

August 3, 2024

The Secretary

Ontario Securities Commission

20 Queen Street West, 22nd Floor, Box 55

Toronto, Ontario M5H 3S8

Email: comments@osc.gov.on.ca

RE: Notice and Request for Comment: Proposed OSC Rules 11-502 & 11-503 and Companion Policies on Distribution of Amounts Paid to the OSC under Disgorgement Orders

Dear Secretary,

I am writing to express my support for the proposed Disgorgement Distribution Program, which represents a significant advancement in protecting retail investors in Ontario. My comments are informed by my experience in investor advocacy and financial regulation, as well as a review of relevant research and international best practices.

Clarifying Disgorgement and Prioritizing Investor Compensation

The proposed rules commendably distinguish between disgorgement and restitution. However, to ensure adaptability across diverse scenarios, I recommend explicitly defining "ill-gotten gains." This definition should encompass all forms of unjust enrichment from misconduct, including unjustly earned bonuses, profits from illegal transactions, and commissions from unlawful activities. Such a comprehensive definition aligns with Canadian jurisprudence principles, as seen in cases like *Strother v. 3464920 Canada Inc.* and *Cadbury Schweppes Inc. v. FBI Foods Ltd.*, where courts have prevented wrongdoers from profiting in any manner from misconduct.

Prioritizing investor compensation over fines in enforcement actions is both ethically sound and supported by empirical evidence. A study in the Review of Financial Studies found that disgorgement significantly deters future misconduct compared to fines. This approach also aligns with OSC Staff Notice 15-702 (Revised Credit for Cooperation Program), which conditions program qualification on:

Self-reporting and Remediation: Market participants are encouraged to promptly self-report violations and take swift action to remediate harm caused to investors or the market.

Compensation to Harmed Investors: Emphasizes providing appropriate compensation to harmed investors, prioritizing investor protection and ensuring accountability.

Prioritizing Investor and Market Protection Over Firm Interests: The OSC will not grant credit for cooperation if the firm prioritizes its interests over its obligations to clients, shareholders, or market integrity.

Addressing Collection Challenges and Streamlining Distribution

The proposed rules acknowledge the challenges in collecting disgorgement, especially from unregulated parties. While the OSC's recovery efforts are commendable, I suggest reviewing U.S. Securities and Exchange Commission (SEC) practices. The SEC effectively collects fines through aggressive enforcement, collaboration with other agencies, and sophisticated data analytics. The OSC could benefit from adopting or adapting some of these approaches to enhance its collection process.

To streamline distribution, I recommend a tiered approach:

Direct Distribution: When harmed investors are easily identifiable, the OSC should distribute disgorgement directly without requiring claims, aligning with the "victim-centered" approach advocated by the International Organization of Securities Commissions (IOSCO).

Simplified Claims Process: For cases with numerous or unknown victims, establish a simplified claims process with clear instructions and minimal documentation, inspired by successful models like the SEC's Fair Fund initiative.

Enhancing Transparency and Guidance

Transparency is crucial for developing and maintaining public trust. I recommend that the OSC publish detailed guidance on:

Standardized Principles: Clearly define principles for calculating disgorgement to ensure public understanding while addressing evidence variability.

Distribution Criteria: Clearly outline criteria for prioritizing distribution, especially when funds are limited.

Regular Reporting: Provide regular reporting on program outcomes, similar to the UK Financial Conduct Authority's (FCA) reporting, including the number of cases, amounts collected/distributed, and processing times.

I support the proposal to make all impacted investors eligible for disgorgement payouts, regardless of participation in complaints or proceedings. The only prerequisites should be that investors have incurred a direct pecuniary loss and did not engage in the contravention. This approach strengthens investor protection and aligns with IOSCO principles on credible deterrence.

Addressing Dealer Disgorgements and Third-Party Compensation

While extending disgorgement orders to parties not involved in the original proceedings, such as dealers, raises concerns about procedural fairness and may exceed the OSC's current rulemaking authority, in my view it is essential to enhance accountability and consumer protection. I urge regulators to identify methods to encourage or oblige dealers to honour disgorgement orders levied on their registered representatives that remain uncollected after a reasonable period (90 days). This recommendation aligns with the G20/OECD High-Level Principles on Financial Consumer Protection.

I also support deducting disgorgement amounts from future compensation received for the same misconduct to prevent double recovery.

Conclusion

The proposed Disgorgement Distribution Program is a significant step forward in protecting Ontario's retail investors. I hope that the recommendations in this letter will contribute to enhancing the program's effectiveness, efficiency, and transparency, ultimately bolstering investor confidence in the province's capital markets.

The views expressed in this letter are my own and do not necessarily reflect the views of FAIR Canada. Thank you for considering my comments.

Sincerely,

Harvey S Naglie

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