



**SUBMISSION**

**TO**

**EXPERT PANEL ON SECURITIES REGULATIONS**

**DEPARTMENT OF FINANCE**

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- “Strengthening the legislative and regulatory framework for Securities Regulations in Canada

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The Retired Airline Pilots of Canada (RAPCAN) is a not-for-profit organization formed over many years ago to promote communications, social activities and pension oversight amongst its retiree members who are dependent on the Air Canada Pension Trust Funds for retirement income. RAPCAN currently have over 2500 members, without including spouses and family members.

Many of the RAPCAN members have been retired for many years. The erosion of the value of their financial resources is extremely significant in an age where inflation and cost of living increases over that period of time have had a great effect on an individual's quality of life and financial security.

The requirement to further review and strengthen the Securities Regulations and Enforcement in Canada, as established by the federal Minister of Finance, February 21, 2008, to help ensure financial security, maintenance of quality of life, viability of pension plans, and to promote Canadian's well being, etc. is becoming ever more apparent and critical.

**The need for an effective regulatory system that protects investors grows more urgent each day.** Innocent investors and particularly retirees are losing their life savings faster than most of them realize. The recent trend of replacing defined benefit pension plans with defined contribution pension plans has placed the burden and responsibility to manage one's entire life savings and pension resources on plan members who generally lack the necessary management skills and expertise. This has resulted in an exponential increase in white collar crime, fraud and professional mis-representation. From coast to coast, horror stories are emerging of investors losing their hard-earned savings due to questionable and improper practices within the financial services industry. The Small Investor Protection Association (SIPA) estimates that Canadians lose over \$20 billion due to wrongdoing and fraud every year. The cavalier attitude of the investment industry towards regulations and the savings of investors are to blame for the ABCP crisis and the global repercussions that have negatively affected financial institutions, corporations, pension funds and individual savers.

That calamity exemplifies the issue that Canadian investors face as regulators, lax enforcement and exemption practices fail to protect them. The Institute for International Finance blames the industry and regulators for the ABCP crisis. Under the current system there is virtually no effective means for wronged investors to seek full recourse, short of legal action - which is often a costly and lengthy process. Even the Ombudsman for Banking Services and Investments (OBSI) is funded and created by the industry. In fact OBSI can only make non-binding recommendations, with a \$350,000 limit to the amount of money it can suggest firms pay up. That's if your case is investigated at all!

Last year, OBSI completed 169 investigations, 65 in banking services and 104 in investments. But it was contacted 11,000 times during that same time period. OBSI also refuses to disclose the average amount of compensation it recommends - as well as how many cents on the dollar investors normally receive.

Critics have long called for the creation of an independent adjudicative body or tribunal - a sort of court system for investors.

A contributing factor to the ABCP upset is that commercial paper is an exempt security provided it has an approved credit rating from an approved credit rating agency. Federal and provincial regulators, all deny responsibility, suggesting that investing in Canada is caveat emptor.

Self regulation in the investment industry is a recipe for disaster. Regulatory patchwork over the years has only made the system weaker and totally ineffective in dealing with worldwide transactions that are ever more complex.

The present system is broken beyond repair. Government must institute a national regulator accompanied by state-of-the art enforcement.

The financial industry has created a continuing stream of disasters as a result of the regulatory system's failure to protect investors and enforce regulations. We learned little from the fall of the Atlantic Acceptance Corp. in the mid 1960s, the Confederation Life disaster in the mid 1990s, the Bre-X, scam of the century and now the ABCP crisis. We completely failed the victims and the alleged perpetrators of these nefarious schemes rarely suffer much or go to jail.

Why is nothing happening to correct this situation? For years the possibility of fraud and wrongdoing has been masked by industry and regulators. Self regulation, without control, simply does not work in a complex volatile industry. It is like expecting the unmanageable to keep order in schools and the workplace or suggesting criminals run the justice system because of their experience.

Regulation works only if it has enforcement teeth, public confidence and the respect of Canadians and international investors. In Canada, we have exactly the opposite. Why should we trust financial institutions that do not trust each other?

In the mutual fund market timing scandal, five mutual fund companies were required to pay \$205 million for cheating their investors.

The Investment Dealers Association (IDA) is a self-regulatory body for investment dealers across Canada. Investors legitimately complain that the IDA will not investigate the senior members of its industry. The penalties levied on the perpetrators seem insignificant and the victims do not get their life savings back from IDA enforcement activities.

The IDA has developed a comprehensive "Complaints and Settlements" database. Unfortunately, this information is not available to the public, in spite of an alleged 12 percent of registrants with complaints registered against them.

Competitive forces and the reward system can be counterproductive to the client's best interest in a self-regulated environment. Many industry insiders privately acknowledge that regulatory reform is overdue and that their industry needs better governance from a neutral regulator. They say, "My principles are intact but I worry that the practices of my peers and competitors give us all a bad name."

