CANADA

Standing Committee on Finance

NUMBER 064 • 1st SESSION • 39th PARLIAMENT

The Chair:

Thank you very much, Mr. Bruce.

We will continue with Al Rosen, president of Rosen & Associates Limited.

Welcome, Mr. Rosen. It's over to you.

Mr. Al Rosen (President, Rosen & Associates Limited):

Thank you.

I have some handouts. Are they being passed around? Is there one page or are there four pages? I need a clarification. Is there only one page?

The Chair:

All right. The handouts are going around right now, Mr. Rosen.

Please commence.

Mr. Al Rosen:

Thank you.

The first handout is only one page, and it has columns one, two, three, and four on it.

This is a live and actively traded income trust, at the moment, and it's trading for around $9. The name has been withheld, but you'll see that we have tracked nine years, from 1997 through to 2006.

The first column is the sale of trust units. It starts in 1997, with $80 million, and it works its way down to 2004, with $85 million. The next column is debt and redemptions. Column three is the income or the loss for those years. The fourth column is distribution. If you add up the distribution, you can see it comes to $335 million over that period of time. You can also see that the income loss is $133.6 million. The translation is that the distributions are 250% of income and they paid out $201 million in excess of what they earned.

Backing away from this for a minute, we work with two corporations. Number one is the Accountability Research Corporation, which does this type of thing. Our second business is forensic accounting, and we're very heavily involved in securities problems. Intertwined with the tax is all of the reporting that is going on.

You can see from this particular situation that the typical lingo for this is a pyramid scheme, or if you can prove conspiracy, recklessness, and so on, it becomes a Ponzi fraud. Having tracked most of this material for several years, my concern has been extensively along the lines of these pyramid schemes and Ponzi frauds being well over half of the income trusts.

If you turn to page 17, you'll see something that starts with “Medical Facilities - IDS”. This is a study we did that was published in November 2005, and I have deliberately brought this material today to show what the situation was like before we had the various flip-flops happening.

The first column is income as a percentage of what was distributed. You can see with the first three, with the dashes, that the income was in fact a loss. As you work down the columns—and there are roughly 50 companies here—you see that very few of them were actually distributing out of their net income. It was coming from other sources.

The next column is the cash yield as of November 9, 2005, and I might add that things have become substantially worse since then. For example, Medical Facilities had 10.90% of a cash yield. This is cash being distributed to people compared to the trust unit price at the time. How much of that 10.9% came from income? It was zero. It was all a return of capital.

There is nothing wrong with returning capital, as long as you tell people that is where it is coming from. The fraud allegations come in as a result of not telling people what the sources are. This is of deep concern to us.

If you keep working your way down the columns, you can see that very little income is being produced by a large percentage of these particular trusts. Overall, you are seeing 4.97% in the third column, and you're seeing 2.98%, which is a straight return of capital. That has become significantly worse since then.

As in the first example I used, you can see how serious the problem is. It's not being regulated. The securities commissions came up with something a couple of weeks ago that does not regulate this. The chartered accountants are not regulating it. They have one subgroup, which is not part of the standards board, that I think has a good idea that needs to be developed.

(1115)

The next page, as you can see, starts with heating oil partners at the top left. The first column over is the issue date, when these items were sold, and then what the offering value to the public was, and then you see the current value and the decline. These declines go from 100% down to 30%, which is where we cut it off. Since then, this table has tripled in numbers and problems.

If we go to the next table, this is one of capital maintenance. The argument is that we are simply distributing back to you depreciation and the tax savings. This is sheer nonsense for two-thirds or three-quarters of the trusts we track, which is most of the business trusts. If you look at the column, you can see that maintenance capital expenditure is 0%, so the money is not being reinvested. What's happening here is quite different from the stories we see in the media. The figures really tell you a totally different story.

(1120)

The Chair:
I have to cut you off, but there will be time for questions, of course.

The Chair:
Thank you, Madam.

Madam Wasylycia-Leis.

Ms. Judy Wasylycia-Leis (Winnipeg North, NDP):
Thank you, Mr. Chairperson.

