

# Toothless regulators offer no protection

## CSA strikes out with proposals for trust reporting

AL ROSEN

Welcome to securities regulation in Canada.

I have started to wonder whether having no securities commissions at all would be better than what we have now. In many ways, the current regime provides little more than a false sense of security to investors. At least if we dispensed with the pretence, it would be starkly clear that investors are truly on their own.

My thinking was prompted by the release of the Canadian Securities Administrators (CSA) recent whiff at the plate; namely, their proposed improvements for income trust financial reporting. I was interested in the long-overdue proposals for two reasons: (1) to see if any efforts would be made at cleaning up the marketing abuses in the sector; and (2) to see what they would recommend in terms of improving the financial reporting of income trusts.

On the marketing front, I had hoped to see some effort at stopping the misuse of the term "yield" in income trust sales pitches. Most reasonable people would agree that yield refers to regular payments of income.

Quoting a "yield" figure that contains a return of capital is highly misleading for investors. Receiving \$100 in earned income on a \$1,000 investment cannot be compared to getting \$100 of your original investment returned to you. Unfortunately, the CSA did nothing to address this issue, despite dedicating much effort to discussing the disclosure of these so-called "yields."

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If any agency has the mandate to rein in marketing exaggerations when it comes to income trusts, it's the CSA. Nevertheless, the interests of investors again lost out to the desires of corporate issuers. Welcome to securities regulation in Canada.

While ignoring the issue entirely is shameful in its own right, it creates even worse optics when compared with the U.S. efforts in the area.

In this regard, I was reminded recently by independent analyst Diane Urquhart of the 1995 book *Serpent on the Rock*. It details the collapse of Prudential-Bache Securities as a result of the marketing abuses that were rampant in the company's oil and gas limited partnership division.

In the deferred prosecution agreement eventually signed by Prudential-Bache, the U.S. government detailed the company's inappropriate marketing tactics, including the misleading use of the term "yield" when referring to distributions that contain a return of capital.

In complete contrast, the CSA has absolutely no problem with income trusts continuing to refer to a return of capital as "yield."

Likewise, the U.S. government also objected to the use of the term "tax-advantaged" when re-

ferring to distributions that contain a return of capital.

Since getting your own money back does not constitute income, no tax is due on the distribution. However, unless this is abundantly clear, some investors are bound to think that distributions are still income, but simply taxed at a lower rate.

In contrast again to U.S. authorities, the CSA says there's no problem with income trust marketers calling the distributions "tax-efficient" or similar. Going one step further, the CSA says

## TO THINK INVESTORS WAITED FIVE YEARS FOR THIS

that marketers don't even have to mention the return of capital at all if they don't want to. If they do happen to mention it, though, the CSA wants them to quantify the breakdown...well, "to the extent practical" anyway. The breakdown can be either stated clearly, or merely "cross-referenced" (i.e., buried in a footnote).

The marketers get to make the call, it seems.

While the CSA's attempts at cleaning up the marketing abuses were a complete bust, I still held out hope for improvements on the financial reporting front. In this sense, all the CSA had to do

was agree with the recommendations issued last fall by the Canadian Performance Reporting Board (CPRB).

I mentioned last November in this column that the CPRB recommendations seemed quite good.

Instead, the CSA decided to weaken the work of the CPRB. Specifically, the CSA proposals allow for more management vagary, or to use the CSA's words, "more discretion in determining acceptable adjustments in the calculation of distributable cash."

The worst aspect, of course, is that while the CPRB can only make suggestions to companies within its mandate, the CSA could have actually required income trusts to implement significant changes.

The CSA did not do this. Rather, they have proposed "a policy rather than a rule" that contains "guidelines" that "suggest" how income trusts could report their distributable cash.

In the end, the CSA managed to accomplish nothing on the misleading side of income trust marketing, and it managed to weaken proposals that had already been made on the financial reporting front.

The real insult is that key aspects of the proposals are either voluntary or haven't been addressed at all. And to think investors waited more than five years for this.

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