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MEMBER
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June 27, 2006

Thomas A. Allen
Chair, CSI Task Force
Modernization of Securities Legislation
121 King St. W.
Suite 1600
Toronto, Ont.
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Dear Mr. Allen:

I'm writing to you today in response to your letter dated June 16, 2006. Specifically, I am giving you permission to reproduce the documentation that I provided in support of the views I presented. Thank you for giving me the opportunity to present them.

A number of developments have occurred since my presentation that have had a material impact on my thinking. Specifically, the IDA's recent decision to split into two organizations is, in my view, an extremely positive development that was egregiously overdue. Another factor that has had an impact on my thinking is the fact that I recently wrote the CSI's Branch Manger's exam and am now more cognizant of certain regulatory matters than I was previously. My concern is one of degree. In the CSI course, I noted that the Canadian Securities Industry has five specific Standards of Conduct:

- Standard A: Confidentiality
- Standard B: Trustworthiness, honesty and fairness
- Standard C: Professionalism
- Standard D: Compliance with the law
- Standard E: Confidentiality

It might be added that in my view, even the highest standards that an advisor might be held to is likely nowhere near high enough regarding the Standard of Conduct set out in Standard B regarding disclosure. As a result, and to my mind, the industry simply isn't doing a good enough job in enforcing its own Standards of Conduct. Standard B enshrines the priority of client interests, the protection of client assets, the giving of complete and accurate information and insistence on meaningful (full, true and plain) disclosure. It does not say precisely what needs to happen in order to meet those lofty objectives. To date, the IDA has always insisted that the bar has been set appropriately regarding disclosure. Still, the major reason why the IDA split in two was the perception that it lacked credibility as both an industry advocacy group and a regulatory body. What was seen as adequate disclosure in the past (when the IDA was effectively marking its own papers) might no longer be good enough. In my view, this is now the case.

Imagine if a provincial industry association representing physicians were to suggest that getting an 'A' in your final year of high school biology was considered sufficient training to hold oneself out as a qualified physician. No one would doubt that there's a standard in place, it's just that few would believe that the chosen standard was the most appropriate. If physicians were to try such a stunt, consumers would likely feel that the federal government would have no choice but to step in and impose unilateral changes to the Canada Health Act to make it more stringent. Presently, there is no requirement in our industry to:

- Disclose that product manufacturers make more money on actively managed products (e.g. through mutual funds) than on passively managed ones
- Disclose that active trading certainly generates more money for broker/ dealers, but does not necessarily result in a more favourable investor experience
- Disclose that it is improbable (but not impossible) that an active approach (e.g. through individual security selection) will lead to more favourable outcomes
- Disclose that trading securities often results in higher annual tax liabilities than a buy and hold approach

Few, if any, of these points are self-evident or obvious to many investors. As you may recall from my presentation, I believe the metaphor of the tobacco industry is appropriate. When disclosures were made mandatory there, the industry resisted on the grounds that the research done by big tobacco was reaching conclusions that were different than the conclusions found by the various Surgeons General. Naturally, people wondered about the independence of those findings. The research supporting the disclosures above goes back decades and has been found to hold true in every major capital market in the world.

The financial services industry depends on maintaining the trust of the people who hand over their life's savings in the hope that the industry is transparent and ethical enough to conduct itself in a manner befitting of that ongoing trust. To my mind, the industry is taking an "ask me no questions and I'll tell you no lies" kind of approach to disclosure. In my view, many of the industry's conspicuous non-disclosures pertain to material factors that could cause investors to make different decisions if they were made initially.

If the disclosures are not material and would not cause people to alter their choices, then why not make them simply in the name of completeness? On the other hand, if, in making the disclosures, investors altered their decision-making, it would essentially prove the materiality of the things that were being withheld previously. The only way we'll know for sure is to make the disclosure mandatory and see what happens. Genuine fairness includes the perception of fairness, as the organization once known as the IDA purports to understand very well. Accordingly, I recommend that disclosures such as the ones itemized above be made mandatory at the account opening stage (with client sign off) without exception. This is an example of how the principles of what was once known as the OSC's "Fair Dealing Model" could be acted upon. In my view, the industry makes it too easy to make implications about value propositions without acknowledging associated limitations.

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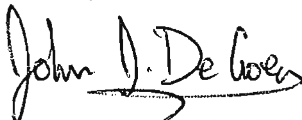
This is the sort of thing the industry should heartily embrace, given its stated desire to minimize misunderstandings with investors. Reduced misunderstandings from the outset would likely also lead to fewer successful lawsuits against member firms. I'm including a cigarette package as a reminder of the starkness in which other industries make their disclosures. Any industry that has nothing to hide should not back down from offering a more overt disclosure of the risks and limitations associated with a given product or strategy.

Right around the time when you will be releasing your final report, I will be releasing the Second Edition of my book (The Professional Financial Advisor II). It will delve into many of these topics in far greater detail. As such, you may wish to reference it for those people who wish to read more on the subject. Once again, thank you for allowing me to offer my input on this important matter. It is my sincere Once again, thank you for allowing me to offer my input. It is my hope that the task force can be a positive voice for change in our industry.

