

Planning *for* Profits

SUMMER 2002

M A G A Z I N E



**TAKING
AIM AT
THE
PREMIER**





THE COMPLIANCE WAR

BY JOHN EITEL

Convergence, consolidation, retrenchment, regulatory authority, raising the bar, know your client, money laundering, due diligence, conflict of interest, offshore, onshore, agency, independent, ...Compliance ...Compliance ...Compliance ...**just shoot me.**

These are the words that will fill the business section of our national newspapers and business journals over the next period of time. The perceived need to protect the unsuspecting public is at times frenzied, bordering on paranoia. The plot thickens when one is witness to the fervent need for the financial industry to be self-regulated while at the same time dealing with the realities of the moral suasion of the Federal Government.

Well, hold on to your hat jack; this one just got noisy. On May 21st Finance Minister Paul Martin stepped up the rhetoric when at a meeting of the Association of Canadian Venture Capital Companies (ACVCC) he announced that the regulatory environment in Canada must change. On its face this may not seem to provocative until you remember that the regulatory authority is a cherished provincial jewel that will be zealously protected to the death by the provinces.

Mr. Martin said, "The status quo will not work and it must change. Otherwise issuers and investors will take their money elsewhere." Yeah, I guess you could blame a fragmented regulatory environment for foreign investors to stay away from Canada, as I am sure that world wide BREX and NORTEL fiasco's would not have done anything to dissuade the world from running to sign up for Canadian securities representing 2% of the worlds wealth. Or maybe it was the confidence that we inspired by the way the government dealt with Quebec and the Bloc (her royal majesties loyal opposition). Or the strong position we take in defending our national currency. But I digress.

Here's two more memorable quotes of contradiction from that same venue that will cause the western provinces to roll over easily, I'm sure. "The federal government **is not going to prescribe what the mechanisms should be**, but whatever model is adopted, surely to God it must be based on today's reality, not yesterday's. And this from the same meeting "Clearly, industry-led solutions are preferred. **But make no mistake, if these are not adequate, regulators and governments will need to act**".

He will intervene or he won't? I guess that depends on what side of the podium you were sitting on at the time.

THE PROBLEM

Mr. Martin is correct when he describes the vagaries of the Canadian regulatory scene. Thirteen (13) different jurisdictions (provinces and territories), 13

different securities regulators. Thirteen different standards, 13 different levels of education for advisors, 13 different management teams who have the politically divine right to protect and set the standard for the safety of their constituents. Thirteen separate kingdoms

Mr. Martin said,

"The status quo will not work
and it must change"

of power and control in the name of safety for their provincial citizens. Armed with this righteous indignation, powered by differing cultures, geography, language, political stripes, old scores, and agendas. Who will be the first to agree to the suggestions of the Ontario Securities Commission (OSC) that the entire country will be under one set of rules and regulations?

This reminds me of the Caribbean community. It is comprised of 13 different countries. This is an economically fragmented part of the world because of the struggle for power. It is true that this region would be a stronger force if they were to speak as one voice, but which 12 countries are prepared and willing to give up their seat/voice at the UN? Which 12 Caribbean Prime Ministers are willing to act as a manager to a central power and explain this change to their people? The answer has been "Zero..nada..bupkus". By the way these are all considered underdeveloped countries.

STATUS QUO

To address this section as anything less than a tangled web of power, ego, control and concern would be to understate a seemingly immovable force.

The first shall be last.

The concern is a healthy one. The

fear is that something catastrophic will go wrong. For example the scandal involving Enron's association with Arthur Anderson. Here in Canada, criminal charges have just been laid against the management of Eron Mortgage Corporation (not to be confused with Enron) where approximately 3,000 BC residents were bilked out of their life savings (\$182 million) on the promise of double-digit returns. They (Eron) were providing a financial investment service to the public with little or no watchdog or prerequisite requirement to sell their wares. Once the receivers are called in, be certain, there will be nothing left for the investors. This concern is not just on the part of the Regulators. The investment and distribution firms themselves, many of them publicly traded companies, know that a bad piece of business will find its way quickly to the media and could crush the company. Negative media is destruction from "from on high" and has little or no accuracy when it lands. Witness the \$100 million dollar settlement that Merrill Lynch just paid to get their names out of the headlines. To contest the charge would have been the death of a thousand cuts if played out in the press in these times of fear and mistrust.

The rules are a nightmarish spider web that may never be unwound. What is a hard and fast offence in one province is completely legal in another. Each province has its own Securities Commission, Insurance Council, Regulators, market watchdogs etc. with its own rules. For example a **sophisticated investor** (an exemption for experienced people to invest without all of the warning hoopla) is often measured by the investors wealth. In Ontario, the number is one hundred and fifty thousand dollars (\$150,000) in British Columbia, given the right circumstances, its twenty five thousand dollars (\$25,000). **Rebating** (paying commission or finders fees to find clients), which is illegal in Ontario, but is legal in Alberta and British Columbia. Make sense?