Let me go to Mr. Rosen first. I'm a bit surprised at John McCallum's suggestion that there's no relationship between what he has documented in possible illegalities and Ponzi schemes and what we're dealing with today, which is the future of income trusts and whether or not the decision made by the government makes sense.

It seems to me that's awfully irresponsible. It would be almost like suggesting that a plane can be cleared for takeoff without making sure it has enough fuel to get to its proper destination. After the sponsorship scandal, I would think the Liberals would be a little more concerned about trying to explore this issue and these allegations.

Hon. Robert Thibault:
It's an interesting relationship.

Ms. Judy Wasylycia-Leis:
It's a very interesting relationship. There's a pattern here, I think.

Mr. Rosen, you have suggested that something fairly significant and unethical is taking place. I don't want to put words in your mouth, but the legal implications of what you're saying almost seem to be on the scale of the Enron scandal in the United States.

Do you want to comment on that and, at the same time, address your numbers on the financing of paid distributions at 250% of income? Is that occurring regularly in Canada? I think that's relevant to John McCallum's assertion and the findings of this committee.

Mr. Al Rosen:
It's extremely frequent. We've been tracking these trusts for a long time.

We have two major concerns that don't get addressed. One is the Accounting Standards Board in Canada. We're the only country in the world that allows the auditors to set the rules, so it's no great mystery that the rules are loose. I'm in court extensively on these types of cases. So I don't know how we can possibly allow that to happen.

We also allow provincial securities commissions, and I've testified before them many times. There's no point in talking to the RCMP, I'm sorry to say. I've done that 20 times and these cases go nowhere. So we have a situation across Canada where no one is looking at the interests of the investors.

On Mr. McCallum's reference to the securities commission and the document it put out a couple of weeks ago, I will have a response to that in the *National Post* perhaps as early as tomorrow. It's very clear that nothing is happening in that area.

We sat through the Nortel fiasco; we're now sitting through the income trusts. If you look at my track record, I've called many of these over the last 20 or 30 years. So I'm saying we have a crisis in Canada—the worst I have ever seen. It absolutely shocks me that we're foot-dragging on what is clearly the cause of the problems of the gentlemen here and many others.

No one is taking action. We're working with the class action lawyers because they're quite concerned. I also write every second issue of *Canadian Business*. Do you think I don't get e-mails, Mr. McCallum? I get tons of them, and they certainly don't support the foot-dragging that's occurring.

We have a major problem here, and passing it off and saying it's the responsibility of the provinces or somebody else is absolutely irresponsible, in my opinion.

(1150)

Ms. Judy Wasylycia-Leis:
One of the suggestions made by some of the witnesses, including Mr. Bruce and others, is that we can ease the pain and not cause any problems by extending the grandfather clause from four years to ten years.

What's that going to solve, Mr. Rosen?

Mr. Al Rosen:
It's not going to do anything. In fact, the e-mails I get are telling me to find someone who's a bigger sucker to sell these things to. So it would be the worst thing on earth to not clamp down immediately.

I'm sorry, gentlemen, but sell your trusts except for a handful of important ones, because we have not seen the end of the decline in trusts. We have gross inflation in the market.

Let me take one example: Aeroplan. Probably no one else in the room knows that when it was formed out of Air Canada all of the obligations to redeem the points were given to Aeroplan; the cash was not. This is the old joke about the marriage and the split-up: I take the house, my spouse gets the mortgage. That thing is selling for $19 now. They frankly admit that 75% of the distributions are return of capital for fiscal year 2006. In 2005 it was 84%. So why is it at that point?

The Chair:
Thank you, Madam Wasylycia-Leis.

We continue now with Mr. McKay. To permit as many members as possible, just go with three minutes, John.

The Chair:
Mr. Dean Del Mastro now.

Mr. Dean Del Mastro (Peterborough, CPC):
Thank you, Mr. Chair.

Mr. Rosen, the finance minister acted very definitively on this issue. We dealt with it in what we felt was the fairest way to deal with it. It was obviously a very difficult situation. Could you talk a little bit about the difference between...maybe you could touch a little bit on how investors were hurt through the various muddlings that went on with the issue in 2005, how a number of people who were in the know made quite a bit of money on that, and talk about how that is wrong.

