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Canadian Investment Regulatory
Organization
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Re: CIRO Notice 24-0290 Distributing Funds Disgorged and Collected through CIRO Disciplinary Proceedings to Harmed Investors (Phase II)

The Osgoode Investor Protection Clinic (“IPC”) appreciates the opportunity to comment on Phase II of the Canadian Investment Regulatory Organization (“CIRO”) proposal for a new regulatory framework that establishes a process to distribute funds collected by CIRO under disgorgement orders to harmed investors (“Proposal”).

By way of background, the IPC, the first clinic of its kind in Canada, is dedicated to providing free legal advice and services to retail investors across the country. Since launching in 2016, we have worked with a wide range of clients who have suffered investment losses. From seniors whose adviser mismanaged their entire life savings on the cusp of their retirement to low-income investors whose advisers recommended leveraged loans, we have worked with vulnerable retail investors who need assistance in seeking recourse but cannot afford to hire a lawyer.

We are pleased to bring their voices to CIRO.

We appreciate your consideration of our comments; in the spirit of brevity, we have focused on specific topics that we think we can best add value to the process.

Sincerely,

Brigitte Catellier, Associate Director
Haben Dawit, Student Caseworker
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The Osgoode Investor Protection Clinic



Overview

We believe that the proposed framework by CIRO advances investor protection in Canada's capital markets by supporting the compensation of investors who have suffered investment losses due to misconduct. More importantly, the proposal would incentivize harmed investors to file complaints with CIRO and hold wrongdoers accountable for their actions. This may result in a much broader and consequential implication, namely that CIRO will be able to identify and hold responsible a wider pool of wrongdoers.

Recommendations

Parallel Proceedings

Under the parallel recovery process, harmed investors are given the opportunity to be “made whole” through CIRO proceedings and other forums, such as civil courts.¹ This is only permitted when the full disgorged amount distributed to harmed investors does not equal the *entire* quantum of lost funds. At the IPC, we regularly assist clients who are unable to afford civil court proceedings or where the quantum of their losses does not justify the cost of litigation. Moreover, many retail investors may feel discouraged from pursuing remedies for loss suffered through the court system, particularly in light of the financial implications of an unsuccessful claim (i.e. ‘sunk costs’ incurred to prosecute the claim plus liability to reimburse defendants for a significant portion of their litigation costs).

As a result, we would recommend that CIRO consider opportunities to further protect investors who may not be “made whole” through CIRO disgorgement orders by sharing information on multiple communication channels to instruct claimants about commencing actions in separate forums in pursuit of full recovery on a timely basis. This information should be in plain language, clear, and include actionable instructions that investors can implement to launch and manage their parallel recovery claims on a timely basis. We would also welcome opportunities for CIRO to collaborate with the IPC on pro bono parallel proceedings for low income and vulnerable harmed investors. This could include, albeit aspirationally, providing, on a without prejudice basis and at the request of a specific Eligible Claimant, documentary and testimonial evidence pertaining to said Eligible Claimant that CIRO collected during their investigation and prosecution processes, which could be leveraged in a parallel proceeding.

We recognize that this recommendation may place additional administrative burdens on CIRO but structuring its storage of electronic and physical evidence in a way that is conducive to pulling relevant evidence upon request from the outset should alleviate some of these burdens. Ultimately, by helping to potentially strengthen viable cases in another forum, CIRO would be acting in furtherance of access to justice.

¹ *Distributing Funds Disgorged and Collected through New SRO Disciplinary Proceedings to Harmed Investors*, CIRO(Oct 21, 2024)

Claim Assessment - Net Disgorged Funds

Another concern that arises from the Proposal has to do with the need to clearly distinguish between the distribution of disgorged funds from restitution and investor compensation to avoid confusion and overlap with existing compensation options. Currently, the Proposal states that any individual or public notices need to be clear and specific regarding the limits of the program and disgorgement ordered and collected.² However, while this information is important to manage expectations, it is insufficient by itself to truly prevent investor confusion and ensure access to justice.

Pro Rata vs Needs-Based Distribution

Under the claims assessment process, net disgorged funds are calculated by assessing the total amount of disgorged funds collected and deducting extraordinary costs. The net disgorged funds are then shared with Eligible Claimants either in full or on a pro rata basis depending on whether they are equal to, exceed, or are less than the aggregate eligible claims. While we agree that a distribution of disgorged funds on a pro rata basis allows for a mathematically proportional distribution, we believe that certain instances may arise where a needs-based model may be more equitable when assessing the impact of the losses. Thus, we would recommend a hybrid model which grants the Administrator the flexibility to choose between a pro rata or needs-based distribution.

Specifically, a needs-based model might be more appropriate in circumstances where investors such as pensioners, near-retirees, retirees, or individuals who are now on the edge of bankruptcy are significantly more impacted by the misconduct. In these cases, the losses suffered would be a greater percentage of their net worth, and they may have also relied on the investment for daily living expenses or retirement.

A needs-based model of distribution will first determine the number of impacted Eligible Claimants and their claims, compare their total claims against their total assets and liabilities, and then apportion the disgorged funds on a claim-to-net-worth basis. While this model will still allow the Proposal's primary focus to be on deterrence, it will grant the Administrator flexibility to carry out the distribution in a manner that best promotes investor protection and lessens the degree of impact and harm caused to the most vulnerable class of investors. Finally, such distribution flexibility will allow vulnerable investors to seek a higher level of recovery from the disgorged funds, which is important as they may not be able to take part in a parallel recovery proceeding due to its prohibitive costs.

In the alternative, should CIRO choose to proceed with the pro rata distribution model for all disgorgement funds ordered and collected as described in the Proposal, we recommend that CIRO refine its processes by focusing on greater information sharing in a simple and actionable manner to ensure transparency and accountability.

² Ibid.

Comprehensive Disclosure

In furtherance of transparency and accountability, and to avoid investor confusion, we would recommend that CIRO provide comprehensive disclosure on how the net disgorged funds were calculated. This would include information on the total number of Eligible Claimants and their claims, and specifically highlighting what costs were incurred.

Regarding the former, the number of Eligible Claimants and their claim amounts should be made available to all relevant parties following the application deadline. To protect the identity of Eligible Claimants, personal information should be redacted. Regarding the latter, CIRO should highlight for every case, if applicable, the extraordinary costs and what makes them reasonable. Setting out parameters that can be used on a case-by-case basis may also allow CIRO to systematically go through each distribution and promote confidence in the new program. In addition, we would recommend that this information be publicly available on CIRO's website.

This disclosure would allow Eligible Claimants to understand and verify the calculation of the net disgorged funds and potentially reduce the administrative costs associated with the reconsideration of entitlements. This disclosure would also support Eligible Claimants seeking to make themselves whole through parallel recovery proceedings.

Conclusion

Overall, we believe that our recommendations further refine the Proposal by ensuring transparency, accountability, and access to justice.