial products that pay the highest commissions. These products that pay the highest commission are mostly the worst products (referred to in the industry as “a piece of crap” for investors’ portfolios and are generally not suitable.

For more information on the deception of Advisors view Investment Advisor Bait and Switch on You Tube.

Many of the major banks now offer a discount brokerage service where trading fees may be as low as ten dollars per trade or lower. These accounts are generally referred to as direct investing accounts. The firms of course have no responsibility for suitability, but investors are able to select the type of product that they want to buy rather than rely upon some unqualified “Financial Advisor” more motivated by commission rather than doing what is in the client’s best interest.

The reports provided by the banks for this direct investing are generally more readable and more easily understood than from other investment firms. A couple of examples follow:

Scotiabank

This example indicates reporting for an investment account of a DIY investor using Scotiabank Direct Investing. The numbers are actual numbers for a Tax Free Savings Account (TFSA) opened in 2013 with a deposit of $5,500 and an additional deposit in 2014 of $5,500 for a total amount of $11,000.

The online report shows the following at the first of March 2014 with totals for the account and numbers for one of the securities (ENB) held in this conservative account.

For Total Account

Cash	$904.54
Market Value Securities	$11,277.25
Net Value	$12,186.79

For each security held

Description	Enbridge Inc (first investment in January 2013)
Symbol	ENB
Quantity	125
Average Cost	$43.094
Market Price	$48.73
Book Value	$5,386.75
Market Value	$6,091.25
Change $	$704.50
Change %	13.08% (Since purchased 15 months ago)

TD Waterhouse Webbroker

This example indicates reporting for an investment account of a DIY investor using TD Waterhouse Webbroker Direct Investing. The numbers are actual numbers for a Tax Free Savings Account (TFSA) opened in 2009 with a deposit of $5,000 and additional deposits in 2010, 2011 and 2012 of $5,000 each for a total investment of $20,000. No further investments were made.

The online report shows the following at the first of March 2014 with totals for the account and numbers for one of the securities (BCE) held in this conservative account.

For Each Account

Total Account Value	$31,851.21
Securities Market Value	$31,681.00
Cash	$170.21

For each security held

Name/Symbol	BCE INC/BCE
Qty	200
Price	$48.23
Book Value	$7,908.87
Market Value	$9,646.00
Gain/Loss $	$1,737.13
Gain/Loss %	21.96%
% of Holdings	30.3%

Each of the reports indicates clearly the cost of the investment and the current market value. They also indicate gain or loss in dollars and as a percentage for each security. This enables investors to determine how each investment is performing on a continuing basis.

If a DIY investor avoids mutual funds with high fees and invests in select securities and ETFs the return on investment should prove superior to most mutual fund investments. A selection of dividend paying banks and utilities provides income as well as opportunity for capital growth. One needs to be careful selecting ETFs as there are many new products labeled ETFs that seem more like modified mutual funds.

The primary advantage of Tax free Savings Accounts (TFSA) is that all of the gains are tax free and when you withdraw the money there is no tax charged unlike with other registered plans such as RRSPs and RRIFs.

DISPUTE RESOLUTION FOR SMALL INVESTORS

With the lack of legislation requiring the investment industry to have fiduciary responsibility when they are handling Canadians' savings, and the fact that the industry is allowed to mislead the public by labeling their sales staff (now registered as dealer representatives) "Financial Advisor" and adding "Vice President" titles for the top sales persons, Canadians are being misled into blindly placing their trust in these "Financial Advisors". However investors need to be aware that portfolio managers are registered as "Advisers" and they have a fiduciary duty to look after your best interests. Always check on the persons registration. Ask for it.

Most Canadians are led to believe they can trust the industry and their financial representatives in the same way that they trust Doctors, Dentists, Accountants and other professionals. The fact that the industry is developing professional qualification designations serves to further convince Canadians that the investment industry generally is trustworthy. Sadly that appears not to be the case.