Mr. Al Rosen:
Yes. I thought in September 2005 that the warning signal had been given, that it was a good move, and that hopefully it would have cleaned things up. The reversal in November floored me, personally. The fallout we've seen after that has been significant.

What amazes me is that somehow or other, on the distributions, if you use a typical 8% distribution and 75% of that is a return of capital—and there are quite a few companies like this—then your real return is 2%. But the market is somehow capitalizing the 8%. If you look at many of the newspapers and the articles, they call that 8% the yield.

From my point of view, the action taken on October 31 was overdue. It should have been taken a long time before, because of the Ponzi frauds.

(1200)

Mr. Dean Del Mastro:
In your opinion, the market correction on trusts was inevitable?

Mr. Al Rosen:
For sure. I can sit here right now and tell you we're going down a long ways still.

Mr. Dean Del Mastro:
Right.

I'm going to give you a quick preamble and tell you a story. My uncle started working full time at 15 years old, retired a number of years ago, and took a significant loss on October 31. He had a significant portion of his portfolio in income trusts. Obviously he was not my only family member who was caught in that.

How did this happen? How did we get here? We've had Bank of Montreal officials come in and compare these income trust investments to junk bonds and high-yield bonds. How did we get here?

Mr. Al Rosen:
Well, it's massive hype. If you want to look at the number of inserts that were in the newspapers that were pure income trusts, if you want to look at the brokers—The brokers call me. You have TV stations doing this. It was just absolutely ridiculous hype telling people what the yields were, what the distributable cash was.

Even calling these income trusts—They are not income and you can't trust them. So with the wording that came out, all of this was highly misleading. Why aren't the underwriters number one on the list to blame? Why aren't the brokers second? Why aren't the accountants third? We can go down the list. Why people are blaming the two federal governments of the last few years is beyond me. Somebody had to act.

The Chair:
Thank you, Mr. Rosen.

Thank you, Mr. Del Mastro.

We'll conclude with a quick question from Mr. Pacetti.

Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.):
Thank you, Mr. Chairman.

Mr. Rosen, I just want to ask you a couple of questions

Just quickly, we're here for tax leakage, and I think we're getting away from the subject. But I think the points you bring up are quite important, and it probably means that we have to spend a little bit of time on this. I think your points were mainly on governance and regulation and on how that's interlinked when investors are putting money into these vehicles, whether it be trust or even shares of companies.

First of all, you have a problem with trust funds, income trusts, but what about the real estate tax sector? The government decided to keep the real estate tax sector going. They're going to have the same problems.

Secondly, for corporate structures, you can't tell me that junior mining companies out there have not undergone significant scrutiny, or non-scrutiny, if you wish, where they state that they've discovered minerals, diamonds, or gold—you name it—and meanwhile they're not worth anything. The marketing or the underwriters, or whoever you want to blame it on, have brought the stock prices up to the sky, and then all of a sudden they've dropped overnight.

So you can't tell me it's just in the trust sector. I'm not sure how you can correlate the two, where you can say it's fine that the corporate sector remains alive, and that the real estate sector and the income trust sector remain alive. You can't have it both ways.

This is not the issue of the hearings, but we're here to find out what the actual tax leakage is and why Canadians suffered all these losses. Again, I agree with your last comment, which was that the actions of the previous government are not necessarily what caused Canadians to lose all their money. But I think the Finance officials say that nothing happened between October 31 and November 1 outside of the government announcement, so I think today's new government has to take part of the blame.

Mr. Al Rosen:

As for your comment about comparing to mining and other industries, I don't know how anybody can look at the figures that I gave you today, plus all the updates we've done since then, and come to any other conclusion than that these were quick disasters. They dropped very quickly. So the whole model, to start with, stunk, and there's no question about that. The winners out of it were the underwriters and brokers.

So if you're saying real estate and other corporate...people are quite well aware of the problems, and you are following along on a particular level. Once you decide that 90% or 80%—whatever the number is—of trusts go down the drain so quickly, I don't know what alarm bells one needs. This was a bad model.

(1205)

The Chair:

Thank you, Mr. Rosen and Mr. Pacetti.