



TO BE FAIR

ORGANIZATIONS WITH THE OBJECTIVE OF PROTECTING INVESTOR RIGHTS ARE GROWING IN POPULARITY.

Story by Isabel Bassett

It might have been true a year ago that Canadians were more willing to talk about sex than their finances. After the market collapse last September many preferred to leave their RRSP statements unread — but that's changing. Tax season forced those dusty envelopes open, and yet again people are angry over popular investment products that don't turn out as advertised. But looking for clear answers in impenetrable prospectuses still leaves most investors tongue-tied.

Ermanno Pascutto, Executive Director of the Foundation for the Advancement of Investor Rights (FAIR), is helping Canadians to find their financial voice. And, more importantly, to gain a seat at the table with the regulators. He believes that our regulatory system has fallen behind when compared to international standards, and that investors should be better served.

"The public would be appalled to know the rules are being set with no input from investors — they're excluded. The Ontario Securities Commission has Bay Street investment bankers and investment lawyers and so on. We've called for one qualified individual to sit on the Commission to represent retail investors. So far the idea has been rejected."

This will not deter Pascutto, a lawyer and former Executive Director of the OSC himself in the 1980's. He left Canada in 1989 to become Vice-Chair of the new Hong Kong Securities and Futures Commission, where he developed the idea for Chinese state enterprises to be listed on the Hong Kong Exchange, now called H-shares. From there he was invited to help develop the Dubai International Financial Centre.

"When I left, I really thought Canada was the world's leading securities jurisdiction in terms of standards and regulation. When I came back in 1999, I began investing my own money for the first time, and I regularly saw transactions that would never pass muster in Hong Kong," he explains.

He was surprised to see how easily energy companies listed on the

TSX were able to do frequent, highly discounted private placements of shares that were "massively dilutive" to common shareholders — without being challenged by regulators.

This motivated Pascutto to begin questioning Canadian regulators. He was eventually invited to be an independent director of what was then Market Regulation Services (now the Investment Industry Regulatory Organization of Canada). "I had a Khrushchev moment, you know, pounding the table with my shoe. I said, 'If you really want to do something, fund an organization that will speak on behalf of Canadian investors, because they don't have a voice in this country.'"

After two years of planning, Pascutto established FAIR in June 2008 with \$3.75 million in funding from IIROC. Osgoode Hall provided office space at York University, and a heavy-hitting Board of Directors was brought together. "We wanted FAIR to have credibility with regulators — to look at the people involved and recognize that we know what we're talking about."

"The biggest issue is the conflict of interest at the stock exchange," Pascutto explains. The TSX is a for-profit publicly traded company, as well as a regulator. When other global exchanges like the NYSE, LSE, HKEx and the ASX went public, they all separated regulation from the business side with proper checks and balances. "If we fix that then we will truly have an independent regulator."

Other recommendations listed on FAIR's website (faircanada.ca) are that retail investors need to be represented on the Commission and that "financial literacy" should be made a priority. So far, these are only recommendations — FAIR has no official authority, which makes for an uphill battle. "Regulators are not used to being criticized. Although we are trying to be as constructive as possible, we've had some feedback that we are being too critical!"

Pascutto raises examples of industry practices that are not fair to investors. The first issue is fees — Morningstar rates Canada with an "F" for having the highest fund fees in the 16 countries rated. "Financial advisors are in a conflict of interest — they are motivated to sell the highest fee product," he says.

He also refers to FAIR's report about Leveraged ETFs entitled, "Heads You Lose, Tails You Lose." These are products that allow investors to bet on the direction of commodities and to double the "daily" price performance. Even when you bet correctly, however, you can still lose if you hold them for more than a "daily" trade — the price correlation between each ETF and its underlying commodity breaks down very quickly. FAIR has called for clear warnings to appear on the front page of the prospectuses.

"They are fine products for their short-term purpose — but the real risks are buried in 60 to 70 page documents that retail investors could never understand. Morningstar calls them Portfolio Killers. We just want people to be informed properly."

Steve Garmaise, Associate Director of FAIR, points out that being better informed is also an investor's responsibility. "Most educated Canadians still prefer to hand over their money to financial planners and be done with it. We are trying to encourage consumers to take some responsibility for their own investments, and to learn to evaluate financial risk."

Pascutto is also passionate about education. "Long-term, the single most important thing that can be done to protect investors in this country is promoting financial literacy. We are graduating generations of people who have no idea about financial matters, and also telling them they have to be more responsible for their own financial future — you have to prepare people for that."

Clearly there is still a wide gap between the average educated Canadian's knowledge of financial products and the complicated fine print of risk disclosure. Pascutto says FAIR's recommendations will go a long way towards improving transparency. "We're focused on getting rules changed so that the system operates better for everyone." ■