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Partnership and Coordination:
The Role of the Regulator and Industry in Investor Education

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The Regulators Role in Issuing Investor Alerts

Providing timely notification to investors of schemes, proposals, products and market actors that may be fraudulent, sub-optimal, high risk or conflicted is an important role for regulators. As is the case with many things, timing is everything. Regulators, acting in coordinated fashion with the industry are well positioned to these risks before the investor has risked his or her capital in a rigged enterprise.

A recent example in Canada was the notice issued by the Investment Dealers Association of Canada regarding “on-line intrusions” into brokerage accounts. Fraudsters gain access to confidential account access information in a variety of ways: by observing as a client enters their PIN, by emailing clients with what appear to be genuine requests by their firm for information or “phishing”, by placing a realistic but phoney banking machine in order to systematically harvest account access information, or by attacking the firms electronic network directly and surreptitiously in order to obtain complete access to client information. In the latter case, the attack will go undetected because the fraudsters delay using the confidential client information for months or sometimes up to a year. Once access is obtained, depending on the controls on the system, cash can be removed or buy and sell orders entered. In a recent Canadian case, buy and sell orders were placed for penny stocks as part of a market manipulation scheme. The regulators were able to issue alerts to the public as soon as they were notified by firms that this activity was underway. The notice contained advice as to how to spot fraudsters “phishing” for confidential information and to monitor their account statements closely for any unauthorized transactions. The IDA Investor page contains additional investor alert information concerning the risks in exempt market investment products and principle protected notes at: http://www.ida.ca/Investors_en.asp.

The Financial Industry Regulatory Authority (FINRA) in the United States has developed an extensive array of Investor Alert information, targeting not only particular schemes and high risk products, but also vulnerable groups such as seniors and sound investment advice. All this information is available at: <http://www.finra.org/InvestorInformation/InvestorAlerts/index.htm>.

The Financial Services Authority (FSA) in the UK has a large amount of information dedicated to investor tools as well as updates on regulatory actions at: <http://www.moneymadeclear.fsa.gov.uk/>. The Ontario Securities Commission (OSC) website contains information for investors on how to spot boiler room schemes, pyramid schemes, Ponzi Schemes and Telemarketing schemes at: http://www.osc.gov.on.ca/Investor/Alert/ia_index.jsp. The Australian Securities and Investment Commission provide a page of investor alerts including illegal investment schemes and theft of confidential information at: <http://www.fido.gov.au/fido/fido.nsf>.

It is fair to say that regulators working in cooperation with industry players have taken very seriously their mandate to provide investors with timely information concerning illegal unfair and abusive practices and products so the investor is not risking their capital in a rigged game. This is not merely a sideline for regulators, but is critical in order to maintain public confidence in the capital markets.

The Role of the Regulator in assisting Investors Navigate the Client Complaint Process

Another timely intervention by the regulator to assist investors is the moment an investors decides that he or she must make a complaint about their financial services advisor or their firm. Questions such as: what can they complain about, who should they complain to, what should they expect when they make a complaint – require immediate answers. It is very much in the interests of the firms to resolve customer complaints quickly and fairly. It is also important for the overall confidence of the public in the capital markets that clients understand there are fair and timely remedies available to them when differences arise.

In Canada the SROs, the IDA and the Mutual Fund Dealers Association of Canada (MFDA) have been developing standards for their member firms in how they manage client complaints. These standards were initiated in response to what they were hearing from investors at an Investor Town Hall sponsored by the OCS, IDA, MFDA as well as the Ombudsman for Banking and Investment Services. The SROs each issued notices in December 2006 signalling their intention to develop these standards and providing interim guidance concerning good complaint handling standards. Member Regulation Notice No. 0441 can be found at: <http://ida.knotia.ca/Knowledge/Fetch/FetchResults.cfm?Ktype=445&filter=MR0441>.

These new standards, developed in consultation with industry participants will define clearly what a complaint is. In addition, they will require firms to appoint an individual to take responsibility for client complaints, set standards for what the firm must do and the information it must provide to the client when it opens a complaint, ongoing reporting on the status of the complaint, the information the firm must provide when it closes a complaint and if compensation is not offered, the other remedies available to the client to obtain satisfaction. Most importantly, firms will be required to resolve, one way or another, client complaints within six months or be able to demonstrate a good reason why this could not be done in any particular case.

