SIPA Sentinel

October 2016

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.

In this issue:

ADVISOR TITLE TRICKERY – Your Financial Advisor is a Commission Sales Person

> *"Financial Advisor, as you noted, is a common title which many persons use, whether they are registered under securities legislation or not. The use of this title is not generally prohibited, and may be used by anyone, including persons who are only licensed to deal in insurance products, mortgage brokers, deposit agents, or employees of financial institutions. …*
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> *As with Financial Advisor, the title of Vice President is increasingly a common title used in the financial services industry. While an officer of a firm may be designated to be a vice president, the use of the title is not reserved to actual officers of a corporation. As such, it is not safe to assume a person described as a vice president is in fact an officer of that corporation."*
>
> ***Chris Besko***
> *Acting General Counsel & Acting Director*
> *The Manitoba Securities Commission*
> *(In response to SIPA inquiry to the CSA Secretariat)*

ADVISOR TITLE TRICKERY

- Securities Acts define an "Adviser" as having responsibility to look after investors' best interests.
- Regulators say "Financial Advisor" is an unregulated business title that can be used by anyone.
- Sales persons are not legally required to look after investors' best interests.
- Industry uses the title "Financial Advisor" for their sales persons to gain trust.

Executive Summary:

Securities Regulators selectively ignore portions of Provincial Securities Acts, letting Investment Dealers deceive millions of Canadian investors in many ways. We will be issuing a series of reports intended to shine a light onto this harm being done to Canadians, by many of our most trusted institutions as well as government authorized regulatory bodies.

In this report, we examine how over 100,000 financial professionals in Canada take advantage and skirt laws against misrepresentation. This allows investment sellers a clear "get-away" from the laws against deception of the public.

In 2012 one of the biggest news stories in Canada was about a selective meat inspection process in Alberta, and the resulting harm to Canadians. It turns out that tainted meat products were being carefully inspected so as to not enter the export markets, but the tainted product was allowed to be sold to Canadians. This called into question both the quality of the product itself, and the government inspection process. This report looks at items which are hidden from investors view, and can similarly do harm to Canadians.

With the knowledge of 13 Provincial Securities Commissions who are responsible for protecting the public interest, these harms appear similarly negligent, to the failures of the meat inspection and regulation process. What if Canadians were consuming tainted investment advice, like some regulators allowed E-coli tainted meat into the system? This report demonstrates that the analogy is a valid one.

Read the complete Report on our website. It contains the facts that show the truth about the deception by the industry and it's captive regulators:

> *"There are 121,932 total registrants in Canada as of Sept 16, 2016 in the investment industry. Only 4,076 persons or 3% of that total are legally registered in the category of Adviser or Advising Representative."*

TOP FIVE MYTHS INDUSTRY WANTS US TO BELIEVE - DEBUNKED

Investor Advocates would like to see anyone who provides investment advice to act solely in the best interests of their clients – finally giving Canadians unbiased guidance instead of a sales pitch. But some in the financial services industry have made the defeat of this proposed change their number one priority. They're using false attacks to stop the initiative from moving forward. If they're successful, Canadians will continue to lose billions of dollars in hard-earned savings every year, as they are saddled with overpriced underperforming investments and often times unsuitable risky investment strategies

Don't fall for their spin:

> Here are the top five myths some in the industry want you to believe:
>
> **Myth:** "We'll have to abandon low and middle income clients because we won't be allowed to charge commissions."
> **Reality:** If brokers and insurance agents do pull back once the rule is final and they have to put their clients' interests first, then the many other advisers who are comfortable operating under the fiduciary standard will step in. There won't be an "advice gap. Robo advisors are also available to the small investor."

Myth: "Wait and see how CRM2 plays out before taking any further action it might not even be necessary."
Reality: No amount of rules or disclosure could ever cover every situation or properly protect Canadians. An overarching principle similarly found in other true professions is needed to act as a guide for addressing situations that fall between specific rules. Moreover, forcing the CSA to wait to act is really just a tactic to delay critical new protections, not only for an ageing population but all Canadians impacted by changes to employee pension plans away from defined benefits to defined contributions.

Myth: "We're already well regulated and have a Code of Ethics to act in our clients best interests.
Reality: No amount of rules can adequately protect Canadians. The SRO's "suitability" standard currently applicable to advisors is weak because it doesn't require them to recommend only what's best for their clients.

