

FAIR

Canadian Foundation *for*
Advancement *of* Investor Rights

Newsletter
October/November 2009

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**Save the Date -
March 25, 2010**

FAIR Canada and the Hennick Centre for Business and Law are holding a joint one-day conference about the client/advisor relationship on

Contracts for Difference: Gambling for Retail Investors

The lead story for this month's FAIR Canada newsletter is our [submission](#) to the CSA on the mutual fund point of sale initiative. However, the announcement of the introduction of a new form of gambling for retail investors prompted us to lead with a comment on CFDs.



FAIR Canada applauds the OSC on the concerns for investor protection expressed in the Staff Notice about [Contracts for Difference \(CFDs\)](#) and foreign exchange (forex) contracts. Enforcing plain language risk disclosure, minimum margin requirements, "know your client" and suitability rules are necessary protections that should also be extended to other complex and high fee products. However, FAIR Canada is concerned that the OSC approved these products (and last year's SPACs/"blind pool" IPOs) without public consultation or consulting retail investors and other affected parties. FAIR Canada strongly believes that the introduction of new speculative products targeted to retail investors (like CFDs and last year's SPACs) require full public consultation and a public examination of their costs and benefits.

OSC Staff Notice and CMC Markets Exemption

The OSC issued a [Staff Notice](#) on October 30, 2009 providing guidance on regulatory requirements for offerings of Contracts for Difference (CFDs), foreign exchange (forex) contracts and other similar products. The issuance of the Staff Notice follows an [announcement](#) on October 26, 2009 by CMC Markets Canada (CMC Markets) that the OSC has approved the offering of CFDs to retail investors. This follows an earlier decision of the AMF in Quebec to permit the sale of CFDs to retail investors.

Thursday, March 25, 2010.

Entitled "**The Fiduciary Standard and Beyond: Rethinking the Financial Advisor-Client Relationship,**"

the conference will inform participants and stimulate discussion about relevant policy initiatives in Canada.

Watch for further information regarding this event.

FAIR Canada's Ilana Singer in Le Devoir - October 18

Ilana Singer recently visited Montreal to meet with several advocacy groups (such as MEDAC) and the media. FAIR Canada was featured in the Business Section of the [October 18th edition of Le Devoir](#).

Financial expert talks about the 'big picture' in Globe Investor - Me and My Money

In a recent Globe Investor entry ([October 9, 2009](#)),

The OSC Staff Notice states that staff are of the view (correctly, we believe) that CFDs are subject to regulation under Ontario securities law. The Notice also identifies significant investor protection concerns raised by the offering of CFDs to retail investors. The OSC's response to these concerns is to require that firms that offer CFDs be registered under securities legislation and be members of IIROC. Requiring firms offering CFDs to be IIROC members goes some way towards addressing investor protection concerns as IIROC imposes rules for minimum margin, "know your client" (KYC) and "suitability." IIROC also expects its members offering CFDs to:

1. Provide retail investors with risk disclosure documents;
2. Assess the investment knowledge and experience of the client; and
3. Set cumulative loss limits for each client account.

The OSC will exempt firms issuing CFDs from prospectus requirements if they follow the requirements to be IIROC members and provide a plain language risk disclosure statement to retail clients.

The OSC response to the serious investor protection concerns raised by CFDs is an appropriate regulatory response. In fact, we recommend that the OSC consider extending the model to other high risk derivative products like leveraged, inverse and commodity ETFs.

The model for high risk derivative products would include:

1. **Mandating IIROC membership which brings with it additional regulatory requirements, including regulation of advertising and marketing, and IIROC oversight;**
2. **Plain language risk disclosure statements;**
3. **Assessment of the investment knowledge and trading experience of the investor; and**
4. **Suitability obligation or client signed waiver of "suitability."**

While the OSC response to CFDs has a number of positive aspects it does raise some concerns about transparency and process. It also raises questions of investor protection and the public interest.

Transparency and Process Demand Public Consultation

The OSC has been considering the application of CMC Markets and the issue of CFDs for three years. The Staff Notice makes it clear that the exemption granted to CMC Markets and the regulation of CFDs is a decision of general application. Why did the OSC not publish its proposed ruling and staff policy decision for public consultation? The issue has been under consideration for several

Donald Dony, principal of the financial advisory firm, D.W. Dony and Associates Inc., and author of the Technical Speculator is featured.

