NORTON ROSE FULBRIGHT

Barristers & Solicitors / Patent & Trade-mark Agents

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Norton Rose Fulbright Canada LLP
1 Place Ville Marie, Suite 2500
Montréal, Quebec H3B 1R1 CANADA

F: +1 514.286.5474
nortonrosefulbright.com

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
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Financial and Consumer Services Commission (New Brunswick)
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Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Our reference
1001045126

To the attention of:

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
Email: comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal, Québec H4Z 1G3
Fax: 514-864-6381
E-mail: consultation-en-cours@lautorite.qc.ca

Comments on CSA Draft Regulation 52-112 respecting Non-GAAP and Other Financial Measures Disclosure and concordant regulations

Introduction

This letter is submitted in response to the CSA Notice of Consultation (the **Notice of Consultation**) regarding Draft Regulation 52-112 respecting Non-GAAP and Other Financial Measures Disclosure (the **Draft Regulation**), the companion Draft Policy Statement (the **Draft Policy Statement**) and concordant regulations (collectively, the **Proposed Regime**) issued by the Canadian Securities Administrators (the **CSA**) on September 6, 2018. It reflects the views of a working group consisting of issuers having a combined market capitalization of more than CAD $200 billion (the **Working Group** or **we**). Members of the Working Group welcome the CSA's initiative to clarify disclosure obligations and increase transparency in our capital markets and appreciate the decision of the CSA not to limit the issuers' ability to disclose different types of non-GAAP financial measures or other financial measures. The members nonetheless believe the CSA's Draft Regulation introduces some highly complex and impractical disclosure requirements that should be re-evaluated. We provide below our general comments and responses to the questions asked by the CSA in the Notice of Consultation. We thank you for

affording us an opportunity to comment on this important matter and we trust that the CSA will consider the views expressed in this letter in finalizing the Proposed Regime.

General comments

The Working Group believes that proper rules surrounding disclosure of non-GAAP and other financial measures can enhance their usefulness to investors' decision-making, provided that such rules are clear and not cumbersome and do not result in cluttering disclosure with overwhelming regulatory statements and mandatory explanations.

After studying the Draft Regulation and Draft Policy Statement, we are of the view that the Proposed Regime is overly complicated and confusing for both investors and issuers and may have a chilling effect on disclosure of information to investors.

In particular, in addition to the elements outlined in our responses to the CSA's questions below, we would like to emphasize the following observations:

1 Complex Categories and Subdivisions of Disclosure Requirements Are Confusing

In addition to non-GAAP financial measures, the Proposed Regime would introduce three new categories of financial measures, each being subject to a specific mix of disclosure requirements. Moreover, under the Proposed Regime, the definition of non-GAAP financial measures would also encompass ratios and financial outlooks, each, again, attracting a slightly modified set of disclosure requirements. The subdivision and multiple combined disclosure obligations are complex and confusing and issuers may respond by limiting the financial information provided to investors so as to avoid the danger of non-compliance. Issuers will also most likely interpret differently certain of the requirements set out in the Proposed Regime, potentially resulting in the selection of different categories for similar measures. Issuers should be provided with a "roadmap" to better understand how to categorize the financial measures they use and what disclosures are required. The differences between various types of disclosure should be clarified. Furthermore, the rationale behind the introduction of four categories and two subdivisions should be better explained by the CSA.

The CSA should focus on facilitating useful and readable disclosure and avoiding complex and confusing rules that lead to overdisclosure and to the adoption of overly detailed "boilerplate" disclosure by issuers intending to mitigate the risk of non-compliance. CSA requirements regarding the disclosure of non-GAAP financial measures and other financial measures must allow issuers to apply their own judgment to determine the level of disclosure that is appropriate to their specific business and financial conditions within the context of their industry and peers.

2 Application to "Issuers"

We note that the Draft Regulation applies to "issuers" rather than to "reporting issuers", which considerably increases the scope of application of the Proposed Regime, consequently also covering "non-reporting issuers".

Under Canadian securities laws,[1] a "reporting issuer" is an issuer that, among other things, has filed a prospectus and received a receipt therefor or has securities that have been listed for trading on a stock exchange recognized by Canadian securities commissions. The definition of "issuer" under Canadian securities laws is significantly broader, usually referring simply to a person or company who has outstanding, issues or proposes to issue, a security.