Myth: "What happened in the UK could happen here."
Reality: Self-interest industry serving lobbyists are quick to cite to recent rules in the United Kingdom that banned commissions, claiming small account savers have lost access to advice. But the evidence shows that the UK market has adapted, small accounts have not lost access to advisory services, and investors may be receiving better advice than before. And, the UK rules actually go beyond what the CSA is considering, reflecting the enormous importance of eliminating conflicts of interest when it comes to investment advice.

Myth: "Disclosure is enough."
Reality: Independent research shows that an education campaign alone will do little to stop the exploitation of investors. In fact, it may make matters worse, since studies show that disclosure can often confuse investors and embolden advisors and their firms to think that, once disclosure has been made, all of their duties are satisfied. Affirmative substantive protections, like the fiduciary best interest duty, not just more fine-print warnings, are essential for investors.

The current investment industry regulatory system does not provide adequate protection for the small investor. Instead it facilitates the industry deception of investors by allowing systemic rule breaching to continue unhindered by failing to strongly enforce transgressions.

THE INVESTMENT INDUSTRY EXPOSED FOR WHAT IT IS

A courageous letter from Julia and Mikhail Lipovetsky to the OSC that represents the dispute experience of all small investors. You must read this letter in its entirety. It is available at:
http://www.sipa.ca/library/SIPAdocs/500%20Julia's%20Letter%20to%20OSC%2020160508_11-774_lipovetskyj-lipovetskym.pdf

"My father (76) and I understand that polite, politically sensitive expression has its time and place. However, as victims of what still somehow passes, well into the 21st century, as an effective regulatory environment in Canada, we are finding it both challenging and exhausting to contain our

very strong emotions. Neither do we think that we should, having already paid for them dearly. So in this letter we will be callings things plainly, what our experience has taught us that they are.

There is another word for white-collar crime – CRIME! In its impact it is assault, is violence, and is grievous harm. Committing physical assault gets people caged, though the act is most often not premeditated, nor methodical or remorseless. Unlike of those who commit theirs wearing a suit.

All crime is essentially a crime of opportunity. Such as the low standard for advice to small investors in Ontario. What standards do exist, are rarely enforced. As clients treated unjustly, we discovered the burden of proof was impossible to meet (if ignoring our total losses, both of us first time dealing with a "Financial Advisor"). Compliance Officers (they came and went) were uncooperative, dealer leadership mute, IIROC and OBSI disingenuous, legal options out of reach. Based on all their long-awaited responses, the reality we were hit with is that a "Financial Advisor" (an egregiously misleading title) is essentially free and clear to spin virtually any yarn they please. First to the investor, then to the Compliance Officer (in our case with), then to IIROC and OBSI. "It all comes down to the account application form", they all say. If it's filled out "properly" and signed by the unsuspecting victim, well then, that victim is just plain out of luck. And so we welcome this opportunity to add ours to the multitude of voices of small invest

We support the OSC and all organizations, groups and individuals who strive, with active persistence and in collaboration, to remake the Canadian financial industry into a source of best practices, admiration and pride in the unfolding world community. This path can only begin with what most people already assume - a Fiduciary/Best Interest Duty Standard. The profession (on par with medicine and law) is capable of doing both much good and much harm - people's livelihoods and lives are at stake! The client's interest must come first, must be paramount, and must be free of conflicts of interest!"

SEGREGATED FUNDS AND WHY SMALL INVESTORS SHOULD AVOID THEM

Segregated Funds cut the risk -- but at one heck of a price

Segregated funds (or Seg funds) are designed to attract risk adverse investors. Most Seg funds come with two basic forms of guarantees. One is a death benefit, so if you die within 10 (or 15) years of putting your money in, your heirs will get some or all of it back. The other is a maturity guarantee: If you hold your money in the fund for 10 years and the portfolio goes down, you get at least a partial refund. If you take it out earlier, the guarantee is voided. A fee is usually charged to close a Seg fund investment.

The actual insurance contract is complex. So read it carefully and ask questions before you invest.

There's another side to Seg funds that helps to attract more than just those small investors who don't want to lose any capital. Because Seg funds are insurance contracts, they have unique legal status that mutual funds don't. For example, in most cases they cannot be claimed by creditors -- which makes them appealing to self-employed people like doctors who want to protect their assets in the case of a lawsuit. They're also exempt from probate fees, the taxes imposed when you die and your will is executed.

Segregated funds are one of the most expensive investment products you can buy, making them a luxury many investors can't afford - and probably don't need. For the insurance companies and mutual fund managers who run them, Seg funds represent a lucrative piece of business. But for investors, there's a cost for peace of mind -- and in the case of Seg funds, it has become so high that they probably aren't worth the money for most retail investor Canadians with fairly simple investment needs.

