mcmillan

Date: October 26, 2021

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Service NL
Northwest Territories Office of the Superintendent of Securities
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Nunavut

Larissa Streu
Senior Legal Counsel, Corporate Finance
British Columbia Securities Commission
P.O. Box 10142, Pacific Centre
701 West Georgia Street
Vancouver, British Columbia V7Y 1L2
Fax: 604-899-6581
lstreu@bcsc.bc.ca

Me Philippe Lebel
Corporate Secretary and Executive Director, Legal Affairs
Autorité des marchés financiers
Place de la Cité, tour Cominar
2640, boulevard Laurier, bureau 400
Québec (Québec) G1V 5C1
Fax: 514-864-8381
consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames,

Re: Comments with respect to the proposed amendments to National Instrument 45-106 - *Prospectus Exemptions* ("**NI 45-106**") (together with consequential amendments to National Instrument 13-101 - *System for Electronic Document Analysis and Retrieval* and National Instrument 45-102 - *Resale of Securities* ("**NI 45-102**"), the "**Proposed Amendments**") to introduce a new prospectus exemption available to reporting issuers that are listed on a Canadian stock exchange and fulfill certain other conditions (the "**Listed Issuer Financing Exemption**" or the "**proposed exemption**")

We are writing in response to the request for comments by the Canadian Securities Administrators (the "**CSA**") with respect to the Proposed Amendments as set out in the July 28, 2021 proposal of the CSA (the "**CSA Proposal**").

At the outset, we wish to thank the CSA for their efforts in moving forward with the CSA Proposal in an attempt to assist smaller issuers in improving their ability to effectively and efficiently raise needed funds that, if conducted in a way to protect investors, would be beneficial to our capital markets and economy. This effort builds upon the work of the CSA and others[1] and therefore there has been much debate on key aspects that form the CSA Proposal, which can serve to assist in reaching a solution. We also recognize that in reaching an appropriate solution, counterbalancing factors that have been acknowledged for decades have to be addressed, including:[2]

- the tension between investor protection objectives and the goal of fostering capital formation;
- the political currency enjoyed by small business financing, which may make it difficult to focus on substantive analysis; and
- the universal tendency to adhere to the status quo.

We are hopeful that our comments will assist the CSA in moving forward with a solution that will meet the goals of burden reduction, capital efficiency and fostering capital formation, while ensuring that its key mandate of investor protection is not undermined.

In Part I of this submission, we begin with a review of the Canadian closed system as well as its historic alternative regulatory model, the integrated disclosure system. In light of the possible impact of the Proposed Amendments on the closed system, we believe it is appropriate to consider the objectives and historical policy basis for the closed system and to consider the policy rationale of an integrated disclosure system and the manner in which it should properly function. We then review historical alternatives to prospectus offerings which were proposed and have not been adopted at this time, that appear to be the foundation on which the Proposed Amendments were based; namely the 2000 CSA Concept Proposal for an Integrated Disclosure System (the "**CSA Concept Proposal**") and Proposal 16 of the Final Report (as defined below) of the Ontario Capital Markets Modernization Taskforce (the "**Taskforce Proposal**").

[1] *Task Force on Small Business Financing Final Report*, OSC (October 1996) [Small Business Report]; *CSA Notice and Request for Comment 44-401, 51-401 – Concept Proposal for an Integrated Disclosure System*, CSA Notice, (2000) 23 OSCB 633 [CSA Concept Proposal]; Capital Markets Modernization Taskforce, *Consultation Report* (9 July 2020), online (pdf): *Government of Ontario* <files.ontario.ca/books/mof-capital-markets-modernization-taskforce-report-en-2020-07-09.pdf> [Consultation Report]; *New Proposals for Securities Regulation – A new way to regulate*, BCSC (5 June 2002), online (pdf): *British Columbia Securities Commission* <bcsc.bc.ca/-/media/PWS/Resources/Securities_Law/HistPolicies/HistPolicyBCN/BCN200220_New_Proposals.pdf> [CMA Proposal].

[2] Small Business Report, *supra* note 1 at 1 (preface).

In Part II of this submission, we contend that a prospectus exemption similar to the Listed Issuer Financing Exemption would be in the public interest and recommend changes to the Proposed Amendments that we believe may strike a better balance between the goals of market efficiency and fostering capital formation, on one hand, and investor protection, on the other hand. Notwithstanding our support for the proposed exemption, we conclude by asking that the CSA examine holistically the closed system with a view to developing a new regime which better meets the needs of the Canadian capital markets.

