

Goodmans^{LLP} Update

New Prospectus Exemptions in Canada for Foreign Distributions

On March 29, 2018, the Canadian Securities Administrators (CSA) announced a new prospectus exemption for resales of restricted securities outside of Canada will come into force on June 12, 2018. The new exemption should provide increased flexibility and reduce compliance costs for Canadian investors selling foreign securities outside of Canada.

In addition, on March 31, 2018, four new exemptions that allow issuers (and in some cases selling security holders) to sell securities outside of Canada without a prospectus came into force in Ontario. The new exemptions are expected to provide greater certainty to issuers and investors in Ontario when selling (or reselling) securities outside of Ontario.

Background

Canadian courts and securities regulators have historically interpreted provincial and territorial securities legislation in a manner that can require securities sold outside of Canada to be qualified by a prospectus or sold pursuant to an exemption from the prospectus requirement. Some provinces and territories apply the prospectus requirement to all distributions by issuers and investors from within the province, while others take a more nuanced approach. For example, the Ontario Securities Commission (OSC) takes the view (previously expressed in Interpretation Note 1 – *Distributions of Securities Outside of Ontario*) that if reasonable steps are taken to ensure securities sold outside of Ontario “come to rest” with investors outside of Ontario, then no Ontario prospectus or prospectus exemption is required (and the securities distributed outside of Ontario will not be subject to restrictions on resale under Ontario securities laws). Unfortunately, even in Ontario, market participants have found this guidance difficult to rely upon in practice, primarily due to the lack of any bright-line tests for determining when a prospectus is required.

Many issuers and investors have expressed concerns that the broad application of the Canadian prospectus requirement, combined with the lack of prospectus exemptions tailored to foreign distributions, have limited opportunities for issuers and investors to participate in global capital markets, or imposed significant compliance costs when doing so. The new prospectus exemptions are an attempt to allow investors (and issuers in Ontario) to compete more effectively with their global peers when accessing or deploying capital in the evolving global marketplace.

New Canadian Resale Exemption

The CSA, after considering comments received on an initial proposal published in June of 2017, are introducing a new prospectus exemption for the resale of certain restricted securities (i.e., securities that are not “freely tradeable” under Canadian securities laws). The new exemption allows investors to resell restricted securities of a “foreign issuer” on an exchange or market outside of Canada, or to a person or company outside of Canada, if the foreign issuer was not a “reporting issuer” under Canadian securities laws either on the date the investor acquired the securities or the date of the sale. A “foreign issuer” is an issuer that, on the distribution date (generally, the date the investor acquired the securities), was not incorporated or organized under the laws of Canada (or a jurisdiction of Canada), unless either (i) the issuer’s head office is in Canada, or (ii) the majority of the issuer’s executive officers or directors ordinarily reside in Canada. Securities sold in reliance on this exemption are generally freely tradeable under Canadian securities laws, even if they are sold back into Canada (although the exemption is not available if the selling security holder takes steps to sell the security in Canada or has knowledge the securities are being purchased for the account of a Canadian investor). In the final version of the rule and in response to feedback received from certain market participants, the CSA has simplified this exemption by eliminating the requirement in the original draft that a “foreign issuer” must have a majority of its consolidated assets outside of Canada.

The CSA have also decided, contrary to the initial draft of the rule, to maintain the existing resale exemption in Section 2.14 of National Instrument 45-102 – *Resale Restrictions* that applies to resales outside of Canada if (i) the issuer was not a reporting issuer on the date the investor acquired the securities or is not a reporting issuer on the date of the sale, and (ii) Canadians own less than 10% of the issuer's securities and represent not more than 10% of the total number of security holders. The new exemption is intended to address challenges that selling security holders have faced in determining if the ownership criteria of the existing exemption are satisfied (and which has resulted in selling security holders frequently seeking and obtaining exemptive relief from the ownership thresholds). On the other hand, unlike the new exemption, the existing exemption can be used to sell securities of domestic companies that otherwise meet the exemption's criteria, so its continued application provides investors with some additional flexibility in that regard.

