

Corporate Securities Law

July 5, 2017

Canadian Securities Administrators Propose Amendments to Regulatory Regime for Distributions of Securities Outside of Canada

On June 29, 2017, the Canadian Securities Administrators (CSA) published for comment proposed amendments to National Instrument 45-102 *Resale of Securities* (“NI 45-102”) and its accompanying companion policy that would replace the existing exemption for resales of securities outside Canada with a new exemption that is intended to be more straightforward and effective in today’s global market. Concurrently with that announcement, the Ontario Securities Commission (OSC) published for further comment a revised version of proposed OSC Rule 72-503 (and accompanying companion policy) – originally published in June 2016 – which is intended to harmonize the regime for resales of securities outside of Canada and respond to comments received on the original version of the proposed rule.

Background

Under the securities laws of most Canadian provinces and territories, for securities distributed in a jurisdiction of Canada to be “freely tradable”, they must either be qualified by a prospectus or meet certain conditions (that are intended to ensure, among other things, that an adequate public disclosure record exists). Canadian securities regulators take different approaches to the question of determining when a “distribution” of securities has occurred in their jurisdiction.

Currently, section 2.14 of NI 45-102 permits the resale of securities (and underlying securities), that were issued on a prospectus-exempt basis, without qualification by a

Canadian prospectus, and without further resale restrictions under Canadian securities laws, if:

- the issuer is not a reporting issuer in any Canadian jurisdiction;
- Canadian residents did not own more than 10% of the outstanding securities of the issuer, or represent more than 10% of the total number of security holders of the issuer, on the distribution date (i.e., the date upon which the securities were originally acquired in an exempt distribution); and
- the trade is made through an exchange or market outside of Canada, or to a person or company outside of Canada.

The policy rationale for this exemption, according to the CSA, is that “it is not necessary to restrict the resale of securities over a foreign market or to a person or company outside of Canada if the issuer has a minimal connection to Canada and there is little or no likelihood of a market for the securities to develop in Canada.”

Investors have increasingly expressed concerns about their ability to rely on this exemption, particularly as a result of difficulty (for both investors and issuers) in determining whether the Canadian ownership condition is satisfied. This uncertainty has limited certain Canadian investors’ ability to participate in certain securities offerings (particularly private placements by foreign issuers), increased their regulatory and compliance costs and inhibited their ability to realize the full value of their investments. At the same time, those investors (and other market participants) have questioned the appropriateness of the existing ownership conditions as a proxy for an issuer’s connection to Canada in the current global capital markets.

The limitations of the existing exemption, and the fact that it may be in the public interest to permit foreign resales of securities on a prospectus-exempt basis even when the ownership conditions may not be satisfied,

have been recognized in various exemption orders issued by Canadian securities regulators in circumstances where the regulator was satisfied that the foreign issuer had a minimal connection to Canada and there was minimal risk of a market for the securities developing in Canada. These factors also contributed to the original release of proposed OSC Rule 72-503, which was intended to set out a more straightforward regime for the distribution and resale of securities outside of Canada.

Proposed New Foreign Resale Exemption

If adopted, the proposed amendments to NI 45-102 would replace the existing exemption in section 2.14 of NI 45-102 with a new exemption that would permit the resale of securities (and underlying securities) that were issued on a prospectus-exempt basis, without qualification by a Canadian prospectus, and without further resale restrictions under Canadian securities laws, if:

- the issuer is a “foreign issuer” on the distribution date;
- the foreign issuer was not a reporting issuer in any jurisdiction of Canada on the distribution date, or is not a reporting issuer on the date of the proposed resale;
- the resale is on an exchange, or a market, outside of Canada, or to a person or company outside of Canada; and
- if the investor is an insider of the foreign issuer, no unusual effort is made to prepare the market or to create a demand in Canada for the security that is the subject of the trade.

The proposed definition of “foreign issuer” would include an issuer that is not incorporated or organized under the laws of Canada (or a jurisdiction of Canada) unless any of the following apply:

- the issuer has its head office in Canada;
- the majority of the executive officers or directors of the issuer ordinarily reside in Canada; or
- the majority of the consolidated assets of the issuer are located in Canada.

The purpose of replacing the ownership conditions in the existing exemption with the definition of “foreign

issuer” is to provide market participants with greater certainty – including at the time of initial purchase – in determining when the exemption will be available. At the same time, since the CSA are proposing to repeal the existing exemption in section 2.14 of NI 45-102, investors would no longer be able to resell securities of non-reporting issuers that, while not necessarily foreign issuers (as defined in the new exemption), nonetheless satisfy the existing ownership conditions.

