July 25,, 2024

The Secretary Ontario Securities Commission
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NOTICE AND REQUEST FOR COMMENT PROPOSED OSC RULE 11-502 DISTRIBUTION OF AMOUNTS PAID TO THE OSC UNDER DISGORGEMENT ORDERS PROPOSED COMPANION POLICY 11-502 DISTRIBUTION OF AMOUNTS PAID TO THE OSC UNDER DISGORGEMENT ORDERS PROPOSED OSC RULE 11-503 (COMMODITY FUTURES ACT) DISTRIBUTION OF AMOUNTS PAID TO THE OSC UNDER DISGORGEMENT ORDERS PROPOSED COMPANION POLICY 11-503 (COMMODITY FUTURES ACT) DISTRIBUTION OF AMOUNTS PAID TO THE OSC UNDER DISGORGEMENT ORDERS MODERNIZE THE PROCESS TO DISTRIBUTE DISGORGED AMOUNTS TO HARMED INVESTORS
https://www.osc.ca/sites/default/files/2024-07/rule_20240711_11-502_11-503_disgorgement-orders.pdf

Kenmar is an Ontario-based privately-funded organization focused on investor education via articles hosted at www.canadianfundwatch.com Kenmar also publishes ***the Fund OBSERVER*** on a monthly basis discussing consumer protection issues primarily for retail investors. Kenmar is actively engaged with regulatory affairs. An affiliate, Kenmar Portfolio Analytics, assists, on a no-charge basis, harmed consumers and/or their counsel in filing investor complaints and restitution claims.

Kenmar Associates appreciates the opportunity to comment on the proposed Disgorgement Distribution Program. This is a positive pro-investor action which follows the good work of the AMF and BCSC.

Empirical IIROC (now subsumed in CIRO) research and other research reveals compensation is the retail investor preference and expectation. Full compensation payment to harmed investors should be considered a positive mitigating factor in settlement hearings while inadequate or no compensation should be considered an aggravating factor. This prioritization will have a stronger deterrence impact AND would be in the Public interest.

We appreciate that in some cases disgorgement collected may not be distributed where investors have not incurred a direct loss. In the case of discount brokers receiving trailer commissions for no advice, we would argue that investor harm was incurred due to the lower returns because of the higher MER even if the investments were profitable.

Kenmar generally support the Proposal, but we believe that there are select sections that need to be clarified and further expanded. In this Comment letter we provide our comments with respect to those sections. Making a direct connection

between a breach of law and compensating harmed clients positively impacts consumer confidence and trust in capital markets.

Commentary

General Comments

According to OSC data, over the 10-year period between April 1, 2014 to March 31, 2024, disgorgement has been ordered in just 75 cases and collected in 45 cases (60%). An analysis of the cases where money has been collected (excluding cases relating to insider trading and where small amounts have been collected) shows that, the Commission may be required to conduct up to 7 distribution processes per year, with the **average** over the 10-year period being approximately **2 per year**.

According to the OAG audit report on the OSC "*Between fiscal years 2011/12 and 2020/21, the OSC collected only 28% of $525 million in monetary sanctions it imposed…"* Only $147 million was collected over 10 years for all monetary sanctions. The OSC has provided more up to date data on disgorgement collection efficacy to fiscal 2024 See APPENDIX 1 Over the past 10 fiscal years the OSC has collected $20,930,725 in disgorgement orders ,representing a 7.85% collection efficiency and an arithmetic average of $2.09 M p.a.

We take *illegally obtained amounts* (ill-gotten gains) to include bonuses unjustly earned, profit on illegal transaction(s), sales commissions received on improper/ illegal transactions etc.

Disgorged funds placed in the Designated fund should be labelled as "*Disgorged payables* "to ensure they are available for distribution.

Per the consultation, the Commission does not have to make a distribution if the costs to make the payment are excessive in the OSC's opinion. The money not distributed should go into the Designated Fund, a fund dedicated to investor education, investor research, whistleblower payouts and the like.

We assume collected disgorgement cash will accrue interest until distributed. The U.S. Fair Fund uses any interest on the collected disgorgement to supplement administration fee payments if needed before debiting the disgorgement with administration charges.

If the collected amount available for distribution is less than the total of eligible claims, the funds would be distributed between the eligible harmed investors on an arithmetic *pro rata* basis. A possible alternative to consider could be to supplement any shortfall by accessing the Designated fund. As at 2020/21, the Designated Fund held $117,000,000

In cases where both a fine and disgorgement is ordered but only the fine is paid, the OSC should be able to use the money it collects to pay disgorged amounts to harmed investors. If the payment is bundled, the OSC Distribution staff should consider

interpreting the payment as payment for the disgorgement order as integral to its calculation methodology.