A multitude of Canadians are losing their savings. Most of them are either retired or at the end of their careers. Many of those who lost are forced back to work to replace any investment income they might have had to supplement the CPP. For those who have worked a lifetime to provide a secure retirement it is a bitter pill to swallow when the perpetrators of these misdeeds seem to escape with little harm.

Many Canadians have become aware of how the industry operates and of the failure or self regulation to protect investors, and so have turned to becoming DIY investors.

This is not a new problem. It has been recognized for decades. An attempt was made in the 1990s to create a national Ombudsman to look after investor disputes. The investment industry was quick to volunteer to provide such a service by re-naming the industry's Canadian Banking Ombudsman to the Ombudsman for Banking Services and Investments (OBSI). Although the first Ombudsman said that his objective was "to make Clients whole again". This turned out to be not possible, but some disputes were resolved with settlements being paid. OBSI provided a quick solution as an alternative to many years of costly civil litigation with questionable outcome. This was enough to convince many victims that half a loaf is better than none. However to receive any settlement victims musto sign a gag order so they will not speak out. These "gag orders" ensure the public never learns of the extent of fraud and wrongdoing in the investment industry.

Currently there is much discussion concerning OBSI and a news article about OBSI is included in this issue. At the same time CBC Marketplace recently aired a program Show Me the Money indicating the problem with lack of qualified people acting as "Financial Advisors". It is disturbing to see that most of the persons interviewed by Marketplace either did not know or worse yet refused to tell a prospective client (with hidden camera) how much mutual fund fees are or how they are applied. Since mutual funds are the mainstay of the investment industry it is difficult to believe that anyone selling investment products would not know the fees for mutual funds. Preet Bannerjee appeared quite amused by the failure of these representatives to answer.

At the same time CBC Go Public aired a program about a Canadian senior living and working in Texas who was undergoing heart surgery in a Texas hospital when a scammer sent an e-mail purporting to be the senior and asked the bank to send $90,000 to his cousin in Alberta. This “cousin in Alberta” was the fraudster’s accomplice. The bank complied. But when the scam was discovered the money was gone and the bank refused to give the senior his money. After a lengthy battle the senior turned to Go Public with positive results.

The following is an article regarding OBSI by Barbara Shector in the Financial Post.

In OBSI’s ‘name and shame’ campaign, about 30% of compensation withheld from investors - Barbara Shector writes in the Financial Post

About 30% of the compensation recommended by Canada’s Ombudsman for Banking Services and Investments was not paid to investors last year because 10 investment dealers refused to comply with the findings of the independent dispute resolution agency. The details behind a growing list of firms that have elected to be “named and shamed” by OBSI rather than comply with the agency’s compensation conclusions were revealed Tuesday in the ombudsman’s annual report.

For the first 17 years of OBSI’s mandate and that of its predecessor, only a single firm was ever subjected to the so-called naming and shaming, which means having details of the dispute and the ombudsman’s findings made public after a refusal to follow the compensation recommendations. Including last year’s refusals, there have now been 13 additional cases in which an investment firm has refused to follow OBSI’s recommendation.

Douglas Melville, the ombudsman, said in the annual report that “it is clear that there will be more refused recommendations” and therefore more so-called naming and shaming through the public airing of cases.

CBC EXPOSES INDUSTRY BEHAVIOUR IN DEALINGS WITH CLIENT

In early March the CBC aired a program by CBC Go Public with Kathy Tomlinson. Kathy has worked as an investigative reporter for more than a decade. She is currently host of CBC Vancouver's news segment Go Public. Go Public stories come almost exclusively from people who write in story ideas. The segment seeks to shed light on untold stories that are of public interest and hold those responsible accountable. The following is part of the story aired. To see the complete story follow link Bank delays payment to re-instate account

Bank delayed taking financial responsibility for mistake for months

By Kathy Tomlinson, CBC News Posted: Mar 03, 2014 2:00 AM PT Last Updated: Mar 04, 2014 10:57 PM PT

The Bank of Montreal has reimbursed one of its customers following a CBC Go Public story about how the bank wired $87,555 of his inheritance money into the hands of a scammer. A spokesman confirmed to CBC News on Monday that BMO customer Bruce Taylor has been reimbursed with interest and the funds placed into his account.