New Ontario Distribution Exemptions

Four new prospectus exemptions – set forth in OSC Rule 72-503 – are now in force in Ontario. The new exemptions provide “bright line” criteria that, if satisfied, permit securities to be sold (or in some cases resold) outside of Canada without filing an Ontario prospectus:

- *Distribution Under Public Offering Document in Specified Foreign Jurisdiction*. The Ontario prospectus requirement does not apply to a distribution of securities outside of Canada by an issuer or selling security holder if (i) the securities are registered under an effective registration statement in accordance with the United States *Securities Act of 1933*, or (ii) the issuer has filed an offering document that qualifies the public offering of the securities in accordance with the laws of a “specified foreign jurisdiction”, including, among others, Australia, Japan, Hong Kong, South Africa, Singapore, the United Kingdom and any member of the European Union (but excluding certain other important jurisdictions such as China, India and Brazil).
- *Concurrent Distribution under Final Prospectus in Ontario*. The Ontario prospectus requirement does not apply to a distribution of securities in any jurisdiction outside of Canada by an issuer or selling security holder if (i) the issuer or selling security holder materially complies with the disclosure requirements (including any available exemptions) of the foreign jurisdiction, and (ii) a receipt has been obtained for an Ontario prospectus qualifying a concurrent distribution of securities of the same class in Ontario.
- *Distributions by Reporting Issuers*. The Ontario prospectus requirement does not apply to a distribution of securities in any jurisdiction outside of Canada by an issuer if (i) the issuer materially complies with the disclosure requirements (including any available exemption) of the foreign jurisdiction, and (ii) the issuer is a reporting issuer in a jurisdiction of Canada immediately before the distribution.
- *Distributions by Non-Reporting Issuers*. The Ontario prospectus requirement does not apply to a distribution of securities in any jurisdiction outside of Canada by an issuer that is not a reporting issuer, so long as the issuer has materially complied with the disclosure requirements (including any applicable exemption) of the foreign jurisdiction.

Securities distributed in reliance on any of the first three exemptions are generally freely tradeable under Canadian securities laws, even if they are sold back into Canada. Securities issued pursuant to the fourth exemption are subject to resale restrictions that apply until four months after the issuer becomes a reporting issuer in Canada (meaning they may never become freely tradeable unless the issuer becomes a reporting issuer in Canada or the securities are sold under another prospectus exemption that does not impose resale restrictions).

The third and fourth new exemptions are only available to issuers and not to selling security holders. The OSC concluded the new exemption available to selling security holders in National Instrument 45-102 (described above) provides sufficient flexibility to selling security holders, and the benefits of harmonization of the resale regime in Canada outweigh the cost of not making these additional exemptions available to selling security holders.

Finally, an issuer (but not a selling security holder) relying on the second, third or fourth prospectus exemptions described above is required to file a new form (Form 72-503F – *Report of Distributions Outside Canada*) setting out certain information relating to the distribution. The form must be filed on or before the 10th day after the date of the sale (or, in the case of investment funds, not later than 30 days after the end of the calendar year in which the sale took place).

Status of Interpretation Note 1 in Ontario

Concurrently with adopting OSC Rule 72-503, the OSC has withdrawn Interpretation Note 1 (described above). At the same time, the companion policy to OSC Rule 72-503 includes a Statement of Principle that effectively reiterates the principles set forth in Interpretation Note 1, including that:

... the [OSC] does not interpret the Ontario prospectus requirement as applying to a distribution of securities outside Canada that is made in compliance with the securities laws of the foreign jurisdiction in which the investor is located. However, the Commission would expect the issuer, a selling security holder, an underwriter and other participants in the distribution to take sufficient measures in the circumstances of the distribution to make it reasonable to conclude that the offered securities come to rest outside Canada, meaning that it is unlikely that they will be redistributed back into Canada by an original purchaser outside Canada that has acquired the securities with a view to distribution, rather than with investment intent.

The companion policy clarifies this guidance has no bearing on the availability of the new prospectus exemptions, and the OSC confirmed in its response to comments received on the draft rule that market participants do not need to rely on the new prospectus exemptions in OSC Rule 72-503 (or any other prospectus exemption) if they conclude the Ontario prospectus requirement does not apply by virtue of the securities having “come to rest” outside of Canada. In that context, it remains open to issuers and selling security holders to distribute securities outside of Canada in compliance with the Statement of Principle in circumstances where the “safe harbour” created by the new prospectus exemptions is not available.

Conclusion

The efforts of Canadian securities regulators – and the OSC in particular – to modernize the regulatory framework for foreign distributions of securities is encouraging. The new national prospectus exemption for resales should significantly enhance Canadian investors’ ability to deploy capital in global markets and efficiently monetize their investments without unnecessary regulatory burdens or compliance costs. The new prospectus exemptions in Ontario should also provide Ontario issuers (and selling security holders to some degree) with greater certainty about when an Ontario prospectus is required for distributions of securities outside of Canada. We hope that other Canadian securities regulators will follow Ontario’s example, and the CSA as a whole will continue to evaluate opportunities to enhance Canadian issuers’ and investors’ ability to compete in global capital markets.

For further information on the recent or proposed amendments, or corporate finance in general, please contact any member of our Corporate Securities Group.

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