It is our view that the reference to "issuers" makes the scope of the Proposed Regime unduly broad and should be restricted to "reporting issuers". Contrary to "non-reporting issuers", encompassed within the term "issuer" and including for example private issuers, private corporations, non-distributing corporations or non-offering corporations, "reporting issuers" are generally subject to the continuous disclosure reporting requirements under

[1] See for instance *Securities Act* (Ontario), RSO 1990, c S.5, s. 1(1).

applicable securities laws in Canada. Accordingly, it is unclear why new disclosure-related requirements, as created by the Proposed Regime, should apply to issuers who are not otherwise subject to obligations of continuous disclosure.[2] While we are aware that the CSA Staff Notice 52-306 (Revised) (the **Staff Notice**) also referred to "an issuer that discloses non-GAAP financial measures" [our emphasis], we note that the Staff Notice only sets out guidelines while the Proposed Regime has force of law. As such, its scope should not be overly broad.

3 Reasonable Person Standard

The Draft Regulation also newly applies a "reasonable person" standard with respect to the usefulness requirement under subsection 3(d)(iii) and the quantitative reconciliation requirement under subsection 3(d)(iv). This is in contrast with the reference to "investors" in the Staff Notice, which referred to investors rather than a reasonable person. We are of the view that the new "reasonable person" standard is inappropriate for governing the level of disclosure with respect to financial information. It is our view that the CSA should either clearly indicate how this standard will affect its expectations with respect to the issuers' compliance with their obligations, or revert to referring to investors.

4 Transition Period

The Working Group is of the opinion that, should the Proposed Regime enter into force, issuers should be given sufficient time to fully implement the new set of disclosure rules. As such, applying the Proposed Regime to 2018 annual documents would be too early. In addition, the Proposed Regime should not start applying mid-year. Issuers should be permitted to complete their reporting year in accordance with the disclosure requirements provided in the Staff Notice rather than the Proposed Regime in order to ensure consistent and comparable reporting over periods.

5 Harmonization with Other Initiatives

The CSA mentioned in its Notice of Consultation that certain accounting standard boards, such as the International Accounting Standard Board, are currently examining the structure and content of financial statements. The Working Group is of the view that the requirements of the Proposed Regime should be harmonized with these important initiatives prior to its entry into force in order to avoid further confusion and the necessity for multiple overarching reviews of the issuers' financial information disclosure process.

Questions

1 Does the proposed definition of a non-GAAP financial measure capture (or fail to capture) specific financial measures that should not (or should) be captured? Please explain using concrete examples.

(a) Ratios

We understand that the Draft Regulation and the non-GAAP financial measure disclosure requirements set out therein now expressly apply to ratios, which were not specifically covered by the requirements of the Staff Notice. As per section 4 of the Draft Regulation and the discussion concerning section 4 set out in the Draft Policy Statement, ratios are included within the scope of the non-GAAP financial measure disclosure obligations, including where all components of such ratios are (a) disclosed or presented in the financial statements; or (b) disaggregations of line items presented in the primary financial statements, calculated in accordance with the accounting policies used to prepare the financial statements.

Hence, ratios composed solely of GAAP components (the **all-GAAP ratios**) are included within the purview of the Draft Regulation and would be, with a few exceptions provided in section 4, subject to the non-GAAP financial measure disclosure requirements provided under section 3.

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[2] Non-reporting issuers are not required to file continuous disclosure documents pursuant to National Instrument 51-102 — *Continuous Disclosure Obligations* or National Instrument 81-106 — *Investment Fund Continuous Disclosure*.

In addition, the discussion relating to section 4 set out in the Draft Policy Statement suggests that a ratio calculated using non-financial information may also be within the purview of the Draft Regulation.

