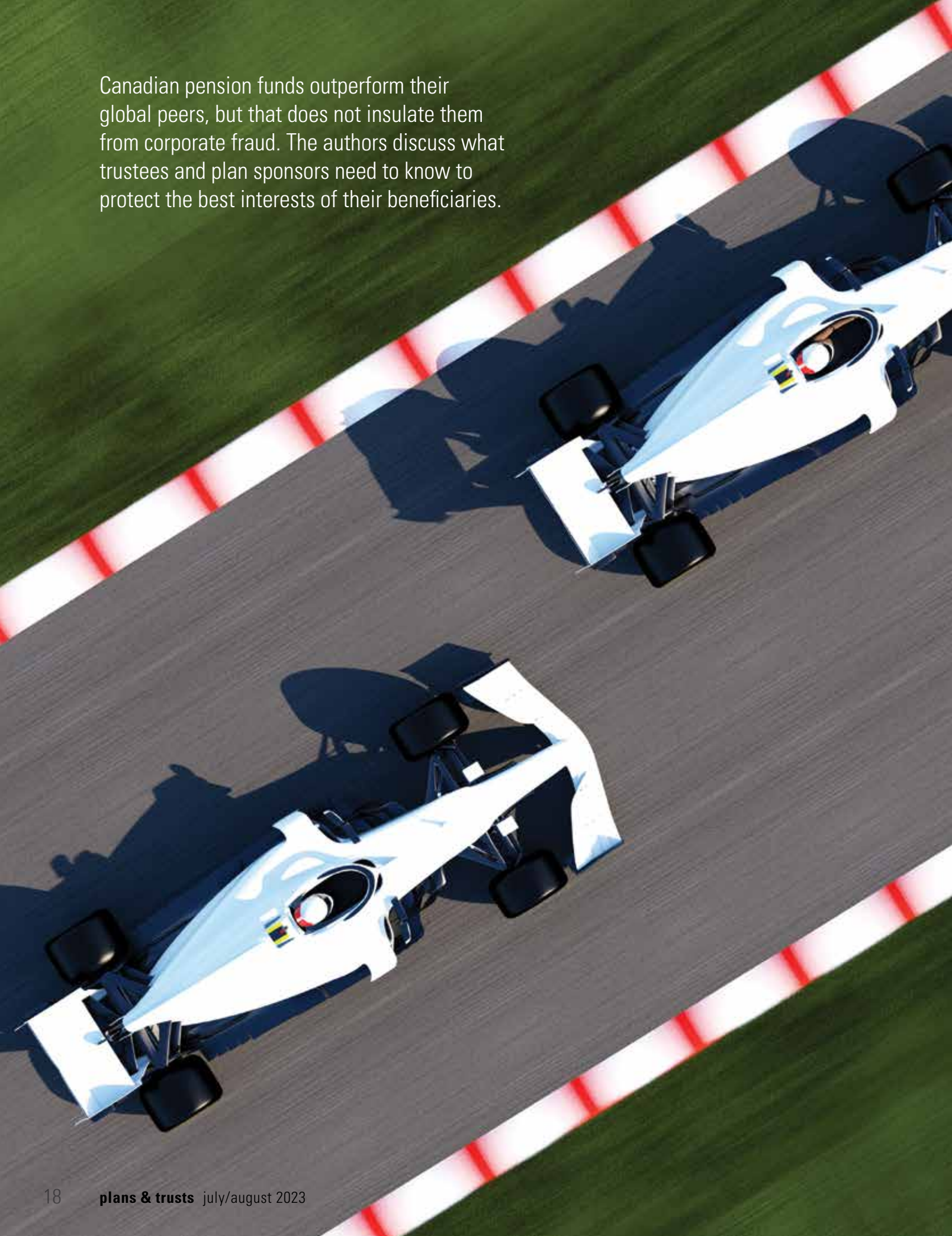
Canadian pension funds outperform their global peers, but that does not insulate them from corporate fraud. The authors discuss what trustees and plan sponsors need to know to protect the best interests of their beneficiaries.



