FAIR Canada Canada's Investor Rights Advocate | Promoteur des droits des investisseurs

October 7, 2024

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

Re: Proposed OSC Rules 11-502 and 11-503 and Companion Policies 11-502 and 11-503 – Distribution of Amounts Paid to the Ontario Securities Commission (OSC) under Disgorgement Orders

FAIR Canada is pleased to provide comments in response to the above-referenced consultation.

FAIR Canada is a national, independent, non-profit organization known for balanced and thoughtful commentary on public policy matters. Our work includes advancing the rights of investors and financial consumers in Canada through:

- Informed policy submissions to governments and regulators
- Relevant research focused on retail investors
- Public outreach, collaboration, and education
- Proactive identification of emerging issues.[1]

A. General Comments

When investors suffer losses due to misconduct, they need and expect to be financially compensated for those losses. Compensating harmed investors shows that the regulatory system works for them and aligns with their expectations.

FAIR Canada supports and is pleased to see the OSC move forward with a proposal for distributing disgorged funds to harmed investors (the Proposal). Once implemented, Ontario will join several other jurisdictions that created compensation schemes enabling harmed investors to recover some losses through a regulatory process. These schemes help promote confidence in the capital markets by offering wronged investors another avenue for financial redress.

[1] Visit www.faircanada.ca for more information.

We appreciate that the Proposal was designed to subsidize the administrative costs with monies collected from other financial penalties to maximize the amount investors ultimately recover from disgorgement orders. We support this approach. However, we encourage the OSC to minimize distribution costs as much as possible and to maximize the amount that ends up in the hands of harmed investors. These priorities should guide the OSC's decisions when implementing the Proposal.

In our comments below, we discuss two main ways to help achieve this goal:

- ***Improve collections***: The disgorgement framework's success will primarily depend on the OSC's ability to collect money subject to a disgorgement order. Legislative changes are needed to give the OSC better tools to improve collections, which will help maximize amounts available to harmed investors.

- ***Minimize administrative costs***: The Proposal contemplates that a court-appointed, third-party administrator (Administrator) will conduct most distributions. Administrators can be costly and should only be used where necessary. In many instances, the regulator can effectively administer the distribution, as is the case when the British Columbia Securities Commission (BCSC) returns money to harmed investors. The OSC should establish clear criteria for when it will seek the appointment of an Administrator and how it will decide who to put forward for the role.

The second part of the letter focuses on specific aspects of the disgorgement framework outlined in the Proposal and offers recommendations to enhance these features. Lastly, we discuss the importance of giving the Ombudsman for Banking Services and Investments (OBSI) binding authority, which will significantly improve investor compensation and protection.

B. Effective Collections are Critical to the Framework's Success

The disgorgement framework's success depends on the OSC's ability to collect on disgorgement orders. Unfortunately, collection rates for disgorgement orders are low. Between 2015 and 2024, the OSC ordered approximately $266 million disgorged but only collected about $21 million, representing a collection rate of under 8%. As the Auditor General's audit of the OSC (the Audit Report) stated, "When monetary sanctions are unpaid, it can weaken the impact that the OSC's orders have in deterring wrongful conduct, the OSC's enforcement authority and the confidence that investors have in Ontario's markets."[2]

Given these low collection rates and their effect in undermining confidence in the system's integrity, the OSC must be given the authority and legal tools to collect financial penalties imposed on wrongdoers. The Ontario Capital Markets Modernization Taskforce Report[3] and

[2] Office of the Auditor General of Ontario, Value-for-Money Audit of the OSC, December 2021, p. 31.
[3] Capital Markets Modernization Taskforce Final Report, January 2021.

the Audit Report recognized this imperative and made recommendations in this regard. For example, both reports recommended giving the OSC the power to restrict a wrongdoer's access to a driver's licence or licence plates when they have unpaid monetary sanctions.

These recommendations were based on amendments to British Columbia's (BC) *Securities Act* in 2019 that significantly strengthened the BCSC's collection powers. Specifically, these include:

- The BCSC can notify the Insurance Corporation of British Columbia not to issue or renew a wrongdoer's driver's license and/or license plates because of failure to pay amounts owing to the BCSC.[4]

- Any amount owing under a BCSC disgorgement order automatically forms a lien and charge in favour of the commission on the entire property of the person or the estate of the person in the hands of any receiver, receiver manager or trustee and, subject to a few exceptions, has priority over all other claims.[5]

- Where a person suspected of breaching the BC *Securities Act* transfers property below market value to a family member or third party, the BCSC can make orders regarding the preservation and disposition of that property.[6]

In addition, in 2023, amendments to BC's pensions laws removed the exemption for certain pension-derived funds from enforcement processes under the *Securities Act*,[7] allowing the BCSC to collect money from wrongdoers' pension-related income as well.