If the client cannot come to a mutually satisfactory arrangement with the firm, they may file a complaint with the Ombudsman for Banking and Investment Services (OBSI). OBSI was developed and is sponsored by the banking and investment industry in Canada in response to a request from the government to provide a lower cost and faster dispute resolution mechanism than was currently available in the civil courts for clients. The banking and investment industries created a fully independent board of directors to manage the affairs of OBSI. Clients may file a complaint with OBSI. OBSI will conduct an independent investigation and make a recommendation. The recommendation is not binding, however, if the recommendation goes against the firm and the firm decides not to abide by the recommendation, this fact is made public by the Ombudsman, on their website and through a news release. In the five years that OBSI has been in operation, it has only had occasion to make one recommendation public. The Ombudsman service is free. Complaints can be filed on-line with the Ombudsman at: <http://www.obsi.ca/default.aspx>.

The Role of the Regulator in Educating Investors concerning the Choice of an Investment Advisor

Clients should have easy access to information that will assist them in choosing an investment advisor appropriate to their financial requirements. A positive and mutually beneficial relationship between client and advisor is in everyone's interest.

Regulators can assist the public in choosing an investment advisor by providing advice on the questions to ask of a prospective advisor. A good example of this type of information provided on-line is available through the Ontario Securities Commission at: http://www.osc.gov.on.ca/Investor/Resources/res_index.jsp.

Equally valuable is individual registrant information concerning education, categories of registration, any terms or conditions on the individuals licence and any record of disciplinary proceedings and complaints. The most comprehensive system for this type of disclosure is FINRA "BrokerCheck" which makes public certain information filed on the Central Registration Depository (CRD). CRD is the securities industry online registration and licensing database, as reported on industry registration/licensing forms that brokers, brokerage firms and regulators complete.

Features of FINRA BrokerCheck include:

- Search capabilities for both a broker and brokerage firm
- Online delivery of a report on a broker or brokerage firm
- Explanatory information to help investors better understand the content, context and source of the information provided
- Links to additional resources and tools

BrokerCheck features professional background information on approximately 669,000 currently registered brokers and 5,100 currently registered securities firms. Information is also available on thousands of formerly registered firms and brokers. The FINRA BrokerCheck site can be found at: <http://www.finra.org/InvestorInformation/InvestorProtection/p005882>.

The ability to provide information to the public in this comprehensive and on-line fashion requires the creation of an electronic filing system of registrant information. In the absence of a legislative foundation, it is difficult to provide all the information potential clients would like to have and still remain in compliance with privacy laws. The Canadian Securities Administrators (CSA) and the IDA developed and manage the National Registration Database (NRD). The IDA provides certain information on individual registrants and firms through an on-line service at: http://www.ida.ca/Investors/MembFirmEmployeeInfo_en.asp, however, it is not as comprehensive as the FINRA BrokerCheck service. For example, certain personal information is not available due to privacy laws and client complaints that have not resulted in a formal discipline proceeding are not available.

The Role of the Regulator in Enhancing Investor Disclosure

It is generally agreed that the current regulatory strategy of ever-increasing volumes of hard copy disclosure is flawed in two respects: (1) the content of the disclosure is designed to mitigate legal liability for the authors (issuers, intermediaries and their advisors) rather than educate investors, and (2) the dense technical format of the disclosure virtually ensures that investors are apt to recycle the disclosure documents (in the best case scenario) rather than read it. Regulators should consider how to move disclosure into a system that takes full advantage of technology.

In an effort to gain a better understanding of the approaches that are being taken in different jurisdictions to improve disclosure, the Canadian Task Force to Modernize Securities Legislation in Canada looked at a number of innovative approaches being undertaken to improve the process of disclosure. The Task Force was sponsored by the IDA, but was independent of the IDA. The Task Force was chaired by Tom Allen, a prominent securities lawyer and included academics and industry participants from dealers and issuers. The full report of the Task Force can be found at: <http://www.tfmsl.ca/>.

