

Coalition urges more investor protection

By LUIS MILLAN

A blue-ribbon panel of industry, academic and political leaders has urged the Quebec government to introduce sweeping securities reforms to overhaul the province's patchwork of rules and practices, overseen by several different agencies and ministries.

The Coalition to Protect Investors has called on the government to bolster protection for investors by establishing an anti-fraud indemnity fund, introducing mandatory evaluation of management performance through a system of certification and rating, and implementing a cohesive government policy.

"The government has to get their act together," says Robert Pouliot, a member of the Coalition, and co-founder and vice-president of the Centre for Fiduciary Excellence (CEFEX).

CEFEX is an independent assessment and certification organization that works closely with regulators, the investment community and the fiduciary industry.

The public finance committee, a 12-member panel representing all political parties in the Quebec National Assembly, held hearings recently examining investor protection and the mutual fund sector in the wake of a series of financial scandals that struck the province over the past two years.

It is estimated that investors stand to lose more than \$675 million due to alleged misdeeds by Montreal hedge fund operator Norshield Financial Group, Montreal financial services firm Norbourg Asset Management Inc. and Montreal financial group Mount Real Corp.

More than 25 individuals and organizations, including Quebec's three professional accounting associations, submitted briefs to the public finance committee but few could boast the presence of such luminaries as the Coalition to Protect Investors, whose members include former Quebec premier Bernard Landry, former provincial finance minister Yves Séguin and former head of the financial co-operative giant Groupe Desjardins, Claude Béland.

The financial scandals have had a devastating impact, according to Andrée De Serres, a founding member of the Coalition and director of the MBA corporate finance program at the Université du Québec à Montréal. It has undermined investor confidence and highlighted the frailties of the existing financial system – an issue compounded by the "piecemeal" approach embraced by the provincial government when enacting new laws and regulations governing the financial sector.

"The government needs to introduce a more contemporary

and modern approach that takes into account all facets of the finance sector," said De Serres.

"We've migrated from an industry that was based on deposits, whereby a person received his savings plus interest, to one based on funds. Savers have now become investors and it is they who now absorb market risk. Yet the regulatory environment hasn't followed suit. Government policy at present is incoherent – and the

latest two bills that the government passed are a case in point." The Quebec government

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Andrée De Serres, Coalition to Protect Investors

recently enacted two bills aimed at modernizing securities laws.

Bill 30, otherwise known as the act to amend the *Supple-*

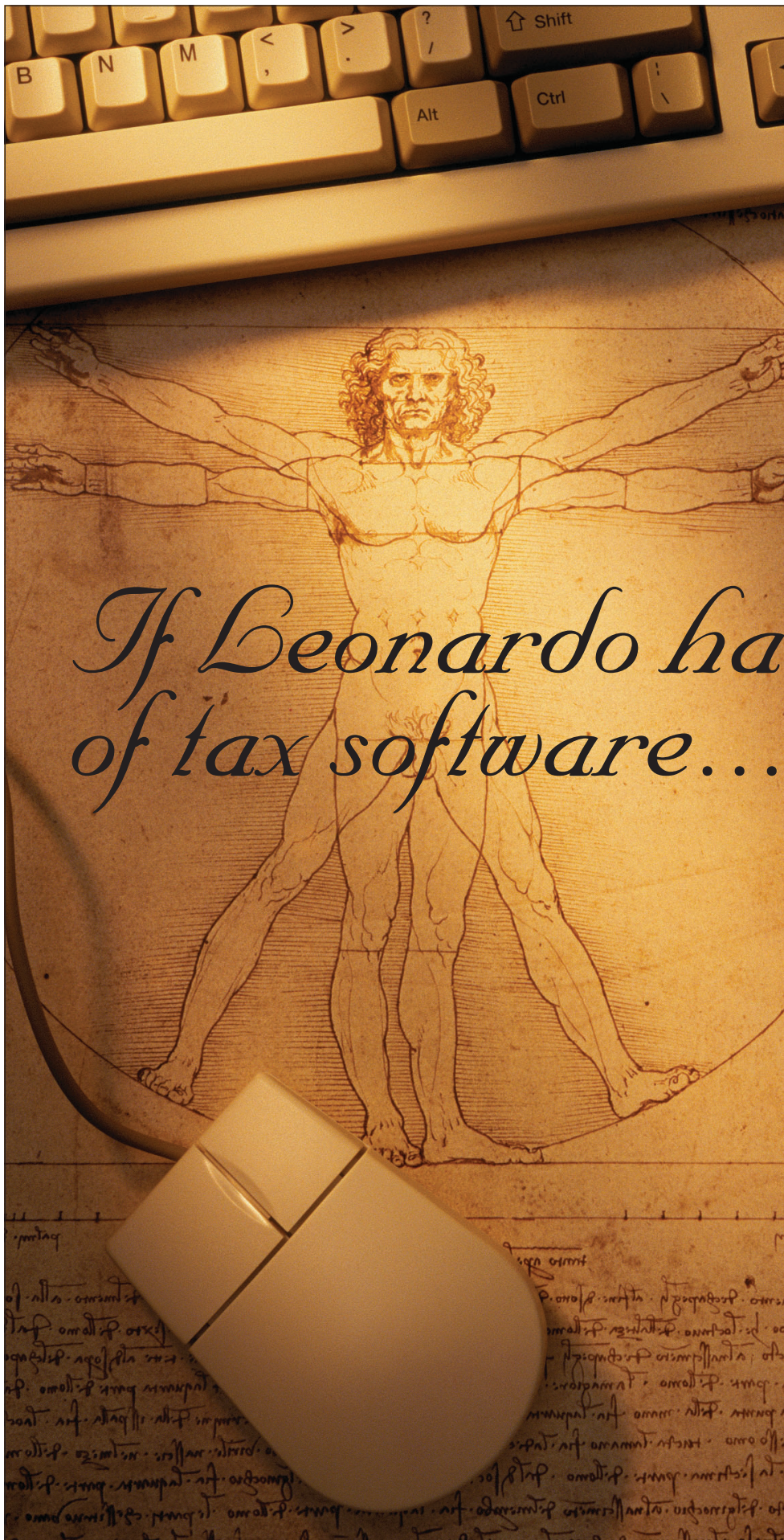
mental Pensions Plans Act, significantly amends the responsibilities of service providers such as actuaries and investment managers, and bestows them with fiduciary obligations.