When the BC government announced the widespread collection and enforcement changes to the *Securities Act* in 2019, the Minister of Finance stated, "Our government is taking action to make sure we have the strongest protections in Canada for people who are investing and tough penalties for those who are abusing the system."[8] We see no reason why investors in Ontario should have weaker protections than those in BC. Ontario is home to most Canadian market participants, and the OSC is Canada's largest capital markets regulator.[9] Given its responsibility to foster confidence and integrity in Ontario's capital markets, the OSC must also be given the tools to enforce tribunal or court-imposed financial penalties, including disgorgement orders.

We urge the Government of Ontario to work with the OSC to amend the *Securities Act* (Ontario) to align with the collection powers in BC. This would give the OSC more effective

[4] BC Securities Act, R.S.B.C. 1996, c. 418, s. 163.2.
[5] Ibid., s. 163.1
[6] Ibid., s. 164.04.
[7] Bill 4, Finance Statutes Amendment Act, 2023; BCSC BC Notice 2023/07, Notice of Amendments to the Securities Act, July 20, 2023.
[8] BCSC News Release, BCSC to Get Strongest Collection and Enforcement Powers in Canada, October 21, 2019.
[9] Government of Ontario, Ontario's Capital Markets, April 22, 2022.

tools to collect monetary penalties and would go a long way toward ensuring the Proposal achieves the intended outcomes for investors.

Finally, we encourage the OSC to periodically review its collections program and consider ways to improve it. The U.S. Securities and Exchange Commission's (SEC) approach is helpful. In 2020, the SEC created a dedicated Office of Bankruptcy, Collections, Distributions, and Receiverships in the Division of Enforcement "to further build upon improvements in distributing money to investors."[10] It oversees the process for collecting monetary judgments and returns money to aggrieved investors. In establishing the Office, the SEC noted that by centralizing functions, it expects to achieve additional efficiencies and maximize results for investors.[11] The OSC should consider measures such as this to strengthen collections.

C. Minimizing Costs and Maximizing Amounts Distributed

The Proposal states that for most distributions, the OSC anticipates using an Administrator rather than distributing the funds itself. In contrast, we understand that using an Administrator to distribute money to harmed investors is uncommon in BC. It is unclear why the OSC would take a different approach, particularly since using an Administrator would be more expensive and could deplete a substantial portion of the OSC's Designated Fund.

We encourage the OSC to establish clear guidelines on the factors it will consider when seeking an Administrator and the process for choosing them. The guidelines should ensure that Administrators are only used when necessary and that their selection and performance are transparent, accountable, and beneficial to wronged investors. We recommend that the guidelines address the following issues:

- ***Criteria for seeking an Administrator***: The OSC should establish criteria for when it will seek an Administrator. The OSC should be satisfied that an Administrator's expertise and resources provide clear advantages that justify the additional costs (e.g., the distribution is complex, involving many investors in multiple jurisdictions).

- ***Request for proposals (RFP) process/fee quotes***: The OSC should create a process for deciding which Administrator(s) to include in its application to the court. The OSC should consider issuing an RFP to develop a roster of qualified, cost-effective Administrators. When a distribution arises for which the OSC is seeking an Administrator, it could request fee quotes and any additional relevant information from roster members. The OSC should be transparent about the extent to which costs are a key factor in who it recommends to the court.

[10] SEC Division of Enforcement, 2020 Annual Report, p. 5.
[11] Ibid.

- ***Accountability***: As part of the RFP process, the OSC should consider whether the Administrator is committed to providing regular, detailed reports to the OSC and updates to the eligible investors, including expense reporting.

D. Additional Comments on Specific Features of the Proposal

1. Eligibility

FAIR Canada supports the definition of "eligible applicant" in section 1 of the Proposal. An applicant must have incurred direct financial losses because of the contravention and not have directly or indirectly engaged in the wrongdoing.

Limiting eligibility to those who suffered a direct financial loss because of the violation is reasonable. Disgorged amounts collected are typically low relative to investor losses. Expanding eligibility beyond those with a direct loss would reduce the already small amount each investor would receive.

We also agree that eligibility should not be restricted to investors identified in the underlying enforcement action, as it may not have captured all harmed investors.