So is the guarantee worth the extra cost? That depends on whether you think stocks will drop over a 10 or 15-year period. History suggests the odds are low.

Fortunately, someone has done the research on exactly how much the insurance part of a Seg fund should cost. Moshe Milevsky, a finance professor at York University's Schulich School of Business, crunched the numbers using statistical models developed for options and determined that a fair price for a 10-year guarantee on an equity growth fund is an extra 0.45 percentage points in fees, or $45 a year on a $10,000 investment. Any more and you're probably getting ripped off; any less and you're getting a good deal.

For funds that hold bonds, the guarantee is worth a lot less, naturally, since the odds that a portfolio of bonds will lose money over 10 years is much lower than for stocks. An investor should pay no more than $13 extra per year on that $10,000 investment for a balanced fund, Mr. Milevsky says, and just $2 (or 0.02 percentage points) for a pure bond fund.

How can insurance and fund companies get away with charging so much more than the mathematical fair value of the guarantees? The more opaque the product, the easier it is to charge more than it's worth. The average Canadian has a difficult time calculating the fair price of an insurance product; the challenge is even greater when the cost of the insurance is buried into one larger number: the MER.

Here are some questions to ask your representative before making a purchase:

- What guarantees does this product offer?
- What fees will apply?
- Could these fees rise? If they do, what are my rights? (Don’t forget that you must usually hold the investment at least 10 years to take advantage of certain benefits.)
- What happens if I have a complaint?
- What happens if the insurance company becomes insolvent?

For further reading:

Quebec Securities regulator Guide to Seg Funds
https://www.lautorite.qc.ca/en/segregated-fund.html

DO BANKS DEAL FAIRLY, HONESTLY AND IN GOOD FAITH OR ARE THEY BANKSTERS

Janet McFarland wrote an excellent article in the Globe and Mail exposing that major banks and fund companies have been cheating clients for over a decade by overcharging fees. The firms agreed to repay millions of dollars to several hundred thousand investors. The amounts were apparently not life altering but clearly illustrate the industry's cavalier attitude towards investors savings and wellbeing.

Fraud and wrongdoing are systemic and continue for years before regulators take action. Why?

CIBC divisions reach deal with OSC over excess client fees

JANET MCFARLAND
The Globe and Mail
Published Tuesday, Oct. 25, 2016 5:41PM EDT

Three divisions of Canadian Imperial Bank of Commerce have reached a settlement deal with the Ontario Securities Commission after revealing they overcharged fees to clients for up to 14 years.

The allegations, revealed Tuesday by the Ontario Securities Commission, involve CIBC World Markets, CIBC Investor Services Inc. and CIBC Securities Inc.

The OSC said some CIBC clients with fee-based accounts paid excess fees for certain mutual funds, structured notes, exchange-traded funds and closed-end funds as far back as 2002, because various products with embedded fees were included in the calculations of their overall account management fees. The result was that the clients paid double fees for the investments.

An OSC statement of allegations said some clients were also not advised they met the minimum investment thresholds to qualify for lower-cost mutual funds within the same class, and instead were sold funds with higher management expense ratios. The OSC said the problem stretched back to August, 2006.

CIBC self-reported the errors to commission staff, the OSC said, and intends to pay compensation to clients and correct weaknesses in internal controls.

The commission did not reveal the amount clients were overcharged. It will hold a hearing Oct. 28 to approve a settlement in the case, but terms of the deal will not be disclosed until it is approved.

CIBC is the latest in a string of investment firms to face an OSC hearing for overcharging clients on mutual fund or account fees.

In July, three Bank of Nova Scotia divisions agreed to pay $20-million to compensate almost 46,000 clients who overpaid for investments back to 2009. Mutual fund giant CI Investments Inc. reached a deal in February to return $156-million to 360,000 clients who bought mutual funds over a five-year period when the company failed to detect errors in calculating fund valuations. In 2014, three *subsidiaries of Toronto-Dominion Bank agreed to repay $13.5-million to clients who were overcharged fees.*

AN ASTUTE COMMENT ON REGULTORS – IN A NUTSHELL

"What is the point of all these rules if they are never enforced? No contest settlement agreements relegate breaches of standards of conduct to that of administrative errors. A best interest standard is only valid if it can indeed be enforced and if firms and advisors can be held accountable for breaches of the standard. Under the no contest settlement, firms are not even being held accountable to the current lower standards of care, and these are actions occasioned by the OSC, a Sec Com that believes current rules are inadequate. It makes no sense! "

SPOTLIGHT ON NICOLE McINTYRE'S FILM "INVESTOR BEWARE"

Nicole McIntyre is a student in her sophomore year at Texas Tech University in Lubbock, Texas. She was born and raised in sunny El Paso, Texas. She is currently working on a double major in English Literature and Technical Communications. She aspires to pursue her studies right through to graduate school. She loves to write and script, and so one of her favourite passions and hobbies is video making.