“My parents worked all their lives and put that bit away every week and they left it to myself and my sister,” Taylor said earlier. “For 50 years they saved that money and then it’s gone — overnight.”

> He had said he's also upset because for several months his bank failed to take financial responsibility for its mistake.
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> "I think [BMO was] just trying to wear me out, hoping I would just fade away ... or die," he said.
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> Taylor is a Canadian engineering consultant who lives and works in Texas. When his account was emptied by BMO, he was in a Houston hospital having open heart surgery. Because of his experience, he believes other customers should be warned.
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> "I'm living proof that [the bank's operations] can be compromised," he said. "In my opinion, It just means nobody's money is safe."
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> This first email, sent by the impostor to Taylor's financial adviser, asked BMO to wire money to his cousin. (Bruce Taylor) Taylor's inheritance was in term deposits at BMO until July 2012, when the investments matured. The money was then automatically deposited into a BMO savings account that, as a U.S. resident, Taylor said he doesn't use.
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> "This was strictly emergency money that I had left in Canada," said Taylor.
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> In August, someone emailed Taylor's BMO investment adviser, using Taylor's email address, saying he needed the money wired to his cousin, immediately. The impostor's emails had several spelling and grammatical errors. The scammer then faxed misspelled transfer requests to Taylor's BMO branch in Grand Falls-Windsor, N.L. – with his account number and an electronic copy of his signature.
>
> "I don't understand why the Bank of Montreal didn't scrutinize those faxes," said Taylor. "You can tell that they were written by someone whose first language was not English."

It is not bad enough that he bank erred in the first place and was not alerted by the misspelled e-mail which was typical of the many scams received daily by Canadians. What is really unacceptable is the Bank's delay in replacing their client's money when it became clear the bank was scammed. It was only after exposure by Kathy Tomlinson and Go Public that the bank relented. This may be an avenue for consideration by anyone with a dispute.

The reason the pubic does not learn of the incredible amounts of loss is because whenever the big financial institutions are forced to pay restitution for their wrongdoing they demand a gag order or restriction on the victim about speaking out. When victims experience the impact on their lives in dealing with the dispute they are only too happy to agree to the gag order to put the life-altering experience behind them. It is common for victims to settle for half or less just to put an end to the stress and strain of a legal battle.

It is indeed Investor Be Aware.

And from the Go Public website"

> Go Public is an investigative news segment on CBC-TV, radio and the web.
> We tell your stories and hold the powers that be accountable.
> We want to hear from people across the country with stories they want to make public.
> Submit your story ideas to Kathy Tomlinson at Go Public
> Follow @CBCGoPublic on Twitter

FINANCIAL PLANNING CONSIDERATIONS

In addition to ensuring that both spouses are aware of their financial situation and investments and ensuring that wills are prepared for estate planning one must prepare for the future. As the population grows older we must deal with the increasing healthcare needs and the development challenges of old age. The following is an article from the Association of American Retired Persons (AARP) dealing with advanced age and diminishing capacity. Unfortunately there are those in the investment industry that may take advantage of the elderly or may not be sufficiently competent to act in the investor's best interest.

AARP - Protecting Older Investors:
The Challenge of Diminished Capacity

As the population ages and the incidence of Alzheimer's disease and other dementias grows, an increasing number of older investors are at risk of having diminished capacity to transact business. Investment advisers, brokers, insurance agents and others selling an array of financial products must be equipped to respond appropriately when a client or potential client signals that he or she may lack the capacity to make financial decisions. Cognitively impaired investors are at risk for financial exploitation, and this threat underscores the urgent need to equip business, government, and the aging network with appropriate interventions.

Diminished Financial Capacity and Implications for the Financial Services Industry
Financial capacity is "the capacity to manage money and financial assets in ways that meet a person's needs and which are consistent with his/her values and self-interest."

