Canadian Securities Administrators | Autorités canadiennes en valeurs mobilières

CSA Notice of Amendments to Early Warning System Amendments to Multilateral Instrument 62-104 *Take-Over Bids and Issuer Bids* and National Instrument 62-103 *The Early Warning System and Related Take-Over Bid and Insider Reporting Issues* and Changes to National Policy 62-203 *Take-Over Bids and Issuer Bids*

February 25, 2016

Introduction

The Canadian Securities Administrators (the **CSA** or **we**) are adopting amendments and making changes, as applicable, to certain provisions forming part of the early warning system in the following:

- Multilateral Instrument 62-104 *Take-Over Bids and Issuer Bids* (**MI 62-104**),
- National Instrument 62-103 *The Early Warning System and Related Take-Over Bid and Insider Reporting Issues* (**NI 62-103**), and
- National Policy 62-203 *Take-Over Bids and Issuer Bids* (**NP 62-203**) (collectively, the **Amendments**).

We are publishing the text of the Amendments concurrently with this notice.

Currently, the regime governing early warning reporting is contained within MI 62-104, NI 62-103 and NP 62-203 in all jurisdictions of Canada, except Ontario. In Ontario, substantively harmonized requirements for early warning reporting are set out in Part XX of the *Securities Act* (Ontario) (the **Ontario Act**), Ontario Securities Commission Rule 62-504 *Take-Over Bids and Issuer Bids* (the **Ontario Rule**), as well as NI 62-103.

In Ontario, legislative amendments were made to the Ontario Act to accommodate the adoption of MI 62-104 in Ontario, as amended by the Amendments and the Bid Amendments (as defined below), such amended instrument, **NI 62-104**. These legislative amendments will come into effect upon proclamation by the Lieutenant Governor of Ontario. The repeal of the Ontario Rule and the related consequential amendments and changes necessary to facilitate the adoption of NI 62-104 in Ontario are referred to as the **Harmonization**.

In addition, we are also concurrently adopting amendments and changes to the regime governing the conduct of take-over bids (collectively, the **Bid Amendments**), which amendments and

changes are set out in the CSA Notice of Amendments to Take-Over Bid Regime dated February 25, 2016 (the **Bid Amendments Notice**).

In some jurisdictions, Ministerial approval is required for these amendments and changes. Except in Ontario, provided all necessary approvals are obtained, the Amendments and Bid Amendments will come into force on May 9, 2016. In Ontario, NI 62-104, and amendments and changes related to the Harmonization will come into force on the later of (a) May 9, 2016, and (b) the day on which certain sections of Schedule 18 of the *Budget Measures Act, 2015* (Ontario) are proclaimed into force. Please refer to Annex N to the version of the Bid Amendments Notice published in Ontario for more information.

Substance and Purpose

The Amendments will provide greater transparency about significant holdings of reporting issuers' securities under the early warning system. They are intended to enhance the quality and integrity of the early warning system in a manner that is suitable for the Canadian public capital markets.

The Amendments will:

- require disclosure of decreases in ownership, control or direction of 2% or more;
- require disclosure when a securityholder's ownership, control or direction falls below the early warning reporting threshold;
- exempt lenders from including securities lent or transferred for the purposes of determining the early warning reporting threshold trigger if they lend securities pursuant to a specified securities lending arrangement;
- exempt borrowers under securities lending arrangements from including securities borrowed for the purposes of determining the early warning reporting threshold trigger in certain circumstances;
- make the alternative monthly reporting (**AMR**) system unavailable to eligible institutional investors (**EII**s) who solicit proxies from securityholders in certain circumstances;
- require disclosure in the early warning report of an interest in a related financial instrument, a securities lending arrangement and other agreement, arrangement or understanding in respect of a security of the class of securities for which disclosure is required;
- enhance the disclosure in the early warning report by requiring more detailed information regarding the intentions of the acquiror and the purpose of the transaction;
- require the early warning report to be certified and signed;
- clarify the timeframe to issue and file a news release and an early warning report; and
- further streamline the information required in a news release filed in connection with the early warning reporting requirements.

The Amendments will also clarify the current application of early warning reporting requirements to certain derivative arrangements and to securities lending arrangements.

Background

On March 13, 2013, the CSA published for comment proposed changes to the early warning system in Canada by publishing proposed amendments and changes to MI 62-104, NI 62-103 and NP 62-203 (the **Proposed Amendments**).

The purpose of the Proposed Amendments was to address concerns raised by a number of market participants regarding the level of transparency of significant holdings of reporting issuers' securities. In particular, the Proposed Amendments responded to concerns that the reporting threshold of 10% was too high and that disclosure in early warning reports filed in Canada was inadequate.

