FAIR | Canadian Foundation for Advancement of Investor Rights

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TACD Resolution on Financial Services Regulation

TACD has issued a **resolution** calling on the EU and the US government to act swiftly to re-regulate the financial services industry in order to ensure that consumers are adequately protected and that future crises are

Leveraged and Inverse ETF Update: A Few Steps Forward - Much Remains to be Done

FAIR Canada published a report on May 14, 2009 entitled "Heads You Lose, Tails You Lose: The Strange Case of Leveraged ETFs". Since then there have been a number of encouraging developments:

(1) The self-regulatory organizations, IIROC in Canada and FINRA in the U.S., have issued notices to their members alerting them to the dangers of these products, and reminding members of their due diligence and suitability obligations to their customers.

(2) The financial press has covered the issue extensively and seems interested in follow-ups.

(3) Morningstar, index investing pioneer John Bogle and other observers continue to issue reports educating the financial industry, regulators and hopefully retail investors about the products.

(4) Prospectus disclosure is slowly improving in both Canada and the U.S.

However, much remains to be done.

(1) Prospectus disclosure for leveraged, inverse and commodity ETFs needs to be further improved to meet the standard of "full, true and plain" disclosure. Listing every risk factor in technical language requiring a law degree and CFA designation to understand does not meet the statutory disclosure requirement. The prospectus should state in plain language that these are day trading products for sophisticated investors and that they do not correlate with the relevant index or commodity over periods longer than a day.

(2) Improved prospectus disclosure is not enough - most investors

avoided.

The **Transatlantic Consumer Dialogue** **TACD** is a forum of US and EU consumer organisations which develops and agrees on joint consumer policy recommendations to the US government and European Union to promote the consumer interest in EU and US policy making.

US Reform Initatives to Protect Consumers and Investors

The Obama Administration's **White Paper on Financial Regulatory Reform** (summary here) would require all financial product advertising and other communications to be "balanced in their presentation of benefits, and clear and conspicuous in their identification of costs, penalties, and risks." The proposed Consumer Financial Protection Agency would define standards for "plain vanilla" financial products and require all financial service providers to offer these products prominently. The White Paper also proposed imposing fiduciary responsibilities on all managers, advisors

do not read the prospectus. Regulators need to enforce prohibitions on misleading disclosure in advertising and marketing. Advertising should not imply that these are products suitable for most retail investors (including suggestions that they are suitable for RRSPs and TFSAs). We need warnings on advertising for leveraged ETFs; for example, pop-up risk descriptions in plain language on web sites and for customers buying them from on-line brokers.

(3) Regulators and the financial industry need to rethink how to regulate exotic derivative based products - whether leveraged and inverse ETFs, structured closed-end funds, Asset Backed Commercial Paper (ABCP) or others. Any product that holds complicated derivatives should be regulated more tightly. These very different products should be identified by a different name. Standard ETFs hold shares or bonds. Leveraged, inverse and commodity ETFs hold cash and derivative contracts. FAIR Canada suggests calling them Listed Derivative Products, LDPs. Regulators might consider whether specific risk disclosure with signed customer acknowledgement of risks should be required, as with options and futures contracts.

(4) The TSX, the financial press and others need to take a more critical view of these products with the goal of protecting individual investors, even if the manufacturers of these products are major clients.

FAIR Canada calls for the Canadian Securities Regulators to Step Up

Canadians need the statutory regulators to act decisively to protect investors. The provincial securities commissions are responsible for supervising the issuers of leveraged and inverse ETFs. The statutory regulators set prospectus disclosure standards and review prospectuses for compliance with those standards. They also establish the rules governing advertising of leveraged, inverse and commodity ETFs.

Some specific steps for the Canadian regulators to consider:

(1) Insist on better plain language prospectus disclosure of risks and of how these exotic ETFs work.

(2) Implement risk disclosure and acknowledgment requirements for any retail investor who wishes to trade these products.

(3) Issue specific guidance on advertising and require warnings on both advertising materials and websites. Enforce restrictions on misleading advertising through disciplinary proceedings.

and salespeople of investment products, and addressing conflicts of interest caused by compensation practices.

The proposals have to overcome resistance from the financial services industry, deal with the overlap with other agencies (notably the SEC), and make their way through the convoluted U.S. legislative process. Still, there is a refreshing new pro-consumer and investor wind blowing from south of the border. FAIR Canada hopes that some of these ideas gain traction in Canada.

Regulators call for investor comments about Point of Sale material

The **Canadian Securities Administrators** "particularly seek feedback from investors" to their latest notice about **Point of Sale disclosure** for mutual funds.

This 10-year quest to implement a simple two-page funds facts to be given to investors when they purchase mutual funds is nearing

(4) Undertake research into all of the issues posed by leveraged, inverse and commodity ETFs, as well as other structured products which hold derivatives. This study should not be a substitute for steps 1 through 3.

Urgent action to protect investors is needed now.

Click here to read full report - The Strange Case of Leveraged and Inverse ETFs, Part 2: A Few Steps Forward; Much Remains to be Done

FAIR Canada will be welcoming new Associate Director - Ilana Singer

Ilana Singer is a seasoned securities regulator and lawyer, with close to eight years of experience with the Ontario Securities Commission. In her most recent role as Senior Advisor, International Affairs, Ilana focused on shareholder and investor rights from a global perspective. Ilana's deep understanding of securities markets and regulation stems from her domestic and international work at the OSC, as well as her experience as a corporate and securities lawyer at McMillan LLP.

At the OSC, Ilana led the International Monetary Fund's assessment of the securities regulatory framework in Ontario and, as the principal liaison within the OSC on international matters, routinely advised the OSC Chair and Vice-Chairs on areas of international interest. One of Ilana's key projects was the corporate governance report for the International Organization of Securities Commissions (IOSCO). That IOSCO report focuses on the rights of minority shareholders in listed issuers.

As a lawyer in the OSC's Corporate Finance Branch, Ilana co-led the development and drafting of National Policy 41-201 Income Trusts and Other Indirect Offerings, and worked on a number of other significant projects and transactions, including the national prospectus instrument.

Ilana is fluent in French, Spanish and Hebrew, and is a member of the Association Internationale des Jeunes Avocats (AIJA). Ilana co-chaired the first AIJA international business trusts conference and is a program leader with the Toronto Centre: Leadership in Financial Supervision. Ilana is also an avid cyclist, swimmer, and triathlete.

Ilana completed her undergraduate studies at Queen's University, and obtained her law degree from the University of Toronto.

Ilana will start with FAIR Canada on August 11, 2009.

its conclusion. The first 8 pages of the 161-page document contain the summary.

Submissions are due by October 17, 2009.

Note that in the last round there were 46 submissions: 44 from the financial services industry and two from investor advocates.

FAIR Canada supports this initiative as long as adequate safeguards are maintained. See our response to the last call for comments here.

Public Consultation regarding Indemnity Fund and the Coalition for the Protection of Investors

The (Quebec) Coalition for the Protection of Investors, with the support of FAIR Canada is sponsoring a Consultation to determine what investors think about this new fund for the protection against fiduciary fraud and negligence.

For the more details, click here (French copy). This article is first of a dozen articles inviting readers to react to/comment on the idea of creating a fund to protect individual investors in case of financial fraud.