It encompasses such core skills as identifying and counting money, understanding debt and loans, conducting cash transactions, paying bills, and maintaining judgment to act prudently and avoid financial exploitation. Financial capacity is one of the first abilities to decline as cognitive impairment encroaches, yet older people, their families, and others are frequently unaware that these deficits are developing. Declining skills are detectable before cognitive impairments progress to a diagnosis of Alzheimer's disease. Once an individual has mild Alzheimer's, skills such as understanding investment options and determining returns decline rapidly.

Because these impairments can appear subtle but progress quickly, planning ahead for possible incapacity—such as setting up powers of attorney, joint accounts, and trusts—is critical. Preventing financial exploitation is vital for those with diminished capacity because they are vulnerable to fraud and abuse. Studies show that the prevalence of financial exploitation is high; a 2011 study estimated that older victims lose $2.9 billion annually.

With the shift toward defined contribution retirement plans and the growing complexity of the financial services industry, good financial advice has become critically important to investors approaching or in retirement. Older investors are served by individuals with a variety of licenses and registrations who recommend or sell a complex array of investment products.

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THE MOTLEY FOOL SPEAKS OUT ON MUTUAL FUNDS

Recently Morgan Hounsel of the Motley Fool speaks out about mutual funds and investing. Morgan Housel is a nationally-syndicated financial journalist and analyst at the Motley Fool. Morgan's words have appeared in the New York Times, TIME, Wall Street Journal, and Washington Post. Some excerpts follow for your amusement and awareness.

"Is Your Financial Advisor Serving You a Load of Bull?"

"When the mutual fund industry was created decades ago, big banks needed a way to get average Americans to buy their products. They reasonably settled on an army of brokers to sell mutual funds to mom-and-pop investors around the country. Brokers need to make a living, so three major types of mutual fund shares were born, all with different ways of compensating brokers.

A-shares are a type of mutual fund share that charge front-end loads. Say you want to invest $100 in a mutual fund with a 5% load fee. Only $95 of your investment will actually be invested in the fund. The other $5 will be paid to the broker and other middlemen. This is what my dad was sold.

B-shares are a more opaque form of A-shares. If you put $100 in a mutual fund, all $100 will be invested in the fund. Great! But if you sell the shares within the first few years of owning them, you could be charged a back-end sales load, taking away 5% or more to pay your broker. Plus, you'll likely pay higher annual fees to the investment advisor running the fund, to cover marketing expenses. B-shares can be such a rip-off that many major brokerages no longer sell them. As fellow Fool Bill Barker once wrote, "The only purpose of a back-end load appears to be to confuse shareholders and make them think they are buying a no-load fund when they are not.

C-shares pay the broker an annual load, typically around 1%, for each year you own the mutual fund — the fee that keeps on feeing."

If all of this sounds confusing, that's just the way the mutual fund industry prefers it. Loads have all the hallmarks of ways Wall Street takes advantage of individual investors. The industry isn't transparent — a lot of investors might not even know they're paying fees. You're charged on the dollar amount of your investment, which is absurd, since it isn't twice as hard for a broker to buy you $50,000 of a mutual fund as it is for him or her to buy you $25,000. And worse, alternatives now exist that make brokers and their fees totally unnecessary. The only thing you need to know about load fees is...You simply don't need to pay them. That's because with the advent of the Internet, anyone can buy or sell almost any mutual fund online with a few mouse clicks. This wasn't true a few decades ago — you really had to go to a broker if you wanted to invest. Today, the purpose of a load fee is almost entirely to support the job of a mutual fund broker at the expense of those who don't realize that this person's job is obsolete.

All investors should seek out no-load funds or other investments that don't come with a sales charge attached. More of your hard-earned money stays with you, and less goes to someone telling you to ignore the pissants.
Do your investments carry loads? Do you even know? Take a look at your investments to find out. If they are carrying loads, there's a good chance that your "financial advisor" is far more concerned with lining his or her pockets than lining yours. Granted, a lot of people do need financial advice. But what they don't need is a broker — who's nothing more than a well-disguised salesperson — looking for ways to make more and more money off them.