In Part III of this submission, we respond directly to the questions set out under "Request for Comments" in the CSA Proposal and to the question set out in "Comments" in Annex E.

The views, opinions and recommendations expressed in this letter are solely those of the lawyers whose names are set out at the conclusion of this letter, and are not made on behalf of McMillan LLP, or its clients.[3] We would be pleased to provide further insight and additional details with respect to our submissions, and would welcome the opportunity to engage further with the CSA.

Part I

A. The Closed System

The closed system model characterizes the distribution and trading of securities in every Canadian jurisdiction today, excluding Manitoba.[4] Under the closed system, all distributions require a prospectus (i.e. the system is "closed" around all distributions), unless an exemption from the prospectus requirement is available.

Under current Canadian securities legislation, there can be no issuance of securities (i.e. no primary market distributions) unless there has been a prospectus filing or the primary market distribution takes place under an exemption from the prospectus requirements.[5] Securities issued in the primary market by way of a prospectus are qualified for distribution, and thereby freely tradeable (outside of the closed system) subject to narrow exceptions.

Where it operates, the closed system functions to restrict the secondary market trading of securities sold initially pursuant to a prospectus exemption.[6] Specifically, the closed system prevents such securities from becoming freely tradeable, unless there is compliance with the specific resale rules imposed by NI 45-102, or a prospectus is filed and receipted to qualify

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[3] This letter was prepared with the assistance of the following summer and articling students: Srinidhi Akkur, Kamal Azmy, Kiira Kaarid, Ishita Kashyap, Sam Kelley, Vaughan Rawes, Cole Singleton, Kendra Wilson and David Zhang.

[4] David Johnston, Kathleen Doyle Rockwell & Cristie Ford, *Canadian Securities Regulation*, 5th ed (Markham: LexisNexis Canada, 2014) at 299 [Johnston].

[5] *Ibid* at 296.

[6] Borden Ladner Gervais LLP, *Securities Law and Practice*, 3rd ed (Toronto: Thomson Reuters, 1988) (loose-leaf updated 2017, release 6), s 17.8 [BLG].

the distributed securities.[7] Failing to do so will relegate the securities to the closed system where they can only be re-sold under a prospectus exemption listed in NI 45-106,[8] a related instrument such as Multilateral Instrument 45-108 – *Crowdfunding* ("**MI 45-108**") or the recently introduced National Instrument 45-110 – *Start-up Crowdfunding Registration and Prospectus Exemptions* (together with MI 45-108, the "**Crowdfunding Exemptions**"),[9] or a local act (such as, the Ontario *Securities Act* ("**OSA**")).[10]

The key purpose of the closed system is to ensure that, before those outside the closed market are able to purchase securities in the secondary market, there is sufficient publicly accessible information available to investors to make informed investment decisions.[11] The closed system was introduced in part as a response to the previous securities law regulatory landscape in Canada, where, in general, there were no restrictions on the resale of securities originally purchased under a prospectus exemption.[12] There were concerns, as expressed by the authors of the *Merger Report* in 1970,[13] that this aspect of the previous legislation provided loopholes for backdoor underwritings, whereby the exemptions served as mere pipelines for covert distributions of securities to the public.[14] These circumstances also created opportunities for sophisticated investors to take advantage of and resell their prospectus-exempt securities to less sophisticated investors who lacked disclosure about the securities and/or the issuers.[15]

The closed system aims to remedy these problems and to protect investors in the secondary market that are outside of the closed market by providing for, "a high continuing standard of disclosure […] coupled with sufficient delay to permit adequate exposure of facts", before resales can take place.[16] NI 45-102 currently achieves this result through the establishment of restricted (or hold) periods and seasoning periods, the primary purposes of which are to allow time for the disclosure to build up and for investors to evaluate it.[17] The availability and sufficiency of the disclosure is realized by making it a pre-requisite that the issuers of the securities be or become reporting issuers, thus subject to continuous and timely disclosure requirements pursuant to Canadian securities laws, before the clock starts running on these