The CSA are accepting written comments on the proposed amendments to NI 45-102 until September 27, 2017.

Revisions to Proposed OSC Rule 72-503

Concurrently with the CSA's announcement of the proposed amendments to NI 45-102, the OSC published for comment a revised version of proposed OSC Rule 72-503 *Distributions Outside of Canada*, as well as the accompanying companion policy. The original version of the proposed rule – described in detail in our July 11, 2016 Update, *Ontario Securities Commission Proposes Rule for Distributions Outside Ontario* – was designed to replace Ontario's existing ‘distributions out’ regime set forth in Interpretation Note 1 – *Distributions of Securities Outside Ontario* (originally published in 1983), and attracted considerable attention and public comment from market participants. Notably, the public comments included a number of suggestions for improving the exemption in section 2.14 of NI 45-102, underscoring the relationship between the evolution of Ontario's distributions out regime and the foreign resale exemption in NI 45-102.

In an effort to harmonize the regime for resales of securities outside of Canada, the OSC has removed certain exemptions from the proposed rule that would effectively be superseded by the new foreign resale exemption in NI 45-102. However, under the revised proposed rule, other foreign resale exemptions would still be available in Ontario, specifically, for distributions of securities to a person or company outside Canada:

- pursuant to a prospectus or other offering document that registers or qualifies the securities

for distribution in the United States or another specified foreign jurisdiction; or

- in accordance with the laws of a foreign jurisdiction if an Ontario prospectus has been filed qualifying a concurrent distribution of the same class, series or type of securities to purchasers in Ontario.

The latest version of the proposed rule (and related commentary) also addresses a number of comments the OSC received in response to the 2016 version of the proposed rule. Some of the notable changes, clarifications and other statements made by the OSC include:

- the important clarification that the statements in the companion policy about when the OSC considers the prospectus requirement to apply to a distribution of securities outside of Canada (including guidance regarding when securities will have “come to rest” outside of Canada) do not constitute conditions to the availability of the prospectus exemptions in the proposed rule;
- as a corollary of the previous point, issuers and selling security holders do not need to rely on an exemption from the prospectus requirement if they conclude that the Ontario prospectus requirement does not apply to a distribution of securities outside of Canada because the securities have “come to rest” outside of Canada (as determined in accordance with the guidance provided in the companion policy to the proposed rule).
- the OSC has added all of the members of the European Union to the list of “specified foreign jurisdictions”, but declined to add any of the other jurisdictions advocated by commenters on the 2016 version of the rule (which included, among others, Brazil, China, India, Israel and South Korea); and
- the OSC has clarified that an issuer or selling security holder meets the requirement of various exemptions to sell to “a person or company outside Canada” if the issuer or selling security holder has no reason to believe that the purchaser is a Canadian person or company.

The OSC is accepting further written comments on Rule 72-503 until September 27, 2017.

Conclusions

We are pleased to see the CSA and OSC recognize the need to modernize the regulatory regime for distributions of securities outside of Canada so that it permits Canadian issuers and investors to participate competitively in the global capital markets. The new criteria in NI 45-102 for determining whether a foreign issuer has a minimal connection to Canada and the addition (in Ontario) of “bright-line” exemptions for the distribution of securities outside Canada should assist in achieving this objective. We expect that, as part of the public comment process, some market participants may express the view that these new proposals could be expanded or clarified in a number of respects. For example, it may be appropriate to also permit resales outside of Canada of securities of domestic non-reporting issuers who nonetheless have a minimal connection to Canada (such as is currently permitted by section 2.14 of NI 45-102). More fundamentally, the differences among Canadian jurisdictions in their approach to determining when the prospectus requirement is engaged in the first instance – in primary and secondary distributions – stands out as somewhat of an anomaly in an era of increasing regulatory harmonization among Canadian jurisdictions. It will also be important to see whether the regime for distributions of securities outside of the jurisdictions participating in the proposed Cooperative Capital Markets Regulatory Authority (as currently proposed in CMRA Policy 71-601 – *Distribution of Securities to Persons Outside CMR Jurisdictions*) is ultimately harmonized with these initiatives.

For further information or to discuss any of these proposals, please contact any member of our Corporate Securities Group.