The Working Group is of the view that subjecting the all-GAAP ratios to the special disclosure requirements set out under the Draft Regulation is unnecessary because, as a financial measure composed exclusively of GAAP financial measures (or other measures disclosed or presented in the financial statements or of disaggregations calculated in accordance with the accounting policies used to prepare the financial statements), the all-GAAP ratios should not meet the definition of "non-GAAP financial measures" per se, and the policy reasons behind the special disclosure are much less compelling. Similarly, the Working Group is of the view that ratios composed exclusively of non-financial measures, or a combination of GAAP financial measures and non-financial measures, should not meet the definition of "non-GAAP financial measures" per se, and be excluded from the special disclosure requirements set out under the Draft Regulation.

By comparison, under Regulation S-K[3] of the Securities and Exchange Commission of the United States (the **SEC**), item 10(e)(4)(ii)(A) and (B), non-GAAP financial measures exclude ratios or statistical measures calculated using exclusively one or both of (A) financial measures calculated in accordance with GAAP; and (B) operating measures or other measures that are not non-GAAP financial measures. Harmonization with the SEC's requirements would be advisable in respect of such matters.

Finally, we note that the discussion relating to section 4 set out in the Draft Policy Statement indicates that "[f]or clarity, ratios include those measures expressed as percentages." Given that, technically, this would cover all decrease or growth percentages used to describe year-over-year or quarter-over-quarter variations in results, the CSA should clarify what was intended to be captured.

(b) Financial outlooks

The Draft Regulation applies to financial outlooks, which are newly expressly captured under the definition of "non-GAAP financial measures" even if such financial outlooks are not presented in the form of FOFI, as defined under the Draft Regulation and Regulation 51-102. Such financial outlooks can be disclosed in a document without the quantitative reconciliation required under subparagraph 3(d)(iv), provided that a specific description requirement is complied with.[4] The description requirement is in addition to the other disclosure obligations set out in section 3 of the Draft Regulation, except for the obligation to provide quantitative reconciliation. We note, however, that in its discussion of subsection 5(2) of the Draft Regulation, the Draft Policy Statement refers to the description requirements set out in sections 5(2)(c)(ii)(A) and (B) as "reconciliation requirements". Accordingly, the statement in subsection 5(2) of the Draft Regulation to the effect that subparagraph 3(d)(iv) (i.e., the reconciliation requirement) does not apply is somewhat confusing and could be misleading.

Under the Proposed Regime, to satisfy the description requirement, the issuer must disclose, along with the financial outlook, the equivalent historical non-GAAP financial measure, and describe either (A) each of the material differences between the financial outlook and the most directly comparable financial outlook for which an equivalent historical financial measure is presented in the primary financial statements; or (B) each of the significant components of the financial outlook used in its calculation ((A) and (B) being collectively referred to as the **Description Requirement**).

The Draft Policy Statement emphasizes that the equivalent historical non-GAAP financial measure is subject to the disclosure requirements in section 3 of the Draft Regulation, including the quantitative reconciliation requirement in subparagraph 3(d)(iv). While not being emphasized in the Draft Policy Statement, such requirements also include the comparative period disclosure requirement in subparagraph 3(c) of the Draft Regulation (and corresponding quantitative reconciliation requirement). In addition, with respect to the "description of" the material differences under subsection (A) above, the Draft Policy Statement specifies that the reconciliation should, to the extent possible, be quantitative. Furthermore, the disclosure should, as per the Draft

[3] Title 17, Chapter II, Part 229—Standard Instructions for Filing Forms under Securities Act of 1933, Securities Exchange Act of 1934 and Energy Policy and Conservation Act of 1975.
[4] S. 5(2)(c) of the Draft Regulation.

Policy Statement, include the significant judgments and estimates that management has made in developing the reconciling items. The alternative (B) prong of the Description Requirement requires in turn a description of "each of the significant components of the financial outlook used in its calculation", while the Draft Policy Statement adds that the description should also disclose the material factors or assumptions relevant to the financial outlook.