Sincerely,



BURGEONVEST SECURITIES LIMITED
John J. De Goey, MPA, CIM, FCSI, TEP, CFP
Senior Financial Advisor

Was That Wrong?

Culpability is a curious thing. Since there are so many sneaky ways that a corporation or financial advisor could hurt a client, the industry has given up trying to enunciate all the permutations of all the possible transgressions. Instead, the industry has opted for a "principles-based" approach to enforcement and regulation. If any individual or company engages in behaviour that is "contrary to the public interest", then sanctions may be applied.

You may remember an episode of Seinfeld that illustrated this kind of approach. In the show, George is working late in an office tower one night when he finds himself alone with a cleaning lady and the two become amorous. The problem with what happened next only became apparent to George when they were discovered.

The next morning, George found himself in the boss' office as he is asked to explain his conduct. The mock-innocent question that George, the new employee, asks his boss is: "was that wrong?" "After all", he says "I checked the Code of Conduct and there's nothing in there prohibiting employees from having sex with the cleaning staff- I can assure you that, had I known it was in any way inappropriate, I wouldn't have done such a thing". The old adage of "It's easier to ask for forgiveness than it is to ask for permission" was alive and well.

This is little vignette also shows how the financial services industry has come to act when dealing with, ahem, corporate indiscretions. For instance, let's consider the market timing scandal that came to light in 2004. While there was nothing in any rulebook prohibiting hedge funds from getting in and out of mutual funds in mere hours to take advantage of global pricing and timing disparities, even though the willful acquiescence regarding this kind of abuse of the system was clearly contrary to long term unitholders' best interests.

After considerable investigation, it was determined that restitution needed to be paid, although payment came by way of a "negotiated settlement". Of course, paying restitution is not the same as being fund guilty. Even as the restitution was quantified and even as the cheques went out to unitholders, the companies found to have engaged in market timing (there were almost certainly others, but the investigation was brought to a mysterious and abrupt end) always pointed out that "market timing is not illegal".

There are two things to think about here. First, did the restitution payment bring a fair closure to this sordid tale? Second, is the lack of explicit illegality a source of concern?

With regard to closure, it is generally accepted that the payments made fall well short of the money that was skimmed by hedge funds. Mutual fund companies point to the fact that they only profited to the extent that they charged hedge fund companies fees in exchange for their speedy in and out shenanigans. However, if long term investors had (let's say) over $400 million in fund valuations stripped out and fund companies paid only $205.6 million in restitution, then unitholders are still out $200 million. For those keeping score at home:

Hedge Fund Companies: Up over $400M
Mutual Fund Companies: Down $205.6M (less fees earned)
Mutual Fund Unitholders: Down about $200M

If, as the industry keeps on telling us, the client always comes first, why were clients out of pocket $200 million even after the improprieties were reconciled?

There's obviously some concern regarding public relations and public perception. Since fund companies are repeatedly pointing out that what they did is not illegal, consumers might be led to believe that they are being well-served and well-protected by the system. Regulators point to the "best interests of consumers" phraseology of a principles-based system as providing a wide enough net to catch unbecoming conduct that might have otherwise avoided retribution. However, if perpetrators are allowed to claim that they broke no laws, then the stench of their misdeeds can still go largely undetected. When the punishment is seen to be modest, the overall system can be called into question.

For instance, what's to stop mutual fund companies from devising some devious (but technically not illegal) kickback scheme where fund companies get to keep somewhere between the restitution amount and the profit and the hedge fund companies keep the rest? Both the fund companies and the hedge funds could be about $100 million better off, for instance. If one ignores the consumer, the basic economic principle of Pareto Optimality shows there's room (even after restitution!) for corporate profits to be made. Putting this even more starkly, if the punishment does not fit the (non) crime because it is too lax, there's a good chance that the (non) criminals will become repeat offenders. Corporations seek to maximize profits and under the current system, there's still plenty of room to do that. Some of the companies caught in the "time arbitrage" scandal are still denying any wrongdoing in their annual reports.

Using a basic metaphor that even a regulator can understand, if person A steals $1,000 from person B, gets caught, is found guilty and is ordered to repay person A $500 dollars, has justice been served? Wouldn't anyone agree that at the very least, person B should get ALL of his money back? Then, shouldn't person A also be asked to pay a fine or do jail time or perform some kind of community service to pay the overall debt to society? Should person A get off any more lightly if he gives the stolen money to person C or loses it on the way home?

If an individual financial advisor found a way to skim millions of dollars out of client accounts, he would be fired on the spot for a clear breach of fiduciary responsibility. That's the "micro" application of a principles-based approach. The "macro" (corporate) perspective is rather different. What hedge fund companies and mutual fund companies colluded in perpetrating would be tantamount to robbery if an advisor did it. But the principles based system allows that their conduct is not illegal. There you have it. Product manufacturers were colluding to effectively legalize robbery.... and they stole from the very people whose interests they insist are being put first.