He describes his worst move as when he held the Horizon BetaPro S&P/TSX Double-Bear ETF too long in 2008, realizing too late that this leveraged ETF does not track the underlying index very well for periods longer than a day.

If industry experts are confused by leveraged ETFs why don't securities commissions require better investor protection?

FAIR Commends SIPA for their Point of Sale submission

In preparing our comment letter to the CSA on the Point of Sale Initiative, we reviewed the letter submitted by the Small Investor Protection Association (SIPA), dated August 26, 2009. The SIPA submission was well researched and written and we recommend that the CSA give serious consideration to its

years so time was not a critical issue. There is really no substantive difference between the CMC Markets exemption and the related Staff Notice and a "rule" or "policy." Had the OSC issued a "rule" or "policy" it would have been required to publish the proposed rule or policy for public comment. The consultation paper would have articulated the issues and the costs and benefits of the proposed "rule" or "policy."

In making the decision on regulation of CFDs, forex and similar products, the OSC had the benefit of submissions from CMC Markets. No doubt the OSC privately consulted stakeholders and clearly involved IIROC in the process.

Retail investors and the general public were not consulted. Clearly retail investors and the public concerns about the introduction of highly leveraged, highly speculative products for sale to retail investors.

CFDs are really a form of gambling. Margin requirements are generally set between 1% and 10%. An investor can lose much more than 100% of his investment. Even with the application of IIROC's stricter margin requirements a retail investor can potentially lose much more than 100% of the initial investment. Retail investors may be better off going to Casino Rama than trading CFDs. At Casino Rama they can only lose 100%.

The OSC appears to have taken the position that it will allow virtually any product to be sold to retail investors, without considering whether the introduction of the product is consistent with its investor protection mandate and in the public interest. Last year the OSC approved the introduction of SPACs or "blank cheque" IPOs (which had been prohibited by the OSC for decades), again without public consultation.

If the capital markets are being expanded to include gaming and if the OSC is expanding its remit to be a securities and gaming regulator perhaps the public should be consulted. We urge the OSC to correct the lack of transparency and the process concerns by conducting a public consultation on CFDs. The OSC might also consider a public consultation on "blank cheque" IPOs where it might articulate why it reversed the decades old OSC policy not to permit "blank cheque" IPOs.

Click here to read the related [Globe and Mail article](#) from October 25, 2009.

FAIR Canada calls for improvements to CSA Point of Sale Initiative

FAIR Canada recently submitted its comments to the Canadian

recommendations. We agree with the SIPA submission on many points.

[Click here](#) to read the SIPA submission.

BC Securities Commission Capital Ideas 2009 Conference

FAIR Canada Board member Neil de Gelder and Associate Director Steve Garmaise met with five senior officials of the BC Securities Commission led by [newly appointed](#) Chair and CEO Brenda Leong following the BCSC's half-day [Capital Ideas 2009](#) Conference on October 20, 2009.

[Click here](#) for full report.

Business Press Warns about High Fee Products

Two recent newspaper articles warned about the harm to investor portfolios caused by complex or high fee products.

Securities Administrators (CSA) on proposed amendments to the mutual fund point of sale initiative (POS).

FAIR Canada expressed strong support for the CSA's goal to provide investors with clear, meaningful and simplified information when mutual funds are sold to retail investors. However, FAIR Canada noted serious concerns about certain aspects of the proposal.

Proposed "Cancellation Right" is a Reduction in Investor Rights

Under the CSA's proposed and misnamed "cancellation right," investors are losing their existing statutory right of withdrawal (i.e. the ability to cancel a mutual fund purchase within two days of receipt of the prospectus). That right is being replaced by a reduced cancellation right, where a consumer is left with less than his or her original investment if the value of the mutual fund investment has fallen in the intervening 1-2 days. This is at odds with the goal of improving investor protection and with the general approach of consumer protection legislation where consumers have straightforward cancellation rights for up to ten days.

"Even though there were no problems with existing withdrawal rights, the CSA is proposing a novel form of "cooling off" period where investors are exposed to downside risk if the mutual fund goes down in value but do not profit when the mutual fund goes up in value," said Ermanno Pascutto, Executive Director of FAIR Canada.

