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 services firm Norshield Financial Group, Montreal financial services firm Norbourg Asset Management Inc. and Montreal financial services firm Norshield Financial Group, Montreal financial services firm Norbourg Asset Management Inc. and Montreal financial services firm Norshield Financial Group, Montreal financial services firm Norbourg Asset Management Inc. and Montreal financial services firm Norshield Financial Group, Montreal financial services firm Norbour

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 financial 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 recently enacted two bills aimed at modernizing securities laws. Bill 30, otherwise known as the act to amend the Supplementary 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.”

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We can only surmise that Leonardo da Vinci was too busy with flying machines and works of art to ever turn his thoughts to income tax software. Think of the benefits for Canadian tax preparers if he had! His sketches would surely have revealed a great and innovative machine designed to avoid wasted time, deliver simplicity with accuracy and above all eliminate “heavy lifting” for all tax professionals.

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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."

The Quebec Order of CA's 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 financing. The CAs think it is possible to prepare a list of indicators that would allow CA's to notify the Quebec securities watchdog, the Autorité des marches 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 compel investment funds to establish a board of directors composed of a certain number of independent members, headed by 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 fund, if the securities regulator suspects under-handiness.

"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 conserva-tive approach, going so far as to warn the public finance committee of the dangers of further regulating an industry already heavily regulated. "We asked ourselves, how far should the provincial govern-ment go in order to protect investors without compromising the necessary balance for the well-being of the financial industry?" said Francois Renauld, the president and execu-tive 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."

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ONE MAN CHARGED

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The RCMP now says its investigation is over. Kerr noted how, for instance, the Liberal gov-ernment 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 con-sider the royalty trusts."

Supporters of the govern-ment’s decision also point out that trusts can stifle competition because they are established under a tax system that encour-ages distributions and discour-ages retention of earned income rather than the reinvestment of profit for research and develop-ment that innovation.

"While the income trust struc-ture may be very appropriate where firms need only to manage existing assets efficiently, it is definitely not appropriate in cases where investment in new assets is required."

He points out that energy trusts are exploring a number of innovative practices that involve healthier environ-mental 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 invest-ment certificates, but who also prefer a certain degree of stability and cash flow.

Energy trusts can provide that, which serves to enhance new community infrastructure. In a related development, the RCMC has laid a single charge against a company which confirmed 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.

Formula 3 was on, until the market closed at 4 p.m. that day there was heavy trading in income trusts and dividend-paying companies, an indication that new information was known.

The charges were for "radiating the development and theRMC investigation, announced as the federal elections were being fought on Dec 28, 2005. The RCMC now says its investigation is over.