There are many consumer advocates who do not believe justice even came close to being served. Please don't misunderstand me. I agree with a principles-based regulatory framework. However, any system (whether principles-based or rules based) needs to have the punishment fit the crime (or transgressed principle, as the case may be) in order to be a credible deterrent that protects consumers. The application of a principles-based approach remains very much open to interpretation. The approach holds much promise, but is off to an exceedingly poor start, given how puny the restitution settlements have been in light of the conduct in question.

Not protecting the public interest can take a number of interesting forms. To hear regulators tell it, you'd think disclosure is a panacea for almost all the industry's woes. Of course, the practical application of disclosure is open to interpretation.

For instance, cigarette companies were forced to disclose that their products are carcinogenic long ago. Mutual fund companies, however, make no disclosures regarding the improbability of actively managed products beating their benchmarks, for instance. If public welfare and the public interest were paramount, that kind of disclosure ought to exist. Many feel that disclosure, if it is ever going to have it's desired effect, needs to be made simpler and more "in your face". Comprehensive disclosure made in the fine print on the bottom of page 54 of a prospectus is not the kind that engenders informed consent.

What if a "distribution" company (the kind that offers financial advice) were to encourage its advisors to buy company stock before doing an IPO, then publicize a business plan that it intended to convert other companies' products into the higher cost (to the client); higher margin (to the company) products? What if the advisors from that distribution company disclosed to their clients that they were owners of the company whose products they were recommending? And what if there was no disclosure at all that the "wealth creation" strategy from the get-go was to leverage their role as trusted advisors to get clients to switch from high-priced third party products to egregiously priced in house products that produced a profit margin that was 8 or 10 times higher?

This becomes an exercise in defining "informed consent". Even if tens of thousands of clients signed disclosure forms that spelled out that the advisor was a shareholder in the company whose products is being recommended, is that enough? It has long been suggested that mutual funds are sold, not bought. If the disclosure documents merely state the fact that the advisor has an equity stake without also disclosing the bias inducing implications of that little fact, most consumers would be ill-equipped to make the linkage. Most consumers, I find, trust their advisors implicitly. The disclosure documents are signed as required, but if you ask a client to explain what she just signed, chances are you'd get a garbled response most of the time. Given the avalanche of associated legal terminology, many people have come to believe that "less is more" regarding disclosure.

If you had the power to recommend consumer products to a client and the products you recommended all paid the same, but one set of products helped to boost the share price of a company where you had a significant portion of your net worth committed to it, would that be an example of bias? Many people think it might be.

The opinions given by advisors who did this will differ, too. Many of them would no doubt answer the way George did on Seinfeld. People will point out the compromise of fiduciary responsibility and the advisors will say- in their most earnest tone- "was that wrong?" Many fair-minded people would suggest that this practice was indeed wrong, even though the regulatory requirements for disclosure were technically met. As a consumer, if an advisor recommended a product to you, ostensibly because it was best for your circumstances, but actually because it was good for that advisor's bottom line, would you feel a certain level of trust had been breached? Would the principle-based test of putting the consumers' best interests first still have been served? Rather than discussing this amongst yourselves, perhaps you could take this up with your friendly provincial securities regulator.

Disclosure of Investment Philosophy

This is to acknowledge that John J. De Goey, MPA, CIM, FCSI, TEP, CFP has advised me that he believes capital markets are sufficiently efficient to justify the exclusive use of passive and/or asset class products. John believes this approach features relative predictability and relatively lower volatility. As such, he has advised that I consider building my portfolio entirely using these investment options, except where no such options exist.

John has further advised me that by using actively managed investment products, I may be compromising the asset allocation set out in my Investment Policy Statement (as some Investment Managers modify their asset allocations on an ongoing basis), and that I may incur higher tax liabilities as a result of higher portfolio turnover. Moreover, these potential shortcomings do not offer any evident or reliably predictable quid pro quo as there is no study evidence to indicate that one can identify, in advance, that those actively managed investment products will reliably outperform passive or asset class alternatives. As such, John's view is that neither fund picking nor stock picking should be attempted.

In essence, John believes that the role of financial advisors involves identifying tax minimization strategies, ensuring that clients have the right amount and right kind of insurance, setting and maintaining suitable asset mixes, extending time horizons and maintaining discipline. The one thing that he does not believe advisors should attempt is to identify securities or securities pickers that will "outperform" after fees over meaningful time horizons. John has provided a copy of the booklet "Redefining Investment Advice" by Brad Steiman in support of this position.

While there can be no assurances that the recommended approach will outperform an active alternative, John has advised me that in the very long run (20 years or more), it is highly probable that a passive or asset class approach will offer satisfactory long term, client specific, risk adjusted, after tax returns and may out perform active alternatives.

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Client	**John J. De Goey**	**Date**