The Working Group considers that the disclosure requirements attaching to financial outlooks, and more particularly the Description Requirement, are overly demanding. The Description Requirement is problematic because it would require providing guidance on each discrete component of the financial outlook. We believe that such additional disclosure would not be helpful to the investment community (assuming that this is the CSA's intended meaning of the term "reasonable person") as it would in many cases require issuers to provide a much wider range of guidance for the equivalent GAAP measure. For example, if issuers were, in the case where they provide guidance for an adjusted earnings measure, required to provide guidance for net earnings (i.e., the equivalent GAAP measure of an adjusted earnings measure), we believe that issuers would have to provide a much wider range of guidance for net earnings in order to protect themselves against the volatility of items that are out of management's control such as, without limitation, share price movements and interest rates. Such wider range of guidance concerning equivalent GAAP measures could be so broad as to become meaningless for investors. Moreover, the requirement to disclose significant judgments and estimates that management made in developing the reconciling items may clutter the disclosure.

The Working Group suggests (i) removing the Description Requirement and only require instead that the corresponding non-GAAP historical financial measure be presented with a historical reconciliation to the most directly comparable GAAP financial measure, but without being required to present the same non-GAAP financial measure (and corresponding quantitative reconciliation) for the comparative period; or (ii) clarifying that the Description Requirement applies only to the extent the components are available without unreasonable efforts. With respect to the second alternative, we note that the SEC's requirements under Item 10(e)(1)(i)(B) of Regulation S-K are analogous, containing an "unreasonable efforts" exception to the quantitative reconciliation requirement with respect to a forward-looking non-GAAP measure.

The Working Group is of the view that overly complicated disclosure requirements will either lead to uncertainty and confusion due to lengthy cluttered disclosure, or have a chilling effect on disclosure of additional information to investors, thus causing reduced disclosure since issuers may opt for ceasing to use certain useful non-GAAP measures to avoid complex disclosure adaptation. This will ultimately lead to less useful information being provided to investors.

2 *Are there any specific additional disclosures not considered in the Draft Regulation that would significantly improve the overall quality of disclosure and be of benefit to investors? Please explain using concrete examples.*

The Working Group does not believe that additional disclosures are required. As indicated above, it is our view that disclosure requirements that are too complex do not benefit investors.

3 *Is specific content in the Draft Policy Statement unclear or inconsistent with the Draft Regulation?*

(a) Application

We note a discrepancy between subsection 2(2) of the Draft Regulation and the discussion relating to Section 2 set out in the Draft Policy Statement in defining the documents to which the Draft Regulation applies. While pursuant to subsection 2(2) of the Draft Regulation all documents that are intended to or likely to be made public, whether or not filed under the securities laws,[5] would be covered under the Proposed Regime, the Draft Policy Statement indicates that in the case of documents that are not filed, they would only be captured if their content

[5] More specifically, the section refers to a document that "is intended to be, or reasonably likely to be, made available to the public in the local jurisdiction, whether or not filed under securities legislation, unless the issuer discloses a specific financial measure in accordance with a requirement of securities legislation or the laws of a jurisdiction of Canada".

could "reasonably be expected to affect the market price or value of a security of the issuer." [Our emphasis] To ensure that the concrete legal obligations of issuers are clearly stated and the scope clearly defined, we are of the view that this limitation should be included in the text of the final version of the Draft Regulation itself and not only in the Draft Policy Statement.

We also noted that although subsection 2(2) of the Draft Regulation refers to the filing of documents "under securities legislation", the Draft Policy Statement refers to the filing of documents with securities regulatory authorities as well as with a government or a government agency under applicable securities or corporate law or an exchange or quotation and trade reporting system under its by-laws, rules or regulations.

In addition, there seems to be some confusion regarding the definitions of certain measures as being disclosed or presented in the notes to the financial statements and the disclosure requirements in sections 6 and 7 of the Draft Regulation, which apply to such measures if they are disclosed in a document other than the financial statements. The intended application could be clarified, for instance in the following instances:

- "capital management measure" means a financial measure that is disclosed in the notes to the financial statements […]
- "segment measure" means a financial measure of segment profit or loss, revenue, expenses, assets, or liabilities that is disclosed in the notes to the financial statements;
- Segment measures: s. 6. If an issuer discloses in a document other than the financial statements a total of segment measures that is not a total, subtotal or line item presented in the primary financial statements, […]
- Capital management measures: s. 7. (1) This section applies to a capital management measure that (a) is disclosed in a document other than the financial statements, and […]

Also, in section 3(v) of the Draft Regulation, in the requirement to explain the reason for a change, if any, in the label, composition or calculation of the non-GAAP financial measure, the prior period of disclosure relative to which "a change, if any" must be appreciated should be specified. While the Draft Policy Statement states that the change must be "from what has been disclosed previously", this remains unclear and should be clarified in the Draft Regulation.