The Proposed Amendments contemplated a lower early warning reporting threshold of 5%, disclosure of decreases in ownership of 2% or more, disclosure if a securityholder's ownership percentage fell below the reporting threshold and enhanced disclosure in early warning news releases and reports. We also proposed changes in relation to the disclosure of certain hidden ownership[1] and empty voting[2] arrangements. Furthermore, we proposed that EIIs that solicit proxies on matters relating to the election of directors or certain corporate actions involving an issuer's securities be disqualified from the AMR system.

Summary of Written Comments Received by the CSA

During the comment period, the CSA received 71 comment letters from various market participants. We have considered the comments received and thank all of the commenters for their input.

The names of commenters are contained in Annex A of this notice and a summary of their comments, together with our responses, are contained in Annex B of this notice.

Summary of Changes since Publication for Comment

On October 10, 2014, we published an update on the Proposed Amendments in CSA Notice 62-307 *Update on Proposed Amendments to Multilateral Instrument 62-104 Take-Over Bids and Issuer Bids, National Instrument 62-103 The Early Warning System and Related Take-Over Bid and Insider Reporting Issues and National Policy 62-203 Take-Over Bids and Issuer Bids*. As indicated in that notice, after considering the comments received and following further reflection and analysis, the CSA have determined not to proceed with certain of the Proposed Amendments. We have also made revisions to certain of the Proposed Amendments.

[1] This refers to the strategy by which an investor can accumulate a substantial economic position in an issuer without public disclosure and then potentially convert such position into voting securities in time to exercise a vote.

[2] This refers to the situation by which an investor, through derivatives or securities lending arrangements, holds voting rights in an issuer and can possibly influence the outcome of a shareholder vote, although the investor may not have an equivalent economic stake in the issuer.

As these changes are not material, we are not republishing the Amendments for a further comment period.

The following is a summary of the key changes that were made to the Proposed Amendments.

(a) Reporting Threshold

We originally proposed to reduce the early warning reporting threshold from 10% to 5%. We considered this lower reporting threshold to be appropriate because information regarding the accumulation of significant blocks of securities can be relevant for a number of reasons in addition to signaling a potential take-over bid for the issuer.

However, a majority of commenters raised various concerns about potential unintended consequences of reducing the early warning reporting threshold from 10% to 5% in light of the unique features of the Canadian public capital markets, including the large number of smaller issuers as well as limited liquidity. These commenters noted the potential risks of reducing access to capital for smaller issuers, hindering investors' ability to rapidly accumulate or reduce large ownership positions in the normal course of their investment activities, decreased market liquidity, and increased compliance costs. Taking into account these concerns, we have concluded that it is not appropriate at this time to proceed with this proposal. We are of the view that the intended benefits of the enhanced transparency are outweighed by the potential negative impacts of implementing the lower reporting threshold.

A number of commenters also suggested that the lower reporting threshold should not apply to certain issuers or certain investors. As a result, the CSA explored alternatives for creating a reduced early warning reporting threshold for only a sub-group of issuers or investors. In considering the policy rationale for the early warning system, the complexity of applying a lower threshold to only certain issuers or investors and the associated compliance burden, we concluded that the reporting threshold should remain at 10% for all issuers and investors.

(b) AMR Regime

We originally proposed to make the AMR regime unavailable for an EII who solicits, or intends to solicit, proxies from securityholders of a reporting issuer 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. We considered that an EII actively engaging with the securityholders of a reporting issuer on such matters should not be eligible to use the AMR regime.

A number of commenters requested that we clarify the scope of the new disqualification criteria. In response, we have specified in the Amendments that the term "solicit" has the same meaning as defined in National Instrument 51-102 *Continuous Disclosure Obligations*. That definition identifies certain activities as constituting "solicitation" activities but also specifically excludes other activities from the scope of the definition, including, subject to conditions, a public announcement of how a securityholder intends to vote and communications to other

securityholders concerning the business and affairs of the issuer where no form of proxy is sent. We have also removed the concept of "intends to solicit" to avoid uncertainty as to the application of the disqualification criteria.

We have further revised the Proposed Amendments to more specifically state that the AMR regime is unavailable for an EII who solicits proxies from securityholders so as to contest director elections or a reorganization, amalgamation, merger, arrangement or similar corporate actions involving the securities of the reporting issuer. The disqualification criteria in the original proposal more generally encompassed solicitations "in relation to" director elections and those types of corporate actions. As a result of the Amendments, in a board-related contest, if the EII solicits proxies in support of a director nominee other than the persons proposed by management, then the AMR regime is unavailable for that EII. Similarly, in a transaction-related contest, if the EII is soliciting proxies in support of a corporate action not supported by management or in opposition to a corporate action recommended by management, the AMR regime will be unavailable for that EII.