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[7] *Resale of Securities,* OSC NI 45-102 (as consolidated 1 November 2018), online (pdf): *Ontario Securities Commission* <osc.ca/sites/default/files/pdfs/irps/ni_20181101_45-102_unofficial-consolidation.pdf> [NI 45-102].
[8] *Prospectus Exemptions,* OSC NI 45-106 (as consolidated 5 October 2018), online (pdf): *Ontario Securities Commission* <osc.ca/sites/default/files/2020-09/ni_20181005_45-106_unofficial-consolidation.pdf> [NI 45-106].
[9] *Crowdfunding*, MI 45-108 (as consolidated 31 October 2016), online (pdf): *Ontario Securities Commission* <osc.ca/sites/default/files/pdfs/irps/ni_20170119_45-108_unofficial-consolidation.pdf>; *Start-up Crowdfunding Registration and Prospectus Exemptions*, OSC NI 45-110, (2021) 44 OSCB 7927.
[10] *Securities Act*, RSO 1990, c S.5 [OSA].
[11] BLG, *supra* note 6, s 17.8.2.
[12] Mark R. Gillen, *Securities Regulation in Canada*, 3rd ed (Toronto: Thomson Carswell, 2007) at 242 [Gillen].
[13] Department of Financial and Commercial Affairs, *Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure raised for investors by Business Combinations and Private Placements* (Ontario: February 1970) [Merger Report].
[14] *Ibid* at para 5.04.
[15] Gillen, *supra* note 12 at 242.
[16] Merger Report, *supra* note 13 at para 5.26.
[17] Gillen, *supra* note 12 at 244.

hold or seasoning periods.[18] A knock-on effect of the resale restrictions imposed by hold or seasoning periods is that they potentially work to incentivize public offerings because securities issued under the prospectus regime will not be subject to the discount that frequently occurs because of the resale restrictions.[19]

NI 45-102 harmonized resale restrictions across the closed system jurisdictions in Canada.[20] Prior to the introduction of NI 45-102, hold periods across Canada ranged from anywhere between six months to a year and a half.[21] The hold period originally suggested by the authors of the *Merger Report* was 28 days.[22] Presently under section 2.5 (the restricted or hold period conditions) of NI 45-102, in addition to satisfying certain other requirements, the issuer must be and have been a reporting issuer in a Canadian jurisdiction for the four months immediately preceding the proposed trade, and at least four months must have elapsed since the original distribution.[23] Under section 2.6 (the seasoning period conditions) of NI 45-102, the requirements are similar to those under section 2.5 (including that the issuer must be and have been a reporting issuer in a Canadian jurisdiction for the four months immediately preceding the proposed trade), but there is no requirement that at least four months must have passed since the original distribution.[24]

Requiring an issuer to be a reporting issuer for the four preceding months under both sections makes certain (assuming the issuer is not in default of its obligations under securities legislation) that there will be at least four months' worth of continuous and timely disclosure materials, pertaining to the issuer, available to a prospective purchaser in the secondary market.[25] These materials would include, for example, interim or audited financial statements, management discussion and analysis ("**MD&A**") and material change reports.[26] The combined disclosure from these documents is considered an alternative to the information that a prospectus would otherwise provide.[27] This reliance on continuous and timely disclosure materials rather than a single prospectus is consistent with the shift in regulatory policy,[28] even though these documents are not subject to the same standard of full, true, and plain disclosure of all material facts, as would be required in a prospectus filing.[29] The additional requirement, under section 2.5 of NI 45-102, that four months must have passed since the

[18] Johnston, *supra* note 4 at 330.
[19] Ministry of Finance, Five Year Review Committee Final Report ~ Reviewing the Securities Act (Ontario) (Toronto: Publications Ontario, 21 March 2003) at 138 [Crawford Report].
[20] Johnston, *supra* note 4 at 330.
[21] *Ibid*.
[22] Merger Report, *supra* note 13 at para 5.25.
[23] NI 45-102, *supra* note 7, s 2.5(2).
[24] NI 45-102, *supra* note 7, s 2.6(3).
[25] Gillen, *supra* note 12 at 248.
[26] BLG, *supra* note 6 at para 17.1.5; Gillen, *supra* note 12 at 247.
[27] Johnston, *supra* note 4 at 304.
[28] Capital Markets Modernization Taskforce, *Final Report* (January 2021), online (pdf): *Government of Ontario* <files.ontario.ca/books/mof-capital-markets-modernization-taskforce-final-report-en-2021-01-22-v2.pdf> at 34 [Final Report].
[29] OSA, *supra* note 10, ss 56(1), 75(1).

initial distribution operates to prevent backdoor underwritings.[30] It has been argued that the imposition of a hold period under section 2.5, and not section 2.6, is because the exemptions subject to section 2.5 are more prone to backdoor underwritings, than those exemptions subject to section 2.6.[31] It may also be argued that the prospectus exemptions subject to section 2.6 (which in effect usually allows securities to be immediately freely tradeable after issuance, as in most cases the issuer has been a reporting issuer for more than four months) are intentionally limited and have built-in safeguards:

- where an issuer sells shares to its existing shareholders subject to a cap of no more than a 100% dilution;[32]
- statutory transactions that usually require disclosure and the consent of shareholders – such as take-over bids, arrangements and amalgamations; and
- where shares are issued to employees and officers of the issuer who should be fully informed and knowledgeable about the issuer's business.[33]

As referenced, the investors for whom exemptions are available, in effect, constitute a closed market for restricted secondary market trading, the existence of which is linked to a presumption that they do not require the protections provided by a prospectus.[34] The rationales, however, for why these investors do not require these protections appear to have changed with the growing list of available prospectus exemptions, which have worked to expand the list of investors allowed entry into the closed market. In Ontario, key capital raising exemptions include those for accredited investors, minimum amount investments (other than by individuals), family, friends and business associates, and existing security holders, among others.[35] Many of these exemptions are rationalized on the basis that these investors are of a certain level of sophistication and have the experience necessary to do the required diligence on the issuer,[36] that there exists some close relationship to the issuer, pursuant to which their trustworthiness and capabilities can be appropriately evaluated, or that the transaction under which the distribution will take place provides sufficient protections and/or disclosure.[37]

In recent years, however, we have seen the introduction of new prospectus exemptions, like the offering memorandum exemption and the Crowdfunding Exemptions, which target a much broader base than previous exemptions.[38] The rationale for these new exemptions appears to be less about the class of investor, and more about the class of issuer. Specifically, they

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[30] Gillen, *supra* note 12 at 248.
[31] Gillen, *supra* note 12 at 248.
[32] NI 45-106, *supra* note 8, s 2.1(6)(a).
[33] NI 45-106, *supra* note 8, s 2.24.
[34] Gillen, *supra* note 12 at 87.
[35] Ontario Securities Commission, *Summary of Key Capital Raising Prospectus Exemptions in Ontario* (28 January 2016), online (pdf): <osc.ca/sites/default/files/pdfs/irps/ni_20160128_45-106_key-capital-prospectus-exemptions.pdf> [Key Prospectus Exemptions].
[36] Johnston, *supra* note 4 at 317.
[37] *Ibid* at 311.
[38] Key Prospectus Exemptions, *supra* note 35.

appear to be responses to the desires of smaller issuers for more cost-effective ways to access capital markets.[39] Another difference between these exemptions and the others is that for an issuer to rely on them, they must provide point of sale disclosure, which is not the case with the majority of the other key exemptions.[40] These newer exemptions thus appear to be the result of a compromise. Instead of restricting the availability of prospectus exemptions to particular investors who are deemed not to require disclosure protections, regulators have opened up the closed market in certain circumstances, but are mandating disclosure in those instances where it is presumed to still be necessary. However, the disclosure standard is less than that required for a prospectus and is not subject to a securities regulator's prior review.

The continued existence of the closed system has not been without critique, as perhaps most notably seen in 2003's *Five Year Review Committee Final Report ~ Reviewing The Securities Act (Ontario)* ("**Crawford Report**"), where the authors claimed that it "ha[d] become increasingly complicated and difficult to administer and comply with."[41] The authors of the Crawford Report questioned the continued need for hold periods for reporting issuers, as discussed in more detail below. For example, the authors felt that backdoor underwriting concerns could be targeted specifically, by deeming those who purchase securities pursuant to an exemption "with a view to distribution" as underwriters,[42] which may have been addressed by the definition of underwriter under the OSA.[43] With respect to the supposed disclosure protections gained through hold periods, the authors of the Crawford Report said that this rationale was not compelling because in their view, "[t]he gap in the quality of disclosure as between the prospectus and continuous disclosure that existed when the closed system was introduced ha[d] narrowed considerably".[44] Moreover, the authors felt that the idea that seasoning periods allow time for disclosure to be disseminated, did not really hold up in a world with "SEDAR and other technological advances [that] permit greater and faster access to information than ever before."[45]

Others have raised similar points. For example, then-Professor Anand questioned whether the closed system lacked "relevance in an era where secondary market disclosures about an issuer are comprehensive and issuers now bear liability for such disclosures."[46] She also suggested that backdoor underwriting was less of an issue now than when "a larger proportion of trading occurred in the primary market and when the monitoring of securities distributions was perhaps less comprehensive and less frequent."[47] Finally, she too raised the point about "technological advances such as SEDAR" perhaps cannibalizing the need for hold periods.[48]

