



Purdy Crawford led ABCP restructuring efforts in Canada

BETWEEN THE LINES

Get a grip

Why does most securities enforcement and regulation rest on conflicted SROs and ad hoc committees?

by Al Rosen



Just when it seems that securities enforcement in Canada and the U.S. couldn't be on more divergent paths, something comes along to change your mind—but not in a good way.

While self-regulatory organizations (SROs) exist in many professions, like medicine and law, they are perhaps most notorious in the securities and investment industry, where the financial stakes and conflicts of interest are high. Given the likelihood of abuse in the self-regulatory system, it should surprise nobody that there are regular and numerous head-scratching incidents to make investors wonder who is really protecting them. So why do Canadian legislators continue to rest the bulk of securities enforcement and regulation on the shoulders of conflicted SROs and ad hoc committees?

Perhaps the two biggest issues to solidify the contrast between Canadian and U.S. securities regulation this year have been the ABCP saga and the increasingly dangerous morass of IFRS.

With the first issue, asset-backed commercial paper, individual and institutional investors alike thought they were getting safe investments for parking short-term money. Instead, they got risky exposure to poor investments, had to seek out loans while their money was frozen, and could still face serious losses over the short term.

The moment the ABCP crisis erupted in August 2007, control was seized not by the Canadian government, and not even by a known SRO, but rather by a makeshift alliance of lawyers, institutional investors and various other parties. While the funds remained frozen, vital information was withheld, delay after delay surfaced, highly inventive legal manoeuvres took place and, over a year later, many institutional investors have been bullied into accepting unnecessary losses. While there are many parties that need to share the blame, it is clear that our government oversight failed miserably.

Contrast that with a very similar situation in the U.S. There the offending investments are auction-rate securities, the market for which started freezing up in late February. Within six months, regulatory investigations had been completed, and state and federal regulators were prepared to press charges against the biggest issuers of the securities. Not surprisingly, multibillion-dollar offers to buy back the funds from clients quickly surfaced.

It's amazing the benefits that an active government can bring to securities markets. Unfortunately, Canadians can only stand by and watch in jealousy.

Turning to IFRS, the new International Financial Reporting Standards coming to Canada, our governments have shown equal disinterest in overseeing an SRO that is selling investors down the river because of clear financial conflicts of interest. In Canada, IFRS was rubber-stamped by the accounting standard-setters who are financially controlled by the auditors who, in turn, disavow any duty of care to investors. While the Canadian Securities Administrators asked for public comment on the new standards, they also telegraphed their clear prejudice by attaching what amounts to a highly misleading letter of recommendation from the conflicted auditors.

In the July 21 issue, this column explained how numerous responses from various government ministries essentially passed the buck when it came to questioning the adequacy of IFRS for investor needs. Despite the fact that our legislators never intended to let our auditors hand over control of accounting standards to a foreign entity, that is what happened.

The mere thought of adopting IFRS in the U.S. prompted the House Financial Services Committee to grill Treasury Secretary

Henry Paulson and Federal Reserve chairman Ben Bernanke on the perceived wisdom of adopting IFRS, given its widely reported shortcomings. And that is just the first of many government hurdles that will need to be cleared before the U.S. even considers the mandatory use of IFRS.

The lesson seems clear: it's time to dump the SROs when it comes to overseeing securities enforcement and accounting standards. The financial stakes are too high, and the conflicts of interest in self-regulation are too great to ignore.

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