And the first shall be last.

Power, ego and control. Every government and territory believes it is their mandate to protect their constituents, and they're right. And for that reason, they each have their regulators in place. Which one of these provinces are going to capitulate and change their modus operandi to standardize to the Ontario view for what is perceived to be, by many, the greater good? Would it be Alberta, British Columbia or Quebec?

Hmmm, yeah that's what I thought too.

Westerners have grown leery and weary of Quebec MP's ...Trudeau, Lalonde, Chretien, (National Energy Program NEP)Mulroney (GST and over 30 federal tax hikes in 8 years) and now Martin. And just to help Mr. Martin's cause in Western Canada, crowd favorite Alan Rock, Industry Minister, (former Health and Justice Minister) national health care architect and federal gun registrar, has instructed his bureaucrats to move toward assisting in the harmonization of provincial regulators.

I can hear the tar bubbling and the chickens squawking now!

All right...All right enough fun.

NEW SHERRIFF IN TOWN....THE COMPLIANCE OFFICER

In the midst of all of this posturing and sabre rattling by the powers that be, today's compliance officer operates in the same environment as the 'cat on a hot tin roof'. As the products and markets of the financial industry come together (Insurance, Mutual Funds, Stocks, Bonds, Segregated Funds) each bringing their own history and corporate culture. The Compliance Officers have had the torch passed to them (albeit handed to them a little lower than what might have been desirable) and must ride shotgun on the trading and placement activity of all of the advisors

under their corporate responsibility. Given the recent rash of consolidation of firms and graduating young minds entering this profession, there are some eighty thousand (80,000) licensed men and women to advise the investing public in some form or another. Given this vast amount of advisors, this job is no day at the beach.

Traditionally, compliance officers have been viewed by the investment industry as a necessary evil. Compliance officers were, by and large, middle management. They were politely locked up in their office in the morning and let out at 4 pm to go home. They were always seen as whining deal-breakers who consistently got hung up on details that had nothing to do with the "art of the deal". High-end commission sales people would complain loudly and management would all but silence the Compliance Department. Things have changed.

Ever since the Royal Trust debacle of high closings, Enron, Arthur Anderson and the events of 9/11, the security surrounding the movement of money has been high. Compliance officers are out of the closet and raging. They now interact at the highest levels of the investment industry and with the full press backing of senior management. It seems that the bigger and more sophisticated the firm, the heavier and more demanding the compliance requirements are on the advisors. Today compliance officers occupy vice presidential levels of large corporations. They have the power to stop a trade, an insurance policy and an advisor. Today's compliance officer is often a lawyer whom has served as counsel somewhere in the company prior to his position in compliance. Others have come up through the ranks of the Investment Dealers Association (IDA), Toronto Stock Exchange (TSE), or their respective provincial securities organizations. Now, compliance officers are invited in at the very early planning stages of any marketing, product consideration or launch. Their new responsibility and influence is substan-

tial and they know it.

CONCLUSION AND GOOD NEWS

The vast majority of financial advisors out there are very honorable, just like the people they represent. It was found that even in the event of forgery, one in every one hundred was malicious. The other ninety-nine were administrative forgeries. That is to say, the advisor made a visit to the client and forgot to have all of the papers signed. Rather than make another trip back, they simply traced the signature to save time. Wrong... but not malicious. The internal audit systems are so tight in the reputable firms, that if someone is stealing or churning your account... they will be found out and dealt with severely.

Ultimately, to protect yourself, ask if your advisor has an affiliation with a reputable organization that is integrally involved in the understanding of the industry and the interest of the public. On an individual basis, ask your advisor if they are members of a reputable, high standard organization such as the Canadian Association of Insurance and Financial Advisors (CAIFA) or Canadian Association of Financial Planners (CAFP). Do they have the letters Certified Financial Planner (CFP) or Chartered Life Underwriters (CLU) on their business cards? If you find that their firms are members of the Investment Dealers Association (IDA), Investment Funds Institute of Canada (IFIC), Mutual Funds Dealers Association (MFDA) or Canadian Life and Health Insurance Association (CLHIA), you are in good shape.

Bottom line: The Canadian investor is quickly becoming the most protected and guarded investor in the world... whether he needs it or not.

John Eitel,

*President of Equitas Corporation
Restricted Securities Specialist
and Consultant to the Financial Industry.
john@johniteitel.com
(604) 709-0870*