We understand the 3 year wait period (or until sufficient amounts are collected to warrant carrying out a distribution) where there is a collection issue. Where the full amount has been paid, we expect the OSC to make payments to impacted investors expeditiously**. Until it is distributed, the cash should be invested in a liquid interest bearing account with the interest on the disgorged amount payable to the harmed investors.** After all, it is the investors' money.

The collection of sanctions and administration of the disgorgement cash collected to be distributed should be effected by staff organizationally independent of enforcement. Enforcement staff should remain laser focused on enforcing securities laws.

Standard for calculating and distributing disgorgement

The definition of disgorgement is broad-this can make calculation sometimes less than precise, except in straightforward cases.

When there are multiple victims and even sometimes in cases with only one victim, calculating the appropriate amount of illegally obtained gains to be disgorged can be complicated. It is no small task to design and oversee the claims process, which will be different in each situation, and may be contentious. This requires skilled staff and documented policies and models for consistent application. The calculation involves determining how much of the profit received from a transaction was "ill-gotten gains" came from illegal activity. That often can't be an exact calculation. In one U, S. insider trading case, a court ruled that the SEC's calculation only needed to be a "reasonable approximation of the profits which are causally connected to the violation."

OSC Enforcement should publish its methodology for calculating disgorgement amounts. Similarly, the Distribution Unit should publish its methodology for distributing disgorged cash which has been collected.

With over 25 years of experience in assessing and handling claims, OBSI's expertise could be useful in establishing the Distribution unit.

Notification and Claim

The OSC must publish a notice of the claims process and time constraints for claims on its website but it is not clear how harmed investors would become aware of this notice.

In our opinion, it is not sufficient to post the notice on the OSC website. Harmed investors should be notified by mail or email whenever possible. Retail investors do not typically seek out an OSC web posted notice. Where the identity of harmed investors is unknown, the OSC should issue a News release and include content in its Newsletters, ALERTS and social media to inform investors. This communication should be very clear, in plain language.

It is critical that any public or individual communication be very specific and clear as to the limitations of the program and disgorgement ordered and collected in each particular case so as not to create unreasonable expectations for investors who would not be eligible to receive a payment through the program.

An investor claim must include a description of the direct financial loss incurred and the amount of the loss as well as applicable supporting documentation. Based on our experience, this may prove challenging for most retail investors. **We recommend that the OSC provide a toll-free HELP line that impacted investors can call if they need assistance in completing the claim form or questions on the process.** This is especially important for seniors and people with disabilities or language difficulties.

We recommend that the opt in time for claims be no less than 90 calendar days after receipt of notice, preferably longer. If a notice is not provided directly to harmed investors, 120 days minimum should be the standard.

In order to receive the disgorgement distribution, the Proposal requires victims to make a claim for the disgorgement. To make a claim through the Program, Eligible Investors would need to provide sufficient documentation confirming their identity, disclose any other proceedings they may have pursued to recover the same losses and prove the amount of their claim. **When the OSC knows which investor(s) were impacted by the illegal act(s), we suggest that a simplified claim should be required.** Further, we very much doubt the average retail investor has the information, records and capability to effect a reliable disgorgement claim. Except in simple cases, like commissions paid, quantification of amount may be difficult.

We agree that the OSC be required to publish a report on each completed distribution to promote transparency and awareness about the distribution process. The report should be posted in an easily identifiable location on the OSC website. The public reporting should provide the date of the Order, the dollar amount ordered as between disgorgement and other financial sanctions, the amount paid to date and the dollar amount outstanding if any.

Accounting for Program administration costs

Harmed investors should not have to pay a charge to receive money owed to them. **Administration costs should not be deducted from the disgorgement payable to harmed investors. We recommend that administration costs (court appointed or Commission) be financed by the Designated fund if not covered by other penalties or fines collected as a result of the proceedings.** If this is not done, the value of the disgorgement Program to harmed investors would be devalued and OSC's public image could be diminished. Could the Designated fund be used to cover administration costs? Could interest earned on the collected disgorgements be used to offset administrative expenses?

If the cost of distributing disgorgement is so high that the effort cannot be cost justified, we do not disagree that it should not be pursued unless a particular case has a strategic investor protection value or message to the marketplace.

To improve transparency, we ask that the OSC provide more guidance on the circumstances that lead to distribution costs being deemed uneconomical e.g. how are factors such as the size of the eligible investor population, their geographic location, currency, communication expenses, administration costs and time or other factors taken into account? Is there an amount in dollars and cents that is considered too small to distribute after expenses?

Compensation by third parties

We concur that investors eligible for receiving disgorgement cash should be required to disclose any payments received from other sources. In practice, the odds are high that an OBSI compensation recommendation will be made well before an OSC Tribunal hearing panel decision is announced. It is an open question if that compensation award considered ill-gotten gains or merely calculated the financial losses incurred by a complainant.