The Task Force noted that regulators in a number of jurisdictions were developing innovative solutions to the problem of ineffective retail client disclosure by including a new technique known as “extensible business reporting language” (XBRL). The challenges faced by the regulators and the industry in moving to XBRL were noted by the Task Force. In order to overcome what was described as the challenge of the “last 20 yards” from the utility pole into the clients’ home, the Task Force proposed a prototype disclosure model based on XBRL. This prototype described the contents of a disclosure document that used XBRL and provided a user friendly navigation interface.¹

XBRL is gaining momentum around the world as a business reporting language that has the potential for efficient analysis and sharing of financial information.² Regulators in North America and elsewhere have been closely studying the usefulness of XBRL.

In Canada, the Canadian Securities Administrators (CSA) has been considering XBRL as a part of its information technology strategy and has initiated a XBRL project. The first phase of this project included a market survey intended to help the CSA understand the level of awareness and experience in the Canadian market with XBRL (CSA Notice 52-314 *Securities Regulators Want Your Feedback on XBRL*). The next step will be to establish a voluntary filing program that would help participants in the Canadian market to gain more practical knowledge and experience with XBRL (CSA Notice 51-323 *XBRL Filing Program and Request for Volunteers*). The CSA launched the second phase of its XBRL awareness program in mid-May 2007.

¹ Task Force to Modernize Securities Legislation in Canada (October 2006), Final Report Volume 1, p.69-84 and Volume 2, p.43-50.

² XBRL is an XML-based language for the electronic communication of business and financial information which makes it easier for companies to share information with each other and with investors and financial analysts across all software formats and technologies, including the Internet. XBRL provides investors and financial analysts with access to information about firms’ balance sheets on a real time basis. More information about XBRL can be found at: www.xbrl.org

The Toronto Stock Exchange was the first public company and the first publicly-listed stock exchange in the world to publish its annual results in XBRL.

In the United States, the SEC launched a XBRL voluntary filing program in the spring of 2005 that has allowed firms to experiment with the new XBRL-based format. Public companies began voluntarily submitting interactive data documents as exhibits to reports and other filings with the SEC.³ The SEC has argued that adoption of XBRL by all firms would result in greater transparency of financial information, reduced costs for investors and analysts, deeper coverage of midcap firms by analysts and, in general, greater market efficiency. Consequently, Chairman Cox has indicated that the SEC will soon issue a formal proposal that would require all companies to use XBRL in their filings with the agency.⁴ In a recent news release he said: “Millions of retail investors rely on mutual funds to finance their retirement, health care, education and other financial needs, so shopping for the right fund shouldn’t be a needlessly time-consuming and frustrating exercise”. With new tools, “investors will be able to comparison-shop among thousands of funds with the click of a mouse. This is a potentially rich new source of investing information for retail investors who need it most.”

Recently in the United States, mutual funds have been added to the voluntary filing program. Among the first mutual funds to participate in the program are Allegiant Advantage Fund, American Funds’ Europacific Growth Fund, Mulhenkamp Fund and Vanguard 500 Index Fund. The coding pulls out data on funds’ investment objectives, strategies, risks, costs and historical performance. To obtain an early look at what investors can expect to see from public companies investors can go to an interactive viewer available through the SEC’s public web site (www.sec.gov) – click on “interactive data,” choose “interactive Financial Report Viewer,” and then go to “XBRL Web application.” Risk and return information on mutual funds cannot be seen through the viewer, and there is no way to easily compare funds yet, but the SEC is considering integrating the fund information into the viewer. The SEC page describing their XBRL initiatives can be found at: <http://www.sec.gov/spotlight/xbrl.htm>).

Various government departments, financial regulators and market participants in the UK, Spain, Germany, Belgium, and Japan are also developing electronic reporting strategies based on XBRL.⁵

³ Apparently firms in the U.S. have not been entirely enthusiastic about the new technology. As of January 2006, the SEC had received only 22 XBRL filings from nine companies.

⁴ A description of the SEC’s XBRL initiatives is at: www.sec.gov/spotlight/xbrl.htm.

⁵ Task Force to Modernize Securities Legislation in Canada, Final Report, Volume 1, p.82-83.