Collaborative Loss Recovery: CANADIAN PENSION PLANS LEADING THE WAY

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Pension funds all over the world would love to trade places with their Canadian counterparts. In a recent study by CEM Benchmarking Inc., Canadian funds of all sizes outpaced their global peers with strong and consistent performance over five, 15 and 20 years, across all metrics.[1] As *The Globe and Mail* has recognized, "Canada has always punched above its weight due to our pensions."[2] The significance of this performance cannot be overstated—The retirements of millions of Canadians directly depend upon the continued success of these funds.

Regrettably, consistent performance does not insulate Canadian pension funds from vulnerability. One risk of investing in public debt or equity securities is that the revelation of corporate misconduct can weaken the value of an investment. For individual Canadian pension funds, those losses can represent millions, tens of millions and, in rare cases, even hundreds of millions of dollars in lost retirement funds.

To generate the returns necessary to fund their beneficiaries' pensions, Canadian funds often invest in the U.S. equity market, the largest in the world.[3] But with those investments comes exposure to corporate misconduct.

This century has witnessed some of the biggest corporate frauds in history—including Enron, WorldCom and Valeant—with corresponding investor losses.[4] In the first quarter of 2023, we saw fraud-induced collapses at FTX, Signature Bank and Silicon Valley Bank, which caused harm to Canadian funds.

Recently, University of Toronto finance professor Alexander Dyck published a study that quantified the pervasiveness and scope of corporate fraud.[5] According to Dyck's study, as reported in *The New York Times* and *The Globe and Mail,* securities fraud by public companies in the United States costs investors at least US$830 billion each year. The study further concluded that, in an average year, 10% of all large public corporations commit securities fraud, with only one-third of these corporate frauds detected. Given that Canadians own more than one trillion dollars of U.S. securities, they suffer a portion of those lost billions each year.[6]

Takeaways

- Canadian pension funds often invest in the United States equity market, the largest in the world. Those investments come with exposure to potential corporate misconduct.
- Public pension plan governing bodies are charged with acting in the best interests of the beneficiaries. Taking steps to recover investment losses caused by a public company's corporate mismanagement and/or fraud is one aspect of acting in beneficiaries' best interests.
- Portfolio monitoring is a simple and cost-efficient way for Canadian pension funds to maximize their potential recovery of losses from securities fraud.
- The monitoring law firms creates confidential reports for the fund's domestic and international securities, providing accurate and timely information allowing trustees resources to pursue any claims once identified.

The Fiduciary Duty of Trustees and Administrators to Minimize Losses

Public pension plan governing bodies (trustees and staff) are charged with acting in the best interests of the beneficiaries, who rely on them to manage their money prudently and in good faith. Taking steps to recover investment losses caused by a public company's corporate mismanagement and/or fraud is one aspect of acting in beneficiaries' best interests.[7]

But what are trustees to do given that Canadians do not have legislative or regulatory recourse in the U.S.? One inexpensive and effective way Canadian pension fund trustees can both fulfill their fiduciary obligations and recover fraud-related losses is by encouraging their funds to participate in securities class action proceedings in U.S. civil courts. Having a fund policy on participation in securities litigation class actions has been considered a "best practice" in Canada and the U.S. for almost two decades.[8]

Securities Class Actions

Securities class actions are private legal actions initiated by individual investors, pension funds or other institutional investors (as opposed to public actions initiated by regulators or other government entities). Unlike Canadian class action proceedings legislation (unique to each province), U.S. legislation applies nationwide. U.S. class actions represent all investors who purchased U.S. debt and equities on a U.S. exchange at prices inflated by fraud, including Canadian pension funds. Because participating in a U.S. class action does not require U.S. residency, Canadian investors can, should and often do participate in U.S. securities class actions.[9]

Private Actions Obtain a Greater Return for Investors

Although regulators, such as the U.S. Securities and Exchange Commission (SEC), often prosecute companies that

commit fraud, the SEC's main focus is to enforce securities laws and regulations, not to recover investor losses. Thus, recoveries secured by regulators often pale in size compared to private class action recoveries. The high-profile meltdown at Valeant illustrates this stark reality.