Residual funds

Residual funds, if any, should be deposited in the Designated fund and not used to subsidize OSC operations.

Distribution

The distribution of disgorged funds to harmed investors should be flexible dependent on victim needs - mailed cheque or e-transfer.

Investor Education

Kenmar agree that the OSC should publish bilingual plain-language resources to help investors understand the new statutory distribution framework and the payment application process. This is a very important success factor for the Distribution program.

Educational materials should explain the meaning and intent of disgorgement. The education materials should inform investors of their right to access disgorgement cash and how it may impact overall investor compensation. Investors would need to know that the proposed process excludes market-driven losses, opportunity cost, interest on losses, and non-financial losses. This education is necessary to avoid investor confusion and address investor lack of knowledge. It is critical that the information about the disgorgement distribution Program clearly explain that acceptance of a payout from the disgorged funds distributed through the Program would not disqualify Eligible investors from seeking further compensation via other channels.

Enforcement/Collection policy

In our view, any uncollected disgorgement cash from a registered Dealer's registered representative should be to the account of the Dealer. See **Ref** *G20/OECD High-Level Principles on Financial Consumer Protection 2022* which Canada endorses.
https://www.oecd.org/daf/fin/financial-education/G20_OECD%20FCP%20Principles.pdf#:~:text=The%20G20%2FOECD%20High-Level%20Principles%20on%20Financial%20Consumer%20Protection,an%20effective%20and%20comprehensive%20financial%20consumer%20protection%20framework . Under Principle # 9 **Financial services providers should also be responsible and accountable for the actions of their intermediaries.** The account agreement is between the Dealer and the client.

Investment Dealer disgorgements

The Dealer's share of the ill-gotten commissions, fees and profits derived from a Dealer Representative's misconduct should ALWAYS be collectible by the OSC. This may require changes to OSC rules, sanction guidelines and practices or a separate enforcement action on the Dealer for disgorgement.

Issues related to disgorgement, complaint handling

We repeat our calls for the OSC/CSA to release a modern complaint handling rule designed to provide fair compensation to harmed investors AND actions to eliminate the root causes of complaints and investor harm. Enforcement, while necessary, is a post mortem activity, robust complaint handling can lead to a more trusted financial services industry by **preventing** recurring problems and systemic issues. Often these initial complaints of a systemic problem can prevent serious investor harm if dealt with early.

As an aside, the OSC should take steps to improve monetary sanction collections- low collection rates raise questions about the credibility of deterrence. **Re** *Credible Deterrence in Securities Regulation* : IOSCO
https://www.iosco.org/news/pdf/IOSCONEWS383.pdf#:~:text=The%20IOSCO%20report%20includes%20real%20examples%20of%20effective,report%20identifies%20seven%20key%20elements%20for%20credible%20deterrence%3A As we have previously suggested , we recommend that the OSC review its monetary sanctions collection program and benchmark domestic and international best practices. The OSC should improve transparency of its sanction collection unit activities.

Conclusion

This initiative is a positive step forward towards improving retail investor protection. Unlike fines, there is no legal cap to disgorgement of "ill-gotten gains" which makes it a very effective enforcement and deterrence tool. We have made several recommendations to amend the Program to make the initiative more investor-friendly.

Complainants do not deserve to be stressed a second time because of an overly-complex Distribution Program design.

Presumably, the OSC is planning to recruit additional staff to manage this Program **- it is crucial that this initiative not drain away existing enforcement resources. The collection of sanctions and administration of the disgorgement cash collected to be distributed should be effected by staff organizationally independent of enforcement.**

We recommend that the OSC provide detailed guidance on standardized best practices for (a) calculating disgorgement amounts by enforcement staff and (b) determining how to fairly allocate dollars to impacted investors by Distribution staff.

The Notification process should be reviewed to ensure Eligible investors are made aware of the Program and can access it.

If ordinary retail investors are compelled to file claims and do the analytical work to justify their claim, we expect the participation rate may not be high, thus adversely impacting the regulatory intent of the Distribution Program. Filing assistance should be made readily available. **The OSC should do everything possible to reduce regulatory burden on investors.**

Disgorged cash should earn interest while waiting for distribution and be payable to harmed investors.

Harmed investors should not be burdened with any distribution or administration costs to receive cash owing to them. The Designated fund should be considered as a source of administrator funding for the Distribution Program if necessary.

Where a single or defined number of investors are involved and known, we recommend that the OSC do most of the spadework and then notify all impacted investors.

We are more comfortable with a 120 calendar day opt-in time for harmed investors.