In her pursuance of online video opportunities, she noticed the SIPA Investor Be Aware Video Contest. http://sipa.ca/contest/contest.html
She shared that she wanted to get involved right away. Coming up with a creative idea for her video submission she explained was challenging. She did not know much about the topic so she actively started researching and learning everything she could about the investment industry. It took time and hard work but gradually her ideas began to gel together and it became easier for her to envision how to best bring her video to life. She engaged the help of her good friend, Matthew Cubillos, as her on-camera co-star, and they set to work filming outside at their university campus. She shared with SIPA that they had a lot of fun dressing up and creating their video.

Nicole's desire is that her video would provide viewers with a fun and engaging way to learn a little something about the dangers investors might face when dealing with the financial industry. Her film takes advantage of the literary use of anthropomorphism by ascribing human traits, emotions and intentions to both her trusting sheep investor and the wily wolf advisor. A commission-based advisor (Dealing Representative a.k.a. salesperson) is incentivized to sell you the highest-commission investment product that will generate the most fees for his employer and the highest payout for him. Investors need to understand that fees and expenses reduce their overall returns. Over the course of a lifetime of investing this can really add up and detract from your savings and ultimately your goals. You want to buy the lowest-fee investment product that will generate the highest expected returns that is right for your unique situation.

Nicole's film points out that it's critical for investors to understand their goals and the interests of their financial advisor may not necessarily be aligned. With only a suitability obligation in place,

investors best interests may not be forefront and therefore a position of Caveat-Emptor or buyer beware is required. The Small Investor Protection Association recommends that investors look for financial advice from someone who is willing to sign the Fiduciary Oath. Read our position here.
http://www.sipa.ca/fiduciaryOath.html
You can download a copy of the form to bring to your advisor from our website.
http://www.sipa.ca/Fiduciary%20Oath%202015.pdf

Nicole shares "If SIPA held a follow-up video contest, I would not hesitate in joining! I learned a lot, both about investment and even about my hobby-- video-making!" Enjoy Nicole's "Investor Beware" video here https://www.youtube.com/watch?v=e-FJ9AhQPUc and take time to view all six of our contest's winning films here http://sipa.ca/contest/contestWinners.html

THE TOP 3 WAYS TO AVOID FRAUD

August 26, 2016 by Jennifer Leach
Assistant Director, Division of Consumer and Business Education

In pretty much every article and blog post we put out, you'll find tips to help you avoid scams. The idea is that, if you can spot a scam, and know how to avoid it, you and your money are more likely to stay together.

Today, we're releasing a brochure that distills those tips down to the top 10 ways to avoid fraud. This brochure – available online and in print – is your one-stop resource to help you spot imposters, know what to do about robocalls, and how to check out a scammer's claims.
Here are three things that can help you avoid scammers who try to call you:

1. **Hang up on robocalls**. If you pick up the phone and hear a recorded sales pitch, hang up and report it to the FTC. These calls are illegal. And plentiful. Don't press 1, 2 or any number to get off a list or speak to a person. That just means you'll get even more calls.
2. **Don't trust your caller ID**. Scammers can make caller ID look like anyone is calling: the IRS, a business or government office…even your own phone number. If they tell you to pay money for any reason, or ask for your financial account numbers, hang up. If you think the caller might be legitimate, call back to a number you know is genuine – not the number the caller gave you.
3. **Talk to someone**. Before you give up money or information, talk to someone you trust. Scammers want you to make decisions in a hurry. Slow down, check out the story, search online – or just tell a friend. We find that people who talk to someone – anyone – are much less likely to fall for a scam.

https://www.consumer.ftc.gov/blog/top-three-ways-avoid-fraud

Thanks to Julia for her incredible letter and thank you for reading the Sentinel. Send us your suggestions or thoughts. We like to hear from you. If you have a story to share send it to SIPA. It can be posted with or without your name … as you prefer. We do not disclose names without prior approval.