The definition also promotes harmonization with BC, which uses a similar definition of eligibility under its regime for returning money to harmed investors.[12]

We support allowing eligible investors to seek compensation from other sources because they will likely not recover their total losses from a distribution of disgorged funds. Therefore, preserving their right to use different avenues to enhance their chances of full recovery is critical.

We agree that investors should not be entitled to double recovery. To prevent this, we support the requirement in section 9(3) that applicants disclose any payments that have been or may be received from other sources.

2. Notice to Investors

Section 4(1) requires the OSC to post notice of the claims process on its website if a distribution is required. The Companion Policy (CP) notes, however, that the OSC *may* provide notice through press releases, social media channels, and investor advocacy organizations. Further, the CP states that if the OSC is conducting the distribution, it will

[12] Securities Regulation, B.C. Reg. 196/97, s. 7.1.

also attempt to send the notice to the last known address (including an e-mail), if available, of any known potential eligible applicants.

We recommend that the requirement be reversed. Notice should be provided through multiple channels unless there is a good reason not to. We believe relying solely on a website posting as the default will never be sufficient. Many investors may be unaware of the OSC or its role, and even if they are aware, they may not appreciate the need to check the website for this type of information.

As the key document that triggers the claims process for the investor, notice should be as broad as possible. As such, for all distributions, in addition to posting notice on the OSC website, the rule should specify that the OSC is required to send notice:

- To potential eligible applicants' last known mailing and email addresses, if available. This aligns with the regulations under the *Civil Remedies Act*, which require notice to be mailed to the last known address, if available, of each known victim who suffered a loss due to unlawful activity.[13] The OSC / Administrator should be required to make reasonable efforts to ascertain the last known addresses;

- By press release. This is consistent with the BCSC's requirement to issue a press release when it has received money that gives rise to a claims process;[14] and

- Via the social media channels the OSC commonly uses.

In addition, where the OSC has reason to believe some harmed investors belong to particular linguistic communities, notices and press releases should be translated into the relevant language(s) and designed to reach investors in remote communities. Finally, we agree that the OSC should use investor advocates to amplify notice, and we support keeping this in the CP.

3. Claims Application

Section 9(1) requires applicants to use a claim form that the OSC provides. The CP states that applicants will generally have the option to file claims electronically or use a paper form. The OSC should also consider accepting claims information by phone in special circumstances to ensure the process does not deter a legitimate claimant.

Section 5 provides that if the information in an application changes in a material respect so that it is untrue or misleading, the applicant must promptly update the OSC or Administrator. Further, section 6 allows the OSC to deny an application if the applicant fails to comply with section 5 or if the application contains untrue or misleading information.

[13] Ontario Regulation 498/06 - Payments Out of Special Purpose Accounts, s. 5(2).
[14] BC Policy 15-603 Returning Funds to Investors, March 27, 2020.

Given the importance of updating a claimant's information, the claim form should include a clear statement to this effect. The statement should explain the applicant's obligations in clear, plain language and include examples of when these obligations are triggered. Everyday investors may not understand a material change, so providing examples of key information that may change would be helpful. Moreover, "promptly" is vague and open to interpretation.

Lastly, the claim form should clearly explain when or why an application might be denied and what the applicant can do if that happens. This will help avoid investors being caught off guard should their application be rejected. In particular, the form should explain that (1) having false or misleading information in the application could cause the OSC to deny the application, and (2) the OSC must allow applicants to provide additional supporting documentation to substantiate their eligibility if the claim is denied in whole or in part.

4. Proof of Financial Loss

Section 9(2) states that unless the claim form provides otherwise, the claim must describe the applicant's direct financial loss and the amount claimed, supported with documentary evidence.

We are pleased that the CP recognizes that there may be cases where the OSC has sufficient information to assess investors' financial losses. We recommend that the OSC try to proactively identify harmed investors and ascertain their claim amounts as much as possible. In such cases, the investor would confirm the claim amount without submitting any documentary evidence (a confirmation of the claims process). However, documentation would be required if the investor wishes to claim a different amount.

There may be situations where neither the OSC nor an applicant can obtain sufficient documentary evidence to support a claim. We therefore encourage the OSC to consider whether this requirement could or should be waived in exceptional circumstances.

5. Timeframes for Filing a Claim and Denial of Claim

We support the requirement in section 8(1)(e) to give investors at least 90 days to file a claim after the OSC provides notice of a claims process. This timeframe aligns with the BCSC regime, in which the application deadline must be at least three months from the date of the notice.[15]

The CP provides that the OSC will not consider any claim filed after the filing deadline. However, we believe the OSC should accept applications after the deadline in exceptional

[15] Ibid.

circumstances. For example, an applicant may be severely ill, hospitalized, or experiencing a period of incapacity during the filing period. In such circumstances, the OSC should allow late applications.

