Goodmans LLP Update

Corporate Securities Law

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Highlights of OSC Corporate Finance Branch 2016-2017 Annual Report

The Ontario Securities Commission (OSC) recently published OSC Staff Notice 51-728 *Corporate Finance Branch 2016-2017 Annual Report* (the "**Report**"). The Report – which summarizes key issues raised by the Corporate Finance Branch's annual continuous disclosure review program and its ongoing review of prospectuses, private placement offerings and exemptive relief applications – provides guidance that can be helpful in navigating the securities regulatory regime in Ontario and avoiding pitfalls that can delay (or worse) capital markets transactions and/or have adverse reputational consequences for companies, their directors and officers and their advisors.

Highlights of the Report

On an annual basis, the OSC conducts both full reviews of companies' public disclosure records, as well as targeted reviews focused on specific issues. The outcomes of the OSC's reviews include education and awareness, prospective disclosure enhancements, refilings, and other outcomes, such as enforcement actions. Much of the key guidance in the Report builds on issues that the OSC has focused on in recent years, and includes:

- *MD&A Generally.* The Report notes many issuers continue to struggle with providing meaningful disclosure in their MD&A, especially with respect to changes in accounting policies, results of operations, risks and uncertainties, and capital resources. Issuers are reminded that MD&A disclosure must be transparent and clear to be informative, and that issuers should avoid boilerplate disclosure that simply repeats information from the financial statements.

- *Non-GAAP Financial Measures.* The Report highlights the OSC's continued concern with the way some companies (particularly those in the mining, real estate, technology and biotechnology industries) present non-GAAP financial measures, such as EBITDA and adjusted earnings per share (among others). The OSC's most significant concerns are the greater prominence being given to non-GAAP financial measures than GAAP financial measures, lack of clarity regarding the manner in which the measures are calculated, and consistency of presentation in companies' public disclosure materials. The Report cautions issuers that the OSC may take regulatory action in response to these concerns. Companies that routinely access the public markets for financing should also be cautious about the potential implications of these issues in the context of prospectus reviews by the OSC and other securities regulators. The Report confirms that the OSC intends to continue actively reviewing the use of non-GAAP financial measures over the next year.

- *Forward Looking Information.* Another area the OSC has focused significant attention on in recent years is forward-looking information and, in particular, disclosure of the assumptions and risks associated with such information, as well as the requirement to update previously disclosed forward-looking information. Of particular concern in the Report are the time period covered by forward-looking information (which must be limited to a period that can reasonably be estimated) and the lack of quantitative descriptions of assumptions used to prepare that information. These issues could require amendments to companies' historical public disclosure, not only as a result of a continuous disclosure review but potentially in the course of a "live" prospectus offering. As with non-GAAP financial measures, inadequate disclosure in a company's public record could materially impact the company's ability to execute on time-sensitive public equity financings. IPO issuers – that often include financial outlooks extending beyond the end of the next financial year – should also ensure that the assumptions upon which such information is based are clearly disclosed and be prepared to justify the reasonableness of those assumptions to the OSC.

• *Social Media Disclosure.* Social media has become a mainstream platform for many public companies to communicate with their investors and other stakeholders. It is critical that companies approach social media disclosure with the same care as they would any other written disclosure, including protecting against incomplete, misleading or selective disclosure. Over the past year, the OSC specifically focused on social media disclosure as one of its issue-oriented reviews and concluded that Canadian public companies generally need to improve the quality of their social media disclosure (see our March 10, 2017 Update, *CSA Provides Disclosure Expectations for Reporting Issuers Using Social Media*). The Report also strongly encourages adoption of a formal social media policy, which may be an effective tool in fostering a culture of prudence when using social media.

• *Cyber Security Risks and Incidents.* During 2016 – 2017, the OSC also conducted an issue-oriented review of companies' disclosure of cyber security risks. The results of that review are summarized in our January 24, 2017 Update, *CSA Provides Guidance on Disclosure of Cyber Security Risks*. The Report reiterates the need to provide detailed and entity-specific risk disclosure if cyber security risk is a material risk, as well as the need to evaluate whether cyber security incidents are material facts and/or material changes that require timely disclosure. Recent high profile cyber security incidents in Canada and abroad highlight the substantial reputational risks companies face if a cyber security incident occurs, which can be significantly exacerbated by inadequate or delayed disclosure of such incidents.

• *Financial Statement Disclosure for Significant Acquisitions.* In the Report, the OSC indicates that when an issuer is filing a prospectus to raise proceeds for an acquisition that will either make up a material portion of its business or is larger than its current business, the issuer may need to provide more disclosure than what is normally required in a prospectus for a "significant acquisition", including additional audited financial statements. It is not clear from the Report what the threshold is for additional disclosure, or how much additional disclosure would be required. Under the current rules, somewhat anomalously, companies making a significant acquisition may be required to provide more disclosure about the business to be acquired in an information circular if buy-side shareholder approval is required (because the buyer is issuing 25% or more of its outstanding shares to the sellers) than they are if they issue the same number of shares under a prospectus. However, in light of the OSC's statements in the Report, it may be advisable for companies to more frequently engage in pre-filing discussions with the OSC to ensure that the prospectus contains adequate disclosure and avoid delays later in the offering process.

• *Primary Business in an IPO.* The Report confirms the OSC will continue to generally require a full set (three years) of historical financial statements for every business acquired by the company within the past three years (two years in the case of a venture issuer) – regardless of its significance – if it is part of the company's "primary business". Historically, exceptions to this rule have been limited to *de minimis* acquisitions (a very low threshold in practice) or acquisitions that have been reflected in a sufficient portion of the company's own historical financial statements. The Report also confirms the OSC's view that a prospectus must include full financial statements for any business that represents more than half of the issuer's overall businesses – even if it is not part of the "primary business" of the issuer. It is vital that companies considering an IPO – particularly those with a recent acquisition history – be aware of these requirements and engage with the OSC very early in the IPO process if any relief from these requirements will be sought.

• *Exempt Market Review.* The OSC is actively reviewing the use of a number of new prospectus exemptions that have been introduced in recent years, including the new offering memorandum exemption that came into force in Ontario in January of 2016. The OSC has identified a number of concerns with issuers' use of that exemption, including failure to comply with disclosure requirements (including financial statement disclosure), failure to file marketing materials as required, insufficient disclosure regarding the company's business and disclosure that is out of date. The Report indicates the OSC will continue to focus on companies' use of this exemption and compliance with its ongoing requirements.

- *Business Acquisition Reports.* The Report provides additional guidance about the often challenging question of whether an acquisition constitutes the acquisition of a "business" for the purpose of the requirement to file a business acquisition report (BAR). The Report also discusses applications for exemptive relief from the BAR requirements and reiterates the view expressed in existing guidance that the cost of complying with the BAR requirements is not a relevant consideration. In our experience, the cost of preparing carve-out financial statements for assets that regulators deem to be a "business" can often be impossible or prohibitively expensive. The BAR requirements are an area that Canadian securities regulators are focused on in their review of ways to reduce the regulatory burden on Canadian (non-investment fund) public companies while maintaining appropriate investor safeguards. See our April 20, 2017 Update, *Canadian Securities Regulators Considering How To Reduce Regulatory Burden on Canadian Public Companies.*

For further information about the above or any other issues raised in the Report, please contact any member of our Corporate Securities Group.