[39] Johnston, *supra* note 4 at 322.
[40] Key Prospectus Exemptions, *supra* note 35.
[41] Crawford Report, *supra* note 19 at 134.
[42] *Ibid* at 138.
[43] OSA, *supra* note 10, s 1(1).
[44] Crawford Report, *supra* note 19 at 138.
[45] Crawford Report, *supra* note 19 at 139.
[46] Anita Anand, "Towards Effective Balance Between Investors and Issuers in Securities Regulation" (1 August 2006) at 46, online (pdf): <citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.595.2928&rep=rep1&type=pdf>.
[47] *Ibid*.
[48] *Ibid* at 47.

Prior to these commentators, in 1996, the authors of the Ontario Securities Commission Task Force on Small Business Financing Final Report acknowledged that the closed system was "badly in need of rethinking but does not lend itself to tinkering, i.e. recommending certain changes without addressing its conceptual underpinnings."[49] Twenty-five years later that statement remains true.

In summary, the closed system model presently characterizes the distribution of securities in almost every Canadian jurisdiction. Its key purpose is to ensure that there is sufficient information in the market available to inform the investment decisions of potential purchasers. It seeks to achieve this objective by preventing the issuance of securities in the primary market unless there has been a prospectus filing or the distribution takes place under an exemption from the prospectus requirement, and by placing restrictions on secondary market trading for securities purchased earlier pursuant to an exemption. Hold and seasoning periods, as found in NI 45-102, and the reporting issuer pre-requisite are key restrictions, which work to ensure there is continuous and timely disclosure material available before secondary market resales can take place (assuming no prospectus is filed to qualify the securities, and there is no reliance on a further exemption). Hold periods are also said to prevent backdoor underwriting, and to promote public offerings. The prospectus exemptions, by contrast, at least those that are restricted to particular classes of investors, have been rationalized on the basis that such investors do not need the protections offered by NI 45-102. However, the emergence of new exemptions that can be used by any investor appear to have a different rationale, one which reflects the desires of smaller issuers to have more cost effective ways for access to public investors. Issues like cost of compliance with the closed system regime have led some to seek out and conceptualize new regulatory models, as for example an integrated disclosure system.

B. <u>An "Integrated Disclosure System"</u>

The closed system is one that is found not just in Canada but also in nearly all countries with regulated capital markets regimes. An alternative to the closed system is an "integrated disclosure system", with such a system obviating the need for hold or seasoning periods and a growing list of prospectus exemptions. Such an "integrated disclosure system" was described by H. Garfield Emerson in *Towards an Integrated Disclosure System for Ontario Securities Legislation* as the creation of "open public securities markets [which] requires, in theory, that there be full and honest publicity of important information in order that the competing judgments of buyer and seller as to the fair price of a security reflects as nearly as possible a just price and establishes a true market value for the security".[50] Emerson further elaborated on such an "integrated disclosure system" as a "co-ordinated disclosure system" where "public files contain, at any given time, information substantially equivalent to

[49] Small Business Report, *supra* note 1 at 105.
[50] H. Garfield Emerson, "Towards an Integrated Disclosure System for Ontario Securities Legislation" (1972) 10:1 Osgoode Hall LJ 1 at 2–3.

a current prospectus—in quantity, quality, timeliness and accessibility".[51] Under a true integrated disclosure system, "issuers could go to market more quickly with new securities issues" and "could raise capital at a reasonable cost without compromising investor protection."[52] A reporting issuer's continuous and timely disclosure documents would be equivalent to prospectus disclosure, and therefore investors in the secondary and exempt markets would have access to the same enhanced public disclosure thereby obviating the need for a closed system for reporting issuers.

In 2003, the Crawford Report examined whether, and under what conditions, hold periods could be removed to effectively introduce an "integrated disclosure system" in Canada. Although the authors of the Crawford Report did not strive to completely eliminate the closed system, they did wish to simplify it through the elimination of hold periods and seasoning periods for reporting issuers. These changes, according to the Crawford Report, would not undermine investor protection and would contribute to capital market efficiency.[53] While hold periods (i) prevent backdoor underwritings, (ii) protect investors by ensuring accurate and up to date information about an issuer is available in the marketplace, and (iii) provide a financial incentive for issuers to complete a public offering, these functions could be or have been achieved by other means.[54] According to the authors of the Crawford Report, hold periods need not apply to all secondary market security issuances in order to capture backdoor underwriters. The Crawford Report proposed modifying the definition of "distribution" instead in order to capture exempt backdoor trades, and proposed that those who acquire securities with a view to distribution may come within the definition of an "underwriter". This modification would then subject backdoor trades to the appropriate hold periods.[55] The Crawford Report also found that regulatory reforms improving the quality of disclosure in both prospectuses and continuous disclosure documents have limited the need for hold periods. Further, the implementation of civil liability for continuous disclosure, upgrading of continuous disclosure standards and a move towards a more integrated disclosure system would reduce if not eliminate the regulatory arbitrage between private and public means of financing, according to the authors.[56]