Section 11(1) gives investors 30 days to provide additional information if their claim was denied in whole or part. In contrast to the BCSC scheme, the Proposal does not give claimants an opportunity to be heard (OTBH).[16] We understand this difference is intended to balance fairness to the investor (so they can explain why their claim should be allowed) and procedural efficiency (so that disputed claims do not unduly delay the distribution). However, we believe the OSC should consider including an OTBH. The benefits of an OTBH include:

- It is a more interactive, transparent process that allows investors to explain their situation and clarify misunderstandings.

- It addresses potential concerns about due process and helps build confidence in the framework.

The OSC could establish clear timelines and parameters around the elements of the OTBH to address concerns about undue delay. For example, once the applicant receives the OSC's decision to deny the claim, the OSC could require the applicant to respond within two weeks indicating they wish to have an OTBH. The OSC could also set deadlines for the OSC and applicant to provide their written submissions.

6. Reporting and Disclosure

We appreciate the OSC's efforts to be transparent about the amount of disgorged funds received and the details of particular distributions. For example, section 3 requires the OSC to publish and update the amount of money received under disgorgement orders. Part 7 requires the OSC to issue a report after disgorged funds have been fully distributed with various details about the distribution.

In addition to reporting on specific distributions, we recommend that the OSC's annual reports include information about how the disgorgement framework is working, including challenges and successes. This transparency will help enhance public confidence in the framework and allow stakeholders to assess its effectiveness and consider ways to improve it.

Under section 2(1)(b), the OSC may decline to distribute funds if, in its opinion, the administration costs would not justify the distribution given the amount of disgorged funds and the number of possible eligible applicants. We are concerned with the lack of

[16] Securities Regulation, *supra* note 12, s. 7.5

transparency regarding how such decisions will be made. A clear, robust, defensible process for the OSC exercising its discretion not to distribute funds will help instill trust in the disgorgement framework.

We recommend that the OSC:

- Establish guidelines setting out how it will determine whether to conduct a distribution to help ensure consistency, and

- Disclose instances where it determined a distribution was unwarranted and why in its annual reports and on its website where it publishes the amount of money received under disgorgement orders.

Where a distribution is deemed impractical, disclosure reassures investors that the OSC appropriately considered their interests. It also helps set investor expectations and clarifies how similar situations may be handled in the future.

7. Plain-Language Materials

We support the OSC's commitment to developing plain-language resources to help investors understand the distribution framework and the application process. We encourage the OSC to ensure that the notice, the key document that triggers the compensation process, is written in a way that boosts investor engagement. The OSC should conduct or draw on behavioural research to determine how best to draft the materials to enhance investor participation. The materials should also manage expectations about what the framework can achieve, given that investors may receive relatively small compensation compared to their losses.

E. OBSI Binding Authority Will Strengthen Investor Compensation

We appreciate the OSC's efforts in developing the disgorgement framework and improving collection rates. However, the reality is that only a fraction of the amount ordered disgorged is actually collected and available for distribution. Between 2015 and 2024, the OSC only collected 7.85% of the amount ordered disgorged.

The low collection rate underscores the need to strengthen other ways for investors to recover their losses. In November 2023, the Canadian Securities Administrators (CSA) published a proposal to grant OBSI the power to issue binding decisions. Binding authority would significantly improve investor protection and compensation and modernize our regulatory system to align with other jurisdictions.

If we are serious about improving outcomes for wronged investors, binding OBSI authority is essential. OBSI's free, accessible, and efficient complaint handling is better suited than

the regulatory framework for handling individual complaints and providing compensation where warranted. We urge the OSC, other CSA members, and governments to work together to expedite legislation to make binding OBSI decisions a reality.

****

Thank you for considering our comments on this important issue. We welcome any further opportunities to advance efforts that improve investor outcomes. We intend to post our submission on the FAIR Canada website and have no concerns with the OSC publishing it on its website. We would be pleased to discuss our submission with you. Please contact Jean-Paul Bureaud, Executive Director, at jp.bureaud@faircanada.ca or Tasmin Waley, Policy Counsel, at tasmin.waley@faircanada.ca.

Sincerely,

Jean-Paul Bureaud
President, CEO and Executive Director
FAIR Canada | Canadian Foundation for Advancement of Investor Rights