Not fully knowledgeable about investing, most Canadians must rely upon financial advisors. Regulators register these people as "sales representatives" while the industry provides them with titles of "financial consultant" or "investment advisor." To the unwary it creates the impression that investors are assured of receiving competent, objective advice rather than just buying a product. Could

this explain why so many investors buy unsuitable products such as allegedly deceptive income trusts and corrupted ABCP?

The financial industry is continually inventing new “structured products” to be sold to retail investors. Often these are designed to circumvent regulations. For example because of the degree of risk involved, hedge funds can be sold only to “accredited investors”, that is, individuals with an income of some \$200,000 and assets in excess of \$1 million. Why then have so many small investors and retirees been duped into buying questionable junk instead of the safe low risk securities which they asked for?

Many Canadians are waking up but unfortunately only after they, their family and/or their friends have become victims. In the fall of 2007 the Innovative Research Group study revealed that one million Canadians were victims of investment fraud.

The *Canadian Business* article “A good country for crooks,” by John Gray, September 24, 2007 provides insider police accounts that indicate enforcement is in serious disarray. The police are frustrated by interference and the lack of follow-through by the crown prosecutors and the court system.

The Office of the Superintendent of Financial Institutions, for example, takes the view that its job is to protect the solvency of the banks, which means depositors' money. “But that's a very narrow definition of depositors. They have an obligation to protect the Canadians who buy securities from the bank-controlled investment dealers.”

White-collar crime is engulfing Canada without a fight. Canada's archaic system of 13 regulators is regarded with disdain by our major trading partners. Everybody loses when the national financial infrastructure is weak and faulty. Foreign investors shun Canadian investments or demand a premium for increased risk. Canadians fear investing. Everyone pays for the inefficiency including those who rely on a healthy economy for regular employment. Canadians and our international investors warrant a system that they can trust. Canada needs a national regulator. Alone however, it promises little to deter white-collar crime and the misdeeds of financial institutions (sub-prime and asset-backed commercial paper). Canada must enact enforceable laws that will deter white-collar crime and the perpetration of frauds that embezzle savings from hard-working citizens. Canada needs a system that protects savers, pensioners and the investment industry at large. We need a national securities investigator because Provinces try to befriend firms they're regulating. Canada has an image as a country that is soft on white-collar crime.

We need both a national securities commission with strong enforcement of securities laws and a parallel and independent securities crime police system enforcing securities fraud under the Federal Criminal Code. In order to establish clear lines of responsibility, public accountability and assured compliance with the Charter of Rights and Freedoms, the securities crime police system should not be integrated with the securities regulatory and self-regulatory agencies. Rather the RCMP Integrated Market Enforcement Team must integrate with the municipal and regional police forces for intake and assessment of securities crime complaints and investigations.

All pension funds are exposed to erosion (BreEx, Livent, YBM Magnex, Nortel, , Conrad Black, Heating Oil Partners Income Fund, FMF Capital and 92 other income trust names with severe distribution cuts averaging -60%). No fund is immune to the ABCP caper

Many RRSP, RRIF and other investments are at risk. A poll in November 2007 indicated that 1 million Canadians have been stung by fraudulent investments and misrepresentation. This will undoubtedly increase as innocent victims of ABCP realize they are holding what they thought was secure short term fixed income carrying highest bond ratings.

The breakdown of the \$32 billion asset-backed commercial paper market amounted to a criminal fraud no one in Canada appears prepared to investigate or prosecute, a House of Commons committee was told recently.

Most witnesses appearing before the House of Commons finance committee were very critical of provincial and federal regulating bodies like the Ontario Securities Commission and the Office of the Superintendent of Financial Institutions for looking the other way while suspect and likely illegal practices were being carried out, failing to investigate abuses and for often granting legal exemptions to financial institutions.

It wasn't supposed to be this way. Four years ago, the RCMP launched its Integrated Market Enforcement Teams, or IMETs, elite squads of investigators who were supposed to work together to crack down on white-collar crime. The results have been disappointing, to say the least. While the U.S. Justice Department has racked up more than 1,200 convictions against high-level executives and scammers in the past five years, the IMETs have managed just two — against the same person.

Craig Hannaford and Bill Majcher — two IMET officers who recently left the force have spent their careers trying to protect investors from fraudsters. Their message: When it comes to white-collar crime, its worse than you think.

They describe the state of Canada's justice system when it comes to dealing with white-collar crime as pretty much non-existent. You can fix something that is hemorrhaging, but if the body is already lifeless, you have to start fresh. We need politicians to admit that the system is broken from the top to the bottom. Canadians have to understand that we have a two-tiered justice system, where people with money can play the system.

The delays in white collar crime cases are just terrible. There is no reason why it should take 10 years to get a resolution in the Bre-X case.

Canada is seen as a haven for criminals. We have strong trust laws, a strong and stable banking system, strong privacy legislation and weak enforcement. As a result there is far less risk to criminal operations in Canada, and you don't spend time in a U.S. prison. How much safer! Simon Rosenfeld [a Canadian lawyer convicted of money laundering in 2005] said it was 100 times safer. Rosenfeld called Canada "la-la land."