Bill 29 aims to harmonize Quebec's securities laws with those of the other provinces and territories of Canada in order to make the so-called passport system more effective. Under a commitment signed in 2004 by

all provinces except Ontario, the passport system – formally known as the Provincial/Territorial Memorandum of Understanding Regarding Securities Regulation – will enable issuers and registrants to only deal with the regulator in their principal jurisdiction, providing a single window of access to capital markets in Canada, except in Ontario.

"In a nutshell, Bill 29 is designed to harmonize Quebec's securities laws with the other provinces and territories,"

See Watchdog on page 12



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Watchdog group says not enough done

Continued from page 11

explained Alfred Buggé, an associate with the law firm Blake, Cassels & Graydon. "Under Bill 29, the regulation of capital markets will be dealt through the passport system."

But neither bill does enough to provide investors with additional protection, according to the Coalition to Protect Investors. In a 75-page brief presented to the public finance committee, the coalition instead proposes nothing less than fiduciary convergence.

"The legislator must underline the fiduciary responsibility of all professionals who manage, administer, intermediate and safeguard assets on behalf of third parties," notes the brief. "Drawing a distinction between those who give advice and those who do not, no longer reflects today's market reality. The walls have become too thin to set such a borderline."

To boost investor confidence, the coalition also recommends the establishment of an anti-fraud indemnity fund that would operate on the model of the Canada Insurance Deposit Corporation. The fund, which would only protect against fraud or fiduciary negligence by funds and investment managers registered, regulated and rated in Canada, would be equally financed by investors and investment management firms.

The premium charged to investment management firms would be based on their fiduciary risk as rated by an independent organization that would have to be created. The annual rating meted out by the independent organization would improve transparency as well as help investors "make a better selection of their managers," says the coalition.

An anti-fraud indemnity fund would also enable small-to-



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medium sized investment management firms to compete against larger institutions, says Pouliot.

In December 2005, the 10 largest investment management firms handled 78 per cent of all Canadian mutual fund assets, according to statistics quoted by the public finance committee.

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Robert Pouliot, Centre for Fiduciary Excellence

The situation in Quebec is even more dramatic, where less than five per cent of mutual fund assets are managed locally.

"The fund would be a way to restore a level playing field," said Pouliot. "Large institutions may give the impression that they are more reliable because of their size but we need to maintain competition within the

market. It would also keep fees low – which are now high, and rank among the highest in the world."

Proposals made by Quebec's three professional accounting groups before the public finance committee were more modest. The Quebec Order of CAs believes it has come up with a solution that will improve investor protection thanks to methods already applied by the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), an organization engaged in the fight against money laundering and terrorist activity financing.

The CAs think it is possible to prepare a list of indicators that would allow CAs to notify the Quebec securities watchdog, the Autorité des marchés financiers (AMF), of certain facts that come to their attention when performing audit engagements. The list of indicators could include the obligation to inform the AMF of certain transactions that appear to be

inconsistent with the client's apparent financial standing or usual pattern of activities.