Under the existing withdrawal right, a retail investor who decides to cancel a mutual fund purchase of \$100,000 within 1-2 days would simply get back the \$100,000 investment. Under the CSA's proposed cancellation right, if the mutual fund drops by 2% in value, the investor gets back \$98,000 and loses \$2,000. On the other hand, if the mutual fund goes up 2% in value and the investment is valued at \$102,000, the investor only gets the original \$100,000 returned.

"Where does the \$2,000 profit go and why is the CSA not making it clear where the profit will go?" asked Ermanno Pascutto. "The profit is not going to the investor. Is it going to the mutual fund manager or the salesman who sold the investment that the investor considered inappropriate? We are puzzled about why regulators whose mission is investor protection would reduce existing investor rights and create this asymmetric cancellation right: where the investor can lose but cannot win."

[Click here](#) to read the full FAIR Canada press release and submission to the CSA.

Jonathan Chevreau, personal finance columnist for the Financial Post, wrote ([October 24, 2009](#)) about the poor track record of Labour Sponsored Investment Funds (LSIFs).

LSIF returns have been very weak, many have suspended redemptions - yet their average MER (fee) is 5.5%!

John Heinzl called one of his Investor Clinic columns in the Globe and Mail ([October 28, 2009](#)) "How to Protect Yourself from PPNs." Principal-Protected Notes seek to appeal to retail investors by combining the possibility of high market returns with the security of guaranteeing their original investment after a number of years.

Such a combination comes at a high price - PPNs typically charge management fees of 3% to 5%, are often sold with upfront loads or deferred charges, and use hard to understand options and derivatives.

FAIR Canada Participates in International Securities Regulation Conference

FAIR Canada was invited to participate in the International Organization of Securities Commissions (IOSCO) annual conference from October 7 to 9 in Basel, Switzerland. The conference was organized by IOSCO's Technical Committee (TC). The TC is composed of the eighteen largest capital markets worldwide, including the US SEC and the UK FSA. Associate Director Ilana Singer represented FAIR Canada at the conference. A number of current issues impacting on retail investor and shareholder rights were discussed, including complex products and dark pools.

Ms. Singer was invited to participate in IOSCO's Dialogue with Stakeholders. This was the first time that a non-institutional shareholder group was invited to attend the meeting. In the context of a discussion about suitability, Ms. Singer made a number of comments about ensuring that the advertising and marketing of structured products remain accurate and balanced. Meeting participants included representatives from the Managed Funds Association and the International Investment Funds Association. The experience at IOSCO's Dialogue with Stakeholders provided FAIR Canada with a unique opportunity to participate internationally in the securities regulatory debate.

[Click here](#) to read full story.

FAIR Canada and CCGG Host French Corporate Governance Expert

FAIR Canada and the Canadian Coalition for Good Governance (CCGG) hosted Mr. Jean-Aymon Massie (photo - seated), President of the **French Association of Corporate Governance** (the Association) in Toronto on September 18. The Association promotes the exchange of information among institutional, retail and employee shareholders. Its areas of focus include: corporate governance, ethics, and sustainable development. The Association's thirteen-member board includes individuals with legal, engineering, banking, investor relations and economic backgrounds.

During the meeting, Mr. Massie presented the most recent [newsletter of the Association](#), which calls for shareholders to take on the role of private regulators. Mr. Massie noted that

governments and regulators did not do enough to prevent the recent financial crisis, and that shareholders should audit regulators and advocate for better corporate governance.

This audit could be undertaken by institutional shareholders, or by organizations with an interest in the area of shareholder proposals and voting. Examples include ISS-Metrics, Ethos, and Manifest.

Attendees at the presentation included Ermanno Pascutto and Stephen Griggs, Executive Directors of FAIR Canada and the CCGG, respectively. Representatives from the boards and senior staff of Fair Canada and the CCGG were also in attendance, as well as representatives from the Ontario Teacher's Pension Plan, the Canada Pension Plan Investment Board, the Investment Industry Regulatory Organization of Canada, the Ontario Municipal Employees Retirement System and the OPSEU Pension Trust.

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