Canada is seen as a soft touch. In a global criminal or terrorist organization, it's very useful to have a Canadian nexus. Then the whole network has the protection of the Canadian charter. If you can show that the Canadian police are involved in an international investigation, you can serve a disclosure application and the Canadian police can be compelled to disclose all the investigation information—even the information given by other law enforcement or intelligence agencies. Canada is absolutely an Achilles heel for international criminal and terrorist investigations.

That's making it harder for Canadian police to work with investigators from other jurisdictions because they view Canada as a big sieve of information. One FBI agent said that maybe they have to start treating Canada like a Third World country; if they need our help on a case; they will tell the RCMP to go to the U.S. embassy to read the file. You can't take notes or take it with you so the courts can't force you to disclose it later and maybe compromise other investigations.

On March 29, 2008 the U.S. Securities and Exchange Commission Chairman Christopher Cox and Australian Prime Minister Kevin Rudd announced that the SEC, the Australian Securities and Investment Commission (ASIC) and the Australian Treasury Department began formal discussions to develop a mutual recognition arrangement for the two nations' securities markets. The discussions are intended to enhance cross-border law enforcement cooperation, facilitate regulatory coordination, and increase investor access to well-regulated capital markets. Sources say that the USA has rejected a similar relationship with Canada because of our weak (non existent) securities regulation and enforcement.

This reputation is affecting Canada because some money managers and investors will not invest in Canada. Money is the greatest coward in the world.

There are money managers out there looking at Canada and wondering about Bre-X or Livent. They are wondering, why did that Canadian bank CIBC pay a US\$80 million fine and a US\$2.4 billion penalty in the Enron case to the U.S. while Canada did nothing? They look at Conrad Black convicted in the U.S. They wonder about Nortel.

Canada's police lack tools that would help improve our track record on white-collar crime.

Because most fraud investigations are so complicated and involve so many documents they are harder to complete.

U.S. regulators end up doing the work of Canada's top securities regulator. Just ask people on Bay Street who they are afraid of. It's not the cops, it's not the OSC. It's the U.S. Securities and Exchange Commission because it has real teeth.

Sentences for white-collar crime in Canada are a joke. A non-violent fraudster is going to get a sentence of two to four years...maybe. Even then, under our system he will usually serve only one-sixth of that sentence. That means he will serve five or six months in a minimum-security Canadian prison that doesn't even have bars. Look at Michael Mitton (the only man convicted of fraud by IMET.) He was sent to jail this year and could be paroled as early as next year. The guy has 105 criminal convictions. What do you think the chances are that he will be going for 106? The sentences handed down in the U.S. have the power to motivate people to co-operate. If you come clean early, show some remorse and provide evidence, it will go a long way to reduce your sentence.

Getting a criminal conviction still sends a message. The police used to have a saying: "The worst thing we could do to some of these fraudsters is giving them a criminal record so they can't cross the border and go down to Florida and enjoy their luxury condos."

There has been a big push by the federal government to form a national securities regulator. A national securities regulator would be a nice first step, but the underlying issue will still exist. There is no effective deterrence because there is no punishment that fits these crimes, and we just don't have the mechanisms to bring people to justice in a timely and efficient manner.

A national securities regulator is not going to solve this. There are serious structural problems throughout the system. We don't seem to have the political will. Politicians get up and say we can solve this with a national securities commission, but the problems are not going to go away. We have the same issues with the courts, the same issues with disclosure, the same issues with sentences and parole. If you don't deal with all of those problems from beginning to end, we will wind up in the same spot—with a national securities regulator that

everyone is angry with because it can't seem to do the job. With a national securities regulator, we are still playing the same game, just the teams have changed.

Former OTTP chief executive Claude Lamoureux, an insider, states "we have people who steal from investors and nothing happens."

There's been too much talk about what's wrong with securities law enforcement in Canada and not enough action, he says, arguing that the Ontario government has done little to achieve real change that will protect investors.

His recommendation! Heed the advice of Osgoode Hall law professor Marilyn Pilkington and former Supreme Court of Canada justice Peter Cory, whose report for the recent task force to modernize securities legislation has fallen on deaf ears.

The Pilkington-Cory report, among its many recommendations, argues that authorities need better tools to crack down on white-collar fraud. It also points out the need for judges that specialize in securities law and related crimes. Implementing this report will go a long way to getting us on the map.

The crime in all of this is our legislators. The legislators are the only people who can change the structures for securities regulation and securities crime policing in Canada. They define the mechanisms of public accountability and civilian oversight to ensure effectiveness of investor protection and the integrity of investigations and prosecutions. When legislators fail to implement the reforms Canadian pension funds and individual investors find necessary, there will be consequences of economic and capital market breakdowns like we have just experienced with ABCP. Breach of trust is not too harsh a phrase for Canadians to begin applying to their legislators who refuse to move forward on a securities reform agenda.