"We have proposed to sit down with the AMF to draw up a list of indicators that would allow it to intervene quickly," said Daniel McMahon, president and chief executive officer of Quebec's CA Order.

The Quebec Order of CGAs

has taken a different tack. It urged the provincial government to establish a board of directors composed of a certain number of independent members, headed by a person other than the president or chief executive officer of the investment fund. The CGAs also recommend the creation of an audit committee that would report only to the board of directors. As well, it recommends that the AMF be granted powers to hand special mandates to auditors other than those who audited an investment firm, if the securities regulator suspects underhandedness.

"When an auditor receives a mandate from an organization, his mandate is not to detect fraud," explained Fortin. "His mandate is to ensure that there is an absence of important inaccuracies in the financial statements. The AMF has a different mandate which is to protect investors, and we believe that if the AMF has suspicions, it should be able to give a mandate to another auditor to examine the situation."

The Quebec Order of CMAs has adopted a far more conservative approach, going so far as to warn the public finance committee over the dangers of further regulating an industry already heavily regulated.

"We asked ourselves, how far should the provincial government go in order to protect investors without compromising the necessary balance for the well-being of the financial industry?" said Francois Renault, the president and executive director of the Quebec CMA order.

"What is the tradeoff? The temptation to fall into the trap of over-regulating can be very strong. But even if we put a police officer on every corner of the street, that will not stop crime."

One man charged

Continued from page 8

announced last October. Kerr noted how, for instance, the government made an exception three months ago by allowing Real Estate Investment Trusts (REIT) to maintain their tax free status, yet "never really fully identified to our satisfaction why they exempted REITs and did not consider the royalty trusts."

Supporters of the government's decision also point out that trusts can stifle competition because they are established under a tax system that encourages distributions and discourages retention of earned income, rather than the reinvestment of profit for research and development and thus, innovation.

"While the income trust structure may be very appropriate where firms need only to manage existing assets efficiently, it is definitely not appropriate in cases where innovation and new investment are key," testified Bank of Canada Governor Dodge to the finance committee.

Kerr argues that the trust structure encourages both innovation and investment. He points out that energy trusts are exploring a number of innovative practices that involve healthier environmental alternatives.

Moreover, he says, they appeal to a large group of investors who want to take more risk and get a better return than if they were investing in guaranteed investment certificates, but who also prefer a certain degree of stability and cash flow.

Energy trusts can provide that, which serves to enhance new investment prospects, Kerr says.

In a related development, the RCMP has laid a single charge against a civil service bureaucrat in connection with an alleged leak regarding government treatment of income trusts.

Serge Nadeau, 50, has been charged with criminal breach of trust. The director general for policy analysis at the federal Finance Department allegedly used insider information to play the market in late 2005.

The then Liberal government of Paul Martin announced after the markets closed on November 23, 2005 that they did not plan to tax income trusts, but would lower tax rates for dividends.

From about 3 p.m. on until the market closed at 4 p.m. that day there was heavy trading in income trusts and dividend-paying companies, an indication of advance knowledge of the Liberal plan.

That led to allegations of insider trading and the RCMP investigation, announced as the federal election campaign was being fought on Dec. 28, 2005.

The RCMP now says its investigation is over.

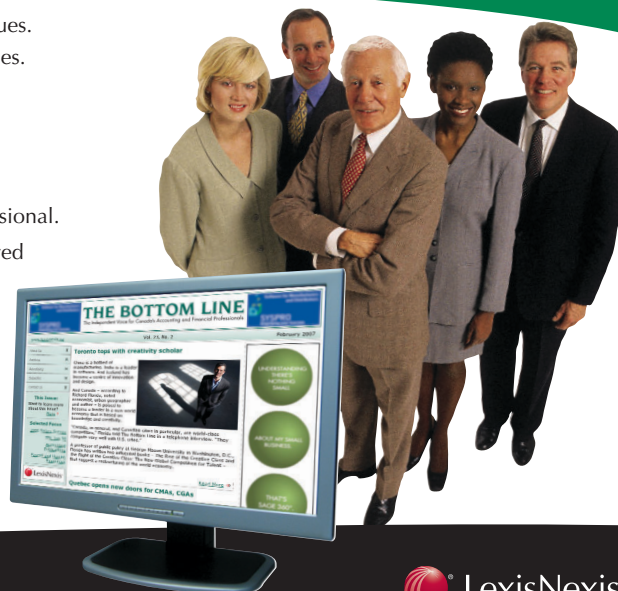
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