

Kenmar Associates
Investor protection and education

George Bentley
Communications and Consultations Manager
Expert Panel on Securities Regulation
Ottawa, Ontario
K1A 0G5
Tel: 613-947-8613
Fax: 613-947-2289
Commscons@expertpanel.ca

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Submission regarding required changes in securities regulation

".. Mr. Diekmeyer, 73, says he lost \$800,000 - his life's savings - when Bre-X collapsed. He also saw his personal friend and stock broker kill himself in 1997, riddled with guilt about his clients' losses. "I survived with great difficulty and a friend of mine committed suicide over it," says Mr. Diekmeyer, who lives in a modest apartment in Beaconsfield, west of Montreal. "I only know this story. I'm fairly certain there are others that are equally disastrous..."

Source: J. McFarland, *No winners in this case*, Globe and Mail, Aug. 2, 2007

[John Felderhof, the former vice chairman and Chief geologist of Bre-X, the gold company rocked by a scandal that wiped out billions of investor dollars almost 10 years ago, had been accused by the Commission of selling \$84 million worth of stock between April and October 1996, while having material information not disclosed to investors. Felderhof was acquitted on July on 8 counts of illegal insider trading and authorizing misleading news releases 7 years after his lengthy trial began. During the trial, the court heard extensive testimony that Felderhof ignored nearly two dozen signs that the amount of gold at Busang, Indonesia was insignificant. The OSC did not appeal the ruling, so in the end no one was held accountable but small investors pain will continue for decades]

Of course there's also Nortel, Norbourg, YBM, Portus, and business income trusts. And let's not forget the great mutual fund market timing scandal, FMF and, Atlas Cold Storage. More recently we've heard about Hollinger, Livent and the disastrous ABCP fiasco. Some estimates have estimated the cost to investors at about \$20 billion p.a. All of this financial assault is taking a horrible toll on the financial and emotional health of Canadian citizens,

Kenmar welcomes the opportunity to make our views known. We would like to focus on the human impact of weak regulatory enforcement as many other submissions will no doubt cover the many well-known deficiencies of Canada's dysfunctional approach to securities regulation

By way of introduction, Kenmar is an Ontario-based organization focused on mutual fund investor education via on-line papers hosted at www.canadianfundwatch.com.

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Kenmar also publishes *the Fund OBSERVER* on a monthly basis discussing investor protection issues primarily for mutual fund investors. An affiliate, Portfolio Analytics, assists abused investors and/or their counsel in filing investor restitution claims.

There is a pressing need for dramatically improved regulatory enforcement.

Take these two examples:

1. A woman in her early seventies had been sold some internet infrastructure and e-business technology funds in 1999. The salesman had befriended her while she was recovering in hospital from heart attack. Within the year, the funds were down 85% and most of her life's savings with them. When she found out, she had a relapse. She was dead within a month.

2. An engineer in his fifties was on a five-year assignment in Africa assisting local authorities develop a mine. His trusted adviser back in Montréal was sent the tax-free earnings and given the authority to invest in conservative securities. When he returned, his \$1.5 million had been melted down to \$146,000. He ended up getting divorced and suffered from depression for the rest of his life. He was never able to trust anyone again. He died a broken man existing month –to–month in a tiny one-room apartment.

Financial assault is an adverse life- altering event. The loss of one's nest egg is a shock that leaves many small investors stunned and immobilized. For seniors and retirees the loss is irrecoverable as time is not on their side. The real negative impact is the physical and emotional collateral damage that white collar crime causes.

Some examples from a variety of interviews, media reports and victim impact statements:

- ?? One man, who lost \$400,000, had to return to work at age 72 to a physically demanding job working the night shift.
- ?? "I believe my first reactions were shock, disbelief and denial, followed by rage, resentment, guilt and then utter depression," one elderly woman observed.
- ?? One man, who lost his life savings of \$175,000, said his golden years are shattered. "It hurts to look at your wife and tell her that we cannot afford to do much but sit around and wait for the end of our lives."
- ?? Several experienced nervous breakdowns and chronic illness since losing their nest eggs

On July 6, 2006 Madam Justice Petra Newton sentenced the 63-year-old swindler, Earl Crackower, a former financial planner at Toronto-based Worldsource Financial Management Inc., to a 5-year term behind bars and ordered him to pay \$3.4 million in restitution to 43 former clients and their families. "Your conduct deprived these people of dignity and respect and the ability to care for their families and themselves in their sunset years." Crown attorney Donna Gillespie told the court that the veteran financial planner artfully manipulated and plotted "the financial, emotional and physical destruction" of his clients, including many elderly women, from 1989 to 2003, Newton told a packed

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courtroom filled with seniors. Besides losing their life's savings, how were the victims affected by this life-altering event?

- ?? Adversely impacted their health and accelerated their ageing
- ?? Eliminated their capacity to trust other people
- ?? Destroyed their sense of self- respect and their dignity
- ?? Created a sense of hopelessness -an abyss of shame and self-doubt
- ?? Paved the road for many of them to near destitution.
- ?? Caused terrible stress within families
- ?? Caused them to have to get part-time jobs to help make up for the losses, despite their ill-health
- ?? Made it impossible to ever buy any gifts for their grandchildren –living with a broken heart
- ?? Destroyed any hope of leaving a legacy to family members

In other cases we've also heard of marital breakdown, severe emotional distress, nervous breakdowns, heart attacks, drug over-dose and even suicide.

