

Corporate Securities Law

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OSC Releases Guidelines for Companies Operating in Emerging Markets

On November 9, 2012, the Ontario Securities Commission (OSC) published Staff Notice 51-720 - *Issuer Guide for Companies Operating in Emerging Markets* (the "Guide"), the latest step in a series of actions taken by the regulator focusing on emerging market issuers. In the wake of a number of high profile failures of issuers listed on Canadian exchanges with operations located in emerging markets, the OSC:

- initiated and reported upon a review of concerns related to emerging market issuers (see our March 20, 2012 update - *OSC Staff Reports on Concerns Identified in Review of "Emerging Market Issuers"*); and
- communicated its commitment to intensify oversight of, and to crack down on, emerging market issuers, with particular focus on gatekeepers such as directors, auditors, underwriters and others to determine whether those gatekeepers have performed their role in protecting investors (see our October 31, 2012 update - *Ontario Securities Commission to Target "Gatekeepers" of Emerging Market Issuers Listed on Canadian Exchanges*).

The Guide provides direction to officers and directors of emerging market issuers on eight risk areas identified by the regulator, which areas are likely to be the focus of the securities commission's increased scrutiny.

The Guide includes general recommendations as to how the key risks should be addressed, in many cases with examples of the type of disclosure that the regulator considers appropriate. Though the Guide does not by its terms change the legal requirements applicable to affected issuers, it speaks to the manner in which the OSC will interpret the requirements and will be a powerful statement as to how "gatekeepers" working with emerging markets issuers should discharge their responsibilities.

The Key Risk Areas

The recommendations of the OSC in the eight key risk areas identified include the following:

1. *Business and Operating Environment*
 - An issuer's board and management must have a thorough understanding of the political, cultural, legal and business environments in which the company operates.
 - Boards are urged to consider the role of foreign government and regulatory authorities in operations, and determine how best to manage relations with these bodies.
 - Foreign members of the board and management must address any "knowledge gaps" regarding Canadian capital markets, including by seeking assistance from Canadian directors and advisors.
 - An issuer's public disclosure should highlight any risks or issues that are unique to doing business in the relevant emerging market jurisdiction(s).
2. *Language and Cultural Differences*
 - The board should include members with appropriate experience in the emerging market.
 - The board should devise appropriate policies, including the use of an independent translator, to overcome any challenges associated with language or cultural barriers, and should engage with local management to understand the manner in which business is conducted in the foreign jurisdiction.
3. *Corporate Structure*
 - The OSC cautions that complex corporate structures, which the regulator acknowledges may be required for international legal or other structuring reasons, can create barriers to effective decision-making. Consequently, boards should consider the risks that may flow from any complexity in corporate structures, focusing in particular on risks associated with separations of control and voting rights and on providing clear disclosure explaining the structure and any associated risks.
4. *Related Parties*
 - The OSC highlights that related party transactions (RPTs) in emerging markets are subject to heightened risks, due to differences in local business practices, cultural norms and legal requirements. As a result, arrangements should be made to ensure that RPTs are identified, monitored and

clearly disclosed so that all relevant stakeholders have the appropriate tools to assess their impact.

- Consistent with the principles of recently introduced changes to relevant IFRS requirements, the issuer's disclosure should at a minimum describe: (i) the relationship and identity of the related persons or entities; (ii) the business purpose of the transaction; (iii) the recorded amount of the transaction; and (iv) any ongoing contractual or other commitments resulting from the transaction.

5. *Risk Management and Disclosure*

- The boards should adopt a written mandate acknowledging its responsibility for identifying principal risks of the company's business.
- The board should implement appropriate risk management systems that are particularly sensitive to the risks associated with operating in relevant emerging markets.

6. *Internal Controls*

- The board should adopt a written mandate expressly acknowledging its responsibility for the issuer's internal control and management information systems.
- The audit committee must actively oversee the monitoring of any identified weaknesses as in internal controls and the risks they create and issuers must clearly disclose any such material weaknesses.

7. *Use of and Reliance on Experts*

- Emerging market issuers should consider retaining properly credentialed local experts to assist with operational issues, such as navigation of foreign tax laws, interpretation and application of foreign laws, and valuation of assets located in foreign jurisdictions (at all times recognizing that experts in different jurisdictions are subject to differing standards of care).

8. *Oversight of the External Auditor*

- The issuer's audit committee should evaluate the external auditor's approach in auditing the areas that present risks specific to the issuer and the jurisdictions in which it operates. The committee is encouraged to maintain frequent informal communications with the external auditor and obtain information about the audit on a real-time basis.

The Guide indicates that the Toronto Stock Exchange and TSX Venture Exchange are also in the process of preparing guidance to address risks associated with listing emerging market issuers on Canadian exchanges. These additional guidelines, which are expected to be published for comment later this month, will clarify the exchanges' expectations of issuers and of the advisory community.

Though emerging market issuers represent a relatively small component of the reporting issuer community both in number and market value, as evidenced by the background information in the OSC's emerging markets study, the OSC is clearly focused on issuers in this space, and on their "gatekeepers." This focus is likely due to a number of recent cases involving high profile emerging market issuers, the potential effect on market integrity, and the likelihood that with increasing globalization the issues raised may be of increasing relevance over time. The OSC has indicated that it is currently investigating several cases involving gatekeepers in these types of situations.

Please contact any of the lawyers in our Corporate Securities Group to discuss these latest guidelines and how they may affect your obligations under Canadian securities law.