Valeant was a pharmaceutical company registered in Canada that allegedly purchased existing drugs (including life-saving drugs) and then used a secretly controlled pharmacy and distribution network to hike prices and boost short-term profitability. Once the alleged wrongdoing underlying the price hikes was revealed, the profits vanished, and the stock plummeted. A private U.S. class action recovered US$1.2 billion for investors in *Valeant,* while the SEC recovered US$45 million.[10]

Because private securities class actions focus on recovering investor losses and can yield recoveries for all investors who are part of the class, Canadian pension fund trustees should ensure their funds have a plan to participate in U.S. securities class action litigation.

The Value of U.S. Recoveries to Canadian Pension Funds

Canadian pension funds have recovered hundreds of millions in losses from class actions pursued in U.S. courts. As noted earlier, Canadian institutional investors that purchase U.S. equities through an American exchange such as the New York Stock Exchange are automatically part of a class action if their purchase falls within the defined class. Because most U.S. equities are purchased through an American exchange, Canadians are frequently part of U.S. class actions and benefit from the recoveries they generate.

Valeant demonstrates the scope of potential U.S. securities class action recoveries, with class actions pursued in both Canada and the United States. In 2020, Valeant paid approximately US$69 million (C$94 million) to settle the Canadian class action and *17 times that amount* to settle the U.S. class action (US$1.2 billion).

How Trustees and Administrators Can Ensure Their Funds Participate in and Benefit From Securities Class Actions

Portfolio Monitoring

Portfolio monitoring is a simple and cost-efficient way for Canadian pension funds to maximize their potential recovery of losses from securities fraud. Some U.S. law firms that specialize in securities class actions offer portfolio monitoring (and related legal advice about recovering such losses) as a free service to Canadian pension funds.

To monitor a pension fund, a pension fund signs a portfolio monitoring agreement with the U.S. securities class action law firm. The monitoring agreement permits the fund's custodian to grant the law firm access to the fund's transactional data (ensuring the data's confidentiality through the attorney-client relationship).

Using this information, the monitoring law firm creates confidential monitoring reports for the fund's domestic and international securities, usually monthly. These reports provide the fund with accurate and timely information (and related expert advice), which allows fund staff and trustees to decide how best to maximize recoveries from losses due to fraud in Canada, the U.S. and around the world. Key for Canadian pension trustees is to ensure their fund is relying on U.S. counsel with the experience and expertise to accurately evaluate potential claims as well as the resources to pursue any claims once identified.

Opting Out

If a Canadian pension fund purchases shares on a U.S. exchange within the time period fixed by the U.S. court, then the fund is most often automatically part of the class action. Typically, after the class action has been tried or settled, the fund will file a "proof of claim form" to receive its *pro rata,* or proportionate, share of the class's recovery.

In some rare cases, a fund may decide to "opt out" of a class action and forgo its pro rata share of a class action recovery by pursuing its own separate action. Although opting out has on occasion increased recoveries for pension funds, even substantially, this approach requires careful analysis from an experienced U.S. class action law firm and is the exception, not the rule.

Lead Plaintiff

In addition to loss, the underlying issues giving rise to corporate fraud may have special resonance for a particular fund. In those instances, a pension fund should consider initiating the class action or acting as lead plaintiff for the class. A *lead plaintiff* is a person or group of persons appointed by a U.S. court to represent all class members in a securities class action. In securities class actions, U.S. courts often prefer to appoint an institutional investor to represent the class because they are sophisticated and engaged investors. Thus, Canadian funds can (and often

do) act as the lead plaintiff in U.S. securities class actions. In doing so, they help to obtain recoveries, effect corporate governance change and promote the rights of all investors.

