SECTION C
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Curb on income trusts badly needed

Investment bankers and lawyers have made $1.4 billion, while the public lost some $5 billion.

Clearly the wolves are worried. With the lucrative lamb supply in jeopardy, they are desperately trying to coax the flock into complaining to the shepherd about new restrictions on the fleecing program.

OK, enough mucking about with the fables. This column is a direct response to two ads in ***CARP*** magazine, which is aimed at the 50Plus crowd. The more provocative full page one trumpets "Minister Flaherty, you've taken away money from my household budget; you've taken away investment choices for me and my family." This was paid for by the Canadian Association of Income Funds (CAIF), so you know who's leading the charge.

A few pages earlier, a quarter-page ad had caught my eye: "Think Flaherty should be limiting your investment choices for retirement? Is your voice being heard in Ottawa? If not, Join us today—Together we can make a difference." Paid for by the Canadian Association of Income Trust Investors (CAITI).

Hmnn! Ordinary Canadian investors are banding together to try and overturn the surprise income trust clampdown by the feds? A quick glance at their website puts that in perspective. The founding members are "four individuals (with an average age of 62 years)." Maybe there's some substance here? Until we read the rest of the list of founding members: Coalition of Canadian Energy Trusts, Sentry Select Capital Corporation, CI Investments, Dynamic Funds, Acuity Funds Ltd., Citadel Group of Funds, Brompton Funds, Gluskin Sheff + Associates, Borden Ladner Gervais, PricewaterhouseCoopers, Lawrence Asset Management Inc.

High priced legal talent, one of the big four accounting firms, and a slew of investment outfits. That's hardly an organization of "investors."

There's no question that income trusts took a big hit last October. There's no shortage of upset retirees. That Alberta senior who tore up his PC membership card and vowed never again to vote Conservative said a lot. Even more telling is the fact that he had 82% of his retirement funds tied up with income trusts. Who was his investment advisor? Which particular wolf would place 82% of a retiree's eggs in one basket? Naiveté of that order cries out for some regulation in this investment wilderness.

It was just one year ago that I first wrote about the income trust fiasco. The thrust came from a disturbing report by Accountability Research Corporation in which Mark Rosen suggested that business income trusts were overvalued by 28% on average. I can bore you for the next ten minutes quoting statistics. Let's just look at two things. There are 288 income trust funds listed on the Toronto Stock Exchange and TSX Venture. CAIF won't tell you this, but up until January 19, 2007, some 60% of the business income trusts were in a capital loss position since their initial and secondary public offerings. That's 170 business income trust offerings in the hole. Hardly a safe haven for retirement savings.

The real problem is not these losses, it is not the trust structure itself, and most certainly it is not the government crackdown. Diane Urquhart, an independent consulting analyst, has been keeping me up to date for a year now, as she hammers away at the cult of secrecy and greed in the income trust world. The simple truth is that there are no accounting rules in place to protect investors.

The investment community has been fighting tooth and nail to prevent full disclosure of those trust distributions. The Canadian Accounting Standards Board published a decision on May 3, 2006, that "the AcSB is concerned that the failure to distinguish clearly between returns on capital and returns of capital is inaccurate and potentially misleading, particularly when terms such as yield are used to describe the amount distributed." In a ***National Post*** interview, Paul Cherry, chair of the AcSB was very blunt: "the income trust sector has somehow convinced people that the cheque they get is a measure of economic performance. That's just drivel…the notion of yield has been distorted from a marketing point of view."

Take Yellow Pages Income Trust for just one example. ***MoneySense*** records that the fund has a distribution yield of 6.4%. Yet the company has an earnings yield of only 3.4%. They're paying out more than they're making. A good chunk of that distribution is your own money being mailed to you in the guise of great investment earnings. The Canadian Securities Administrators don't want you to know that, neither does the investment community.

Unfortunately, too many investors don't see the problem. The reaction is "so what! The value of my fund has gone up every year. I can't be just getting my money back because the fund is now worth more than I paid for it." Forensic accountant, Al Rosen, has a simple answer for that in ***Canadian Business*** magazine: "Investors are willing to bid up the price of trust units above their fundamental profitability." And why are the doing that? Because most unsophisticated investors just don't realize that those terrific yields are a smokescreen; that their income funds are not doing as well as the inaccurate accounting implies. They think everything is tickety boo and they're willing to pay more and more. Eventually reality catches up and, in the extreme, the fund goes bankrupt. That's already happened. Just ask investors in Heating Oil Partners Income Fund, which owned 88.1% of one of the largest residential heating oil distributors in the US, how they feel. A safe, secure retirement fund that is now worth precisely zero.

If you still want to participate in a letter writing campaign, I would suggest a note to Dalton McGuinty. Ask him why, under his government's watch, Sentinel Capital Corporation made a cash profit of $107 million on the conversion of Spinrite into an income trust. This was a sound and previously successful business in Listowel. Yet, in just 18 months since that fund was floated, investors have lost $186 million. The wolves, of course, are still howling with laughter; their own millions of up-front cash safely in the bank. While you're at it, ask Dalton why the CEO of Teranet Income Fund management hit the jackpot with a $70 million plus bonus for restructuring Teranet on his government's behalf. Something smells here.

In her report, "Income Trusts—Heads I Win Tails You Lose", Diane Urquhart pointed out those two rip-offs. She has a lot more horror stories if you want to see them. Ask Dalton if he's read that report. Ask CAITI to explain why we poor innocent sheep should go to bat for the benefit of investment bankers, lawyers, and accountants that made $1.4 billion of fees on the business income trust offerings where the public has capital losses of $5 billion. Ask someone—anyone—why we should fund the retirement dreams of greedy CEOs?

And do write Flaherty. He'd like to know what he did wrong by trying to stop the slaughter.

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