OSC Sanction guidelines should be amended to provide for disgorgement of ill-gotten gains obtained by the Dealer if the Dealers' representative is ordered to disgorge commissions related to illegal activity, where those commissions were shared between the Dealer and the Representative .If no regulatory action is taken, the ill-gotten gains would be unjustly retained by the Dealer and not be available for distribution to harmed investors.

Transparency of this program's operation is essential.

We recommend the OSC to plan well in advance of the first claim being received what resources will be needed, including consideration of a claims database, automated call logs and trained staff.

The OSC should identify any additional legal tools it needs to achieve credible deterrence /enhance collection efficacy and pursue appropriate legislation.

Beyond disgorgement, we expect the OSC to prioritize, where applicable, investor compensation in enforcement actions over the allocation of fines and other sanctions. No-contest settlements should be used whenever applicable/ possible as all harmed investors are dealt with without the need for filing a claim. We believe this modern practice is in the Public interest and will be impactful in effecting credible deterrence. **Kenmar fully support the use of no-contest settlements to secure harmed investor compensation.**

Permission is granted for public posting of this comment letter.

Please do not hesitate to contact us if there are any queries regarding our submission.

K. Kivenko, President
Kenmar Associates

APPENDIX 1 OSC disgorgement statistics provided by the OSC

Please see below the statistics regarding the amounts of disgorgement ordered by the Capital Markets Tribunal and received by the OSC over the past 10 years.

Fiscal Year	Total Amount of Disgorgements Ordered ($)	Total Amount of Disgorgement Collected ($)
2015	36,668,029.37	2,158,472.42
2016	39,848,825.01	2,835,295.97
2017	12,327,286.33	544,575.00
2018	4,986,009.54	27,338.91
2019	69,778,053.67	2,312,749.67
2020	4,107,436.06	3,713,833.06
2021	5,473,698.18	1,020,209.21
2022	12,754,330.32	3,903,849.64
2023	10,313,716.76	4,045,715.97
2024	70,182,645.39	368,686.19
	266,440,030.63	**20,930,726.04**

Overall % collected= 7.85%

REFERENCES

Allocation and use of funds from sanctions and settlements
https://search.app/ZFEPs1GNfzck9ZLG6

FINRA puts investor compensation first
The U.S. Financial Industry Regulatory Authority (FINRA), a self-regulatory organization, mandates that its adjudicative tribunals and staff put their highest priority on investor restitution for the harm caused by investment firms. See
https://www.finra.org/rules-guidance/enforcement

Credible Deterrence In The Enforcement Of Securities Regulation: IOSCO
FR01/2024 Credible Deterrence in the Enforcement of Securities Regulation (iosco.org)

DETERMINING DISGORGEMENT IN SECURITIES LAW
https://glcmumbai.com/lawreview/volume10/Vidhi%20Shah.pdf

Qualitative Research among Complainants: IIROC
https://www.iiroc.ca/media/14356/download?inline

Disgorgement instead of Damages?
https://www.canadianfraudlaw.com/2022/04/disgorgement-instead-of-damages/

What Fraud Victims Should Know About Recovery Through Securities Regulators – Problems with Relying on OSC Disgorgement Orders: ACFI
https://www.acfi.ca/2015/11/27/what-fraud-victims-should-know-about-recovery-through-securities-regulators-problems-with-relying-on-osc-disgorgement-orders/

Individuals or companies with unpaid OSC sanctions | OSC
https://www.osc.ca/en/enforcement/osc-sanctions/individuals-or-companies-unpaid-osc-sanctions

The Ontario Task force to modernize securities regulation recommended that OSC disgorgement orders be distributed to harmed clients:
Enhancing investor protection 46. Require that amounts collected by the OSC pursuant to disgorgement orders be deposited into court for distribution to harmed investors in cases where direct financial harm to investors is provable *A statutory process to support the distribution of disgorged funds to harmed investors is important for investor protection in Ontario and is vital to the trust and confidence people have in the capital markets and in the OSC's enforcement capabilities. It is important that ill-gotten gains recovered through the OSC's collection efforts be distributed to the investors who were harmed, as investors may not be able to independently recover from the respondent. In fact the OSC has used a Superior Court appointed receiver to distribute funds disgorged to the OSC in two test cases.*

BMO to pay nearly $50 million in compensation to clients over excess fees as part of settlement with OSC

"Bank of Montreal intends to compensate clients in the amount of $49,885,661, as part of a settlement with the Ontario Securities Commission over "excess" fees the bank charged some clients. The OSC approved a no-contest settlement Thursday with four subsidiaries of Bank of Montreal, which stipulated that Canada's fourth-largest bank would also pay $2,100,000 "to advance the OSC's mandate of protecting investors," plus $90,000 toward the costs of the OSC investigation.
https://search.app/zsVjyV32VznhxfPb6