The pain is amplified should a determined investor seek to obtain restitution.

"I don't know if I'll ever be able to recover my life after losing \$800,000. I feel I have been living in hell for the last few years. The determined defense of the firm's ombudsman wore me down emotionally. After 3 years I decided to back out but it has taken a terrible toll on me. I'm now on a permanent pill popping regime to keep me from depression After losing my home and my wife, I now live in a tough neighbourhood and fear for my safety "

The journey to a successful complaint conclusion can be aggravating, time consuming and add stress to an already stressful situation. Restitution claims require diligence, persistence, determination and a thick skin. Investors are made to look stupid or greedy by the financial institution. The case will be drawn out with carefully crafted letters that make abused investors look unreasonable. If the firm drags out the proceedings long enough investors could lose your right to civil litigation thanks to shortened provincial statute of limitation periods introduced in 2004.

Regulators refer retail investors you to the MFDA and IDA. They in turn advise that they may be able to fine or sanction those involved but they can't get people their money back. If civil litigation is attempted, investors can expect to spend thousands of dollars in legal bills with an uncertain result. They can try industry-sponsored and funded OBSI but it's shortcomings are well documented. Assuming all has gone well, a rare event, investors have to sign a settlement release order in order to receive compensation. Part of this may be a " gag" order preventing you from discussing the case or the terms of settlement with anyone else including others damaged by the scam. The entire process is designed to deter claims and frustrate resolution .It thus adds further to the pain and amplifies the anger and despair. No wonder so few bother to complain.

Let's examine the role of provincial securities commissions in dealing with white-collar crime. The provincial securities Acts are regulatory in nature and not penal. The focus of regulatory law is the protection of societal interests, not punishment of an individual's moral faults. The ABCP crisis and the infamous mutual fund market timing cases demonstrates just how ineffective Canadian regulators are in dealing with white collar crime As the Supreme Court has stated: "While criminal offences are usually designed to condemn and punish past inherently wrongful conduct, regulatory measures are generally directed to the prevention of future harm " Their potential sanctions involve fines or orders restricting future activity, such as cease-trade orders or orders prohibiting an individual from serving as a director or officer. Big deal, if you've suffered huge financial losses and your life has been turned upside down. The well publicized plight of retail investors who were sold non-bank ABCP is a small example of a much bigger problem.

Until there is an appropriate response to criminal misconduct in Canada's capital markets i.e. for the federal and provincial governments to treat white collar crime as a criminal, rather than a regulatory problem, and assign to it the high priority and necessary resources which it requires, financial assault will remain unpunished and investors unprotected and uncompensated. Ultimately, these huge losses will result in a burden on taxpayers as retirees and pensioners will need public assistance to survive. As an aside, we mention that a recent academic study found that Canada had the highest mutual fund fees in the world.. Internationally known pension expert Keith Ambachtsheer has estimated that the drain on savings is of the order of \$25 billion p.a. Securities regulation and enforcement is simply too important to be a provincial matter. The job is not getting done.

As a first step we'd suggest the formation of a national Investor Protection Agency, an agency with adequate resources, expertise, critical mass and supporting legislation to enforce securities law nationally. We'd suggest wrapping OBSI into this organization to more effectively and fairly deal with investor restitution. FCAC could be merged into this unit as well to give it a kick-start –its restricted mandate would of course have to be amended dramatically. Professor Stephen Salterio at Queens University has some interesting and practical ideas in this regard..

We add parenthetically that 21st century securities regulation must address complex products like Seg funds, PPN's , MWB's, ABCP and a growing array of structured products. These products originate from multiple sources in the financial services industry. Thus , the definition of "security" needs a new look. It is perhaps this issue which drove Quebec to have a integrated approach to investor protection crossing the banking, investment , mutual fund , hedge fund and insurance industries. It is a model the Panel will likely want to examine .

Summary

Poor regulation and deficient regulatory enforcement is taking a heavy toll on Main Street Canada, financially, physically and emotionally. It cannot go on as the impact gets

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greater each year that regulatory enforcement shows its impotence. Canadian citizen demographics in fact is making a bad situation worse, since seniors robbed of their life's savings cannot recover from these undue losses. Additionally , the rapid decline of defined benefit pension programs means that Canadians retirement is exposed as never before. Investor protection is a fundamental right-it should not be constrained by provincial borders. It is a embarrassment that, other than Bosnia –Herzegovina, Canada is the only country in the world without a national regulator . If retail investors were consulted, there is no doubt in our minds that there would be overwhelming support for a national approach to protecting investors, regardless of province of origin. Until the necessary changes are made, retail investors are exposed to unacceptable risks.

Should you require any additional information, do not hesitate to contact us.

Ken Kivenko P.Eng.
President, Kenmar Associates
2010 Islington Ave., suite 2602
Etobicoke, On M9P3S8
kenkiv@sympatico.ca
(416)-244-5803