(c) Derivatives

We originally proposed to include "equity equivalent derivatives" for the purposes of determining whether an early warning reporting obligation is triggered. The "equity equivalent derivative" concept would have captured derivatives that substantially replicate the economic consequences of ownership. We believed that it was appropriate to change the scope of the early warning system in this way to ensure proper transparency of securities ownership interests in light of the increased use of derivatives by investors.

However, a number of commenters submitted that there is no clear evidence to suggest that derivatives are used in Canada as a means to accumulate substantial economic positions in issuers without public disclosure to exert influence over the issuers or voting outcomes. Instead, these commenters contended that investors use derivatives for risk management purposes or as part of a trading strategy. Some commenters also expressed concern that the inclusion of "equity equivalent derivatives" within the early warning threshold calculation would create a significant compliance burden. The commenters cautioned that this change may render the early warning threshold calculation unduly complex and onerous for investors and, moreover, would not provide relevant information to the market.

In light of the CSA's consideration of these concerns, we have concluded that it is not appropriate at this time to proceed with this proposal. Instead, we have provided new guidance regarding certain derivative arrangements that may be captured under the early warning system.

Specifically, we have added guidance in NP 62-203 regarding the circumstances under which an investor may have to include in the early warning threshold calculation an equity swap or similar derivative arrangement. This could occur when the investor has the ability, formally or informally, to obtain the voting or equity securities or to direct the voting of voting securities held by any counterparties to the transaction.

(d) Securities Lending

The Amendments provide an exemption for lenders from the early warning reporting trigger for securities transferred or lent pursuant to a "specified securities lending arrangement".

We did not, however, originally propose an exemption for persons that borrow securities under a securities lending arrangement. We believed that securities borrowing could give rise to "empty voting" situations and that it was appropriate to include such positions within the early warning calculation when determining if the disclosure requirements are triggered.

A number of commenters suggested that an exemption from including borrowed securities for the purposes of determining the early warning reporting threshold trigger should be available for borrowers in the context of short selling. We acknowledge that generally persons borrowing securities in the ordinary course of short selling activities are doing so for commercial or investment purposes and not with a view of influencing voting or intending to vote the borrowed securities and, as such, these short selling activities ought to not give rise to empty voting concerns. Therefore, we have introduced a new exemption for borrowers from the early warning reporting threshold trigger. The exemption is subject to certain conditions, including that the borrowed securities are disposed of by the borrower within 3 business days and that the borrower does not intend to vote and does not vote the securities. We have also provided guidance to clarify the application of this new exemption.

We have not changed the Proposed Amendments to remove the carve-out from disclosure of lending arrangements in early warning reports. As a result, securities lending arrangements in effect at the time of a reportable transaction must be disclosed in the report even if the triggering transaction did not involve a securities lending arrangement.

(e) Enhanced Disclosure

The Amendments require detailed disclosure in the early warning report in relation to the class of securities in respect of which the report is required to be filed. The Amendments also require disclosure about the material terms of related financial instruments, any securities lending arrangement and other agreements, arrangements or understandings involving the securities. We have clarified that disclosure of the material terms of such agreements, arrangements or understandings are not intended to capture proprietary or commercially-sensitive information as such information is not relevant to the ownership of, control or direction over, voting or equity securities. We believe that the enhanced scope of the disclosure requirements will result in more comprehensive disclosure about the acquiror's economic and voting interests in the class of securities of the reporting issuer for which the report is filed and address the transparency concerns associated with these types of agreements, arrangements and understandings.

(f) Other Changes

The Amendments clarify that an early warning news release must be issued and filed no later than the opening of trading on the next business day (rather than simply "promptly"). In addition, the Amendments provide for further streamlining of the news release content by permitting the

news release to make reference to the early warning report for specified further details. This change is intended to reduce the compliance burden for investors.

We originally proposed to repeal the accelerated early warning reporting provisions during a take-over bid which require disclosure of acquisitions by a party other than the offeror at the 5% level. Since we are not reducing the early warning reporting threshold from 10% to 5%, we are retaining this requirement.

Local Matters

Annex F is being published in any local jurisdiction that is making related changes to local securities laws, including local notices or other policy instruments in that jurisdiction. It also includes any additional information that is relevant to that jurisdiction only.

Contents of Annexes

The following annexes form part of this notice:

Annex A - Names of Commenters
Annex B - Summary of Comments and CSA Responses
Annex C – Amendments to MI 62-104
Annex D – Changes to NP 62-203
Annex E – Amendments to NI 62-103
Annex F – Local Matters

Questions

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