In deciding whether to act as lead plaintiff, a fund's trustees and staff should seek advice from experienced U.S. lawyers who have the resources to maximize recovery by litigating the case all the way to trial if necessary. Trustees must ensure that the fund asks prospective U.S. counsel hard questions about their financial and human resources; their history and experience in prosecuting securities cases to a successful conclusion including trial; and their results, as illustrated by their past recoveries.

Acting as lead plaintiff is a decision that is made after internal discussions and external advice. When considering how to proceed, it is important to know what is and is not involved in being a lead plaintiff.

A lead plaintiff does not fund the litigation. In most U.S. class actions, counsel funds all the costs associated with the litigation and is paid only if the action settles or the class prevails at trial. Counsel recovers fees, if any, from the entire class's recovery fund in a process overseen by the U.S. federal court (i.e., not from the pension fund itself). Moreover, unlike in Canada, "loser pays" is not the American rule. Defendants bear their own litigation expenses.

Serving as lead plaintiff does not require an inordinate amount of time or resources from the fund. Besides funding the litigation, competent U.S. counsel handles the vast majority of the work.

Canadian funds cannot count on another party acting as lead plaintiff. As Dyck's study indicates, securities fraud is often unprosecuted or underprosecuted. Furthermore, due to their size and stature, Canadian funds are quintessential lead plaintiffs—favoured by U.S. courts and legislation—who often have the biggest loss and thus the most to gain by maximizing the recovery and ensuring accountability.

BIOS

Darren Robbins has served as lead counsel in over 100 securities class actions over the past two decades. Darren has extensive insight into corporate securities fraud and in positioning the class to ensure the largest achievable recovery. He is regularly named one of the top securities litigators in the U.S. and was awarded Lawyer of the Year 2023 by Best Lawyers and California Lawyer of the Year 2022 by the *Daily Journal*.

Donna Campbell is an Ontario lawyer with 30 years of litigation experience. As senior enforcement counsel at the Ontario Securities Commission, Donna prosecuted one of the largest insider trading and tipping cases in Canada *(In the Matter of Paul Azeff et al.)*. Donna sits as an adjudicator for the Canadian Investment Regulatory Organization (CIRO).

Christopher Kinnon is an attorney from Saskatchewan and British Columbia, who practices securities litigation at Robbins Geller. Christopher was a Clarence Darrow Scholar at the University of Michigan Law School and worked on two of the largest securities cases in the past decade: *Valeant* and *Twitter*. He was awarded California Lawyer of the Year 2022 by the *Daily Journal*.

Conclusion

The scope of corporate fraud revealed by Dyck's study, together with the increasingly volatile nature of capital markets in 2022 and 2023, underscore the importance of careful vigilance by Canadian pension funds' trustees and staff. By encouraging their funds to participate in and benefit from U.S. securities litigation, trustees and staff of Canadian funds both fulfill their fiduciary obligations and protect their beneficiaries' pensions by maximizing potential recoveries from securities fraud. In doing so, trustees and staff also project Canadian values—such as good governance, transparency and accountability—abroad, helping to create fairer capital markets for all investors and economic equality.

Endnotes

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8. Ibid.

9. See *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247, 273 ("Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States.").

10. *In re Valeant Pharms. Int'l, Inc.* Sec. Litig., 2021 WL 358611, at *1 (D.N.J. Feb. 1, 2021), affirmed in part, appeal dismissed in part sub nom. *TIAA v. Valeant Pharms. Int'l, Inc.*, 2021 WL 6881210 (3d Cir. Dec. 20, 2021). *Valeant* is not an isolated circumstance. See also *In re American Realty Cap. Props., Inc.* Litig., No. 1:15-mc-00040-AKH (S.D.N.Y.) (U.S. class action recovering $1.025 billion compared to $8 million paid in the SEC action); *In re Cardinal Health, Inc.* Sec. Litig., No. 2:04-cv-00575 (S.D.Ohio) (U.S. class action recovering $600 million compared to $35 million paid in the SEC action); *In re Enron Corp.* Sec. Litig., No. H-01-3624 (S.D.Tex.) (U.S. class action recovering $7.2 billion compared to approximately $450 million paid in the SEC action).

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