(b) Additional Definitions

We note that the term "disaggregation" is used frequently in the Draft Regulation and Draft Policy Statement without being defined or explained. The Staff Notice does not refer to disaggregations and accordingly, this term is rather new in the context of non-GAAP financial measures disclosure. This term is not defined either under International Financial Reporting Standards (IFRS). It would therefore be beneficial to clarify the meaning of this term in a separate definition.

Furthermore, the definition of "capital management measure" should be expanded and clarified; for example, it is not clear whether measures like "free cash flows" would be captured by such definition, or whether they are instead intended to be non-GAAP financial measures. Examples of measures that constitute capital management measures should be provided as well.

Also, in sections 4(1)(b) and 7(2)(a)(ii) of the Draft Regulation, the term "similar financial measures" should be defined.

(c) Financial Outlooks

Should the CSA decide to maintain the Description Requirement related to the disclosure of Financial Outlooks for which FOFI has not been disclosed, we are of the view that further clarifications and explanations (including actual examples) are required in order to better enable issuers to understand the new obligations incumbent on

them as per the Description Requirement. For instance, illustrative examples should be provided as to what the CSA considers to be appropriate disclosure in respect of (i) material differences between the financial outlook and the most directly comparable financial outlook for which an equivalent historical financial measure is presented in the primary financial statements, and of significant judgments and estimates that management has made in developing the reconciling items, for purposes of section 5(2)(C)(ii)(A); (ii) the process followed in preparing and reviewing the financial outlook, including the material factors or assumptions relevant to the financial outlook, for purposes of section 5(2)(C)(ii)(B); and (iii) the explanations specific to the non-GAAP financial measure used, to an issuer, to the nature of the business and the industry, and to the way the non-GAAP financial measure is assessed and applied to decisions made by management, for purposes of the requirement of subparagraph 3(d)(iii) of the Draft Regulation.

Should the CSA decide to maintain the Description Requirement related to the disclosure of financial outlooks for which FOFI has not been disclosed, we are of the view that a review of the Draft Policy Statement and Draft Regulation should be made to ensure no additional requirements are contained in the Draft Policy Statement. The inclusion in the Draft Policy Statement of additional requirements to the already complex Proposed Regime creates increased complexity and potential for additional confusion for issuers. Examples of additional requirements found in the Draft Policy Statement include:

- in respect of subsection 5(2) of the Draft Regulation, to include the significant judgments and estimates that management has made in developing the reconciling items and to disclose the material factors or assumptions relevant to the financial outlook;

- in respect of subparagraph 3(d)(iv) of the Draft Regulation, to discuss significant judgments and estimates that management has made in developing reconciling items;

- in respect of the requirement of subparagraph 3(d)(iii) of the Draft Regulation, the requirement that the explanation should be specific to the way the non-GAAP financial measure is assessed and applied to decisions made by management; and

- in respect of subparagraph 3(d)(iv) of the Draft Regulation, the requirement that explanations of reconciling items cover the circumstances that give rise to the particular adjustments.

(d) Footnoting and Cross-Referencing

The Draft Policy Statement should clarify that a disclosure-related footnote is not required each time a non-GAAP financial measure is used in a document. Furthermore, the Draft Regulation should expressly permit to comply with the Proposed Regime by cross-referencing to documents filed with a securities regulatory authority that contain the disclosures required under the Proposed Regime, when applicable.

(e) Quantitative Reconciliation

(i) Overlapping Requirements

The Working Group is of the opinion that there may be an overlap in the list of manners in which quantitative reconciliation is to be made under section 3(d)(iv)(A) and (C). Subparagraph 3(d)(iv) reads as follows:

> *(iv) subject to subsection 4(3) and section 5, provides a quantitative reconciliation, to the most directly comparable financial measure presented in the primary financial statements, which reconciliation*
>
> > *(A) is disaggregated in such a way that it provides a reasonable person an understanding of the reconciling items,*

(B) does not describe a reconciling item as non-recurring, infrequent or unusual when a similar loss or gain is reasonably likely to occur within the next two years or has occurred during the prior two years;

(C) is explained in such a way that it provides a reasonable person an understanding of each reconciling item.

