Goodmans LLP Update

# Corporate Securities Law

March 14, 2013

## CSA Proposes Significant Amendments to Early Warning Regime

The Canadian Securities Administrators (CSA) have proposed a sweeping set of amendments to improve the early warning regime in the wake of increased shareholder activism, and to bring it into conformity with the regimes of other key jurisdictions, including the United States and the United Kingdom.

The proposals have been published for a 90-day comment period and include:

- dropping the early warning reporting threshold from 10% to 5%;
- a requirement to disclose a 2% decrease in ownership;
- a requirement to include certain equity derivative positions and security lending arrangements in calculating whether the threshold has been reached; and
- the exclusion from the alternative monthly reporting system if the investor solicits, or intends to solicit, proxies from the security holders of a reporting issuer.

### Reporting Thresholds and Acquisition Disclosure

*Lowered Threshold for Acquisitions*

In the CSA's view, increasing shareholder activism and the ability of 5% shareholders to requisition shareholders' meetings has prompted a need for increased market transparency and a lowering of the reporting threshold from 10% to 5%.

*New Threshold for Decreased Ownership*

The CSA proposes amendments that would also require disclosure of a decrease in ownership of 2% or more. Currently, investors have the discretion to determine whether a decrease in their ownership constitutes a material fact requiring disclosure.

*Falling Below 5%*

The CSA proposes that shareholders be required to issue a press release and file a report if their ownership decreases below the 5% threshold.

*Enhanced Disclosure*

The proposals require enhanced disclosure in early warning reports relating to the purpose of the reported change, including detailed disclosure of the intentions of the person acquiring securities and the purpose of the acquisition. In the CSA's view, enhanced disclosure is needed to effectively evaluate the potential impact of the change. The CSA raised a concern that 'boilerplate' language is overused and wants to see more specific and contextual disclosure.

### Empty Voting and Hidden Ownership

*Disclosure of Economic and Voting Interests*

The CSA expressed concern about the use of derivatives by sophisticated investors to increase their economic interests in issuers without triggering any disclosure requirements (often referred to as "hidden voting"). Similarly, so-called "empty voting" tactics have enabled investors to accumulate significant voting stakes through derivatives or securities lending arrangements without having an equivalent economic interest in the issuer. The CSA's proposals would require disclosure of an investor's economic interest in an issuer and its voting interest, improving transparency and market integrity.

*Inclusion of Equity Equivalent Derivatives*

The CSA also expressed concern that hidden ownership strategies can significantly undermine the early warning regime since an investor may have access to securities held by the derivative counterparty while avoiding a disclosure obligation. The proposals seek to remedy this gap by requiring an investor to include within the early warning calculation certain equity derivative positions (defined in the proposals as "equity

equivalent derivatives") that are *substantially equivalent* in economic terms to conventional equity holdings. A derivative would substantially replicate the economic consequences of ownership of a specified number of reference securities if a dealer that took a short position on the derivative could substantially hedge its obligations under the derivative by holding 90% or more of the specified number of reference securities. Examples of equity equivalent derivatives include total return swaps, contracts for difference and other derivatives that provide the party with the notional "long" position with an economic interest that is substantially equivalent to the economic interest the party would have if the party held the securities directly. Importantly, the CSA proposes that an "equity equivalent derivative", such as an option and collar that provides the investor with only limited exposure to the reference securities, would not include partial exposure instruments.

*Reporting on Securities Lending Arrangements*

Through its proposals, the CSA seeks to provide greater transparency about, and ensure appropriate disclosure of, securities lending arrangements for the purposes of early warning disclosure requirements. The proposed amendments would require a lender of securities to report any loan that has the effect of *decreasing* the lender's ownership of the applicable securities by 2% or more. This position is consistent with the proposal (described above) requiring disclosure of both decreases and increases in ownership.

### Changes to Alternative Monthly Reporting

The early warning regime currently permits eligible institutional investors (EII) having a passive intent with respect to their ownership or control of securities to report changes on a more relaxed timetable than other investors. Under these rules (known as the alternative monthly reporting system (AMR)), an eligible institutional investor may defer reporting changes until ten days after the end of the month in which the change occurred unless it (i) makes, or intends to make, a takeover bid or (ii) proposes, or intends to propose, a reorganization, amalgamation, arrangement or similar business combination. The policy underlying the AMR is that there is less market sensitivity to changes involving passive investors, and therefore less urgency for disclosure of those changes.

Currently, an EII that solicits, or intends to solicit, proxies from the securityholders of a reporting issuer may use AMR even though its intent may be to actively engage with the securityholders of the reporting issuer. The CSA stated its belief that allowing an EII access to AMR in this circumstance is not consistent with the policy intent of the regime. As a result, the CSA proposes to exclude from AMR any EII which solicits, or intends to solicit, proxies from securityholders on matters relating to the election of directors or a reorganization, amalgamation, merger, arrangement or similar corporate action involving the securities of the reporting issuer.

### Implication of the Proposed Amendments

The early warning system was established primarily to deal with concerns relating to the take-over bid regime. The CSA's proposed amendments reflect its understanding of a need to re-evaluate this regime in the wake of a significant increase in shareholder activism and in particular proxy contests. If implemented, the proposed amendments will bring Canada's early warning disclosure regime into closer conformity with the requirements in the U.S. and the UK, which will provide investors and issuers with more detailed and timely market intelligence about the ownership activity and intentions of significant shareholders. At the same time, these changes will eliminate some of the perceived 'activist friendly' features of Canada that may have contributed to the rise in shareholder activism. It remains to be seen what, if any impact these changes will have on the level of shareholder activism in Canada.

For further information on the proposed amendments to the early warning regime and their implications, please contact any member of our Corporate Securities Group.