More particularly, subsection (A) appears to merely constitute a specific way to comply with subsection (C). A disaggregation would likely be accompanied with a statement explaining the disaggregation so as to clarify the use of reconciling items. It is unclear whether a disaggregation so explained would be considered as meeting both the obligations provided under subsection (A) and (C) or whether a separate explanation, distinct from the disaggregation, would be required. As such, given the principles of legal interpretation, we are of the view that subsection (A) is unnecessary and should be reformulated to be included under subsection (C).

(f) Exemptions under financial reporting framework

The Working Group is of the view that it would not be appropriate for the Draft Regulation to require an issuer to provide information on a financial measure for the comparative period where a new accounting standard for the financial reporting framework used in the preparation of the issuer's financial statements does not require full retrospective application (e.g., IFRS 16 – Leases, in effect for annual periods beginning on or after January 1, 2019). Therefore, the Draft Regulation should provide for an exemption from the comparative disclosure requirement in such circumstances.

4 Is the proposed exemption for SEC foreign issuers appropriate? If not, please explain.

The Working Group considers the exemption appropriate and also necessary in order to maintain the corresponding exemption for Canadian issuers under the Multijurisdictional Disclosure System and under the SEC's equivalent rules.

5 Is the proposed exclusion of oral statements to the application appropriate? If not, please explain.

Excluding oral statements from the purview of the Draft Regulation is appropriate and necessary given that providing the required disclosures in public speeches would be considerably impractical.

Transcripts of oral statements should similarly be excluded from the purview of the Draft Regulation. Should the CSA require that the required disclosure be added to transcripts made available following oral statements, this would deter issuers from making those transcripts public, to the detriment of investors.

6 Is the proposed inclusion of all documents to the application appropriate? If not, for which documents should an exclusion be made available? Please explain.

As mentioned in our answer to question 5, the Working Group is of the view that transcribed oral statements should be exempted from the application of the Draft Regulation. The disclosure requirements set out in the Draft Regulation are complex and demanding and we believe that many issuers who have been publishing written transcripts of relevant conferences, speeches and analyst calls on their websites will respond by refraining from doing so. The impact would then mostly be felt by less sophisticated investors who are unable to obtain transcripts of oral statements by other means. It is therefore our view that transcribed statements should be exempted from the application of the Draft Regulation, provided that they indicate in a clear and conspicuous way that they are transcripts of oral statements.

Moreover, as indicated under question 3, the Draft Regulation should expressly specify that the documents that are not filed with a securities regulatory authority are within the purview of the Draft Regulation only if their content can reasonably be expected to affect the market price or value of a security of the issuer.

In addition, offering memorandums whose form is not prescribed by regulation should be excluded from the documents to which the Draft Regulation applies. Such offering memorandums are prepared on a voluntary

basis. The prospectus exemptions upon which issuers rely are not based on the information the investors received, but on the investors' sophistication. Issuers are already careful to ensure that offering memorandums do not contain a misrepresentation. The disclosure requirements set out in the Draft Regulation would create an unnecessary burden for issuers who choose to provide information to investors. Voluntary offering memorandums are not documents that are intended to or likely to be made public, and as such should not be covered under the Proposed Regime. Even in those jurisdictions where such voluntary offering memorandums must be filed pursuant to applicable securities laws of such jurisdictions, these documents are not made publicly available for viewing on SEDAR, and remain private.

Conclusion

As explained above, the view of the Working Group is that the Proposed Regime is overly complex and should be re-evaluated. The Working Group is concerned that many of the new requirements will result in disclosure which will not benefit the investing community and may deter issuers from disclosing information which may be helpful for investors. We trust that the CSA will consider our above comments and amend the Proposed Regime. We thank you for allowing us to comment on this important matter.

Yours very truly,

(signed) Norton Rose Fulbright Canada LLP