Similarly, the Crawford Report found that seasoning periods could also be made obsolete for reporting issuers. While seasoning periods were initially introduced in order to allow time for newly minted reporting issuers to disseminate information into the marketplace, the use of SEDAR and other technological advances has permitted faster access to information. The Crawford Report found the focus on seasoning periods obfuscates a primary concern of the closed system, namely quality of disclosure.[57] Its authors argued that although seasoning

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[51] *Ibid* at 58.
[52] Crawford Report, *supra* note 19 at 125.
[53] *Ibid* at 139.
[54] *Ibid* at 138.
[55] *Ibid*.
[56] *Ibid*.
[57] *Ibid* at 140.

periods are often encouraged in order to allow the quality of an issuer's disclosure record to improve over time, it is unclear whether that is true.[58]

The Crawford Report presented a co-ordinated integrated disclosure system concept, similar to that envisioned by Emerson. The Crawford Report was critical of the complexity of the closed system, especially in relation to the inefficiencies and costs associated with the resale of securities that are subject to hold periods and seasoning periods. To address these issues, its authors recommended the Ontario Securities Commission (the "**OSC**") conduct a review of the closed system, "with a view to implementing meaningful reform".[59] The Crawford Report recommended updating the broader securities regulatory regime to include enhanced continuous disclosure standards across Canada, active continuous disclosure review programs ("**CDR Program**"), statutory liability for continuous disclosure, rigorous enforcement of disclosure standards across the country, as well as appropriate escrow requirements applicable to securities held by management and insiders of the companies that go public.[60] These recommendations in conjunction with the elimination of hold and seasoning periods would bring the Canadian securities market towards a more "integrated disclosure" system as contemplated by Emerson.

We note that the term "integrated disclosure system" has been utilized in a variety of ways in securities law. For instance, the CSA Concept Proposal advocated for an integration of the information reporting issuers are required to provide to investors in both the primary and secondary market. The CSA Concept Proposal, further explored below, is distinct from the concept of an "integrated disclosure system" as it is merely a modified closed system that still requires a form of prospectus for primary distributions. The United States of America (the "**U.S.**") also has an alleged integrated disclosure system in place. Their integrated securities system merged two disclosure regimes contained in the *Securities Act of 1933,*[61] and the *Securities Exchange Act of 1934.*[62][63] This disclosure system is still very much a traditional closed system, as it requires prospectus disclosure for primary distributions and imposes resale restrictions similar to the current Canadian securities regime. As such, the CSA Concept Proposal and the U.S. "integrated disclosure system" are distinct from a true "integrated disclosure system".

A true integrated disclosure system would eliminate the distinction between the primary and secondary markets of securities by requiring a coordinated disclosure system whereby disclosure documents are distributed on a timely basis and contain information equivalent to current prospectuses. This would result in the disclosure record of reporting issuers containing all relevant material information on an ongoing basis, which is likely an unrealistic goal. Securities issued by a reporting issuer in an integrated disclosure system would not be subject

[58] *Ibid*.
[59] *Ibid* at 141.
[60] *Ibid* at 140.
[61] *Securities Act of 1933*, Pub L No 73-22, 48 Stat 74 (codified as amended at 15 USC § 77a – 77mm).
[62] *Securities Exchange Act of 1934*, Pub L No 73-291, 48 Stat 881 (codified as amended at 15 USC § 78a – 78qq).
[63] Milton H. Cohen, "The Integrated Disclosure System – Unfinished Business" (1985) 40:3 Bus Lawyer at 987–88.

to hold periods or seasoning periods, except possibly if their distribution fell within the parameters of a backdoor underwriter transaction or a control block distribution.

C. 2000 CSA Concept Proposal for an Integrated Disclosure System

Background

In 2000, the CSA proposed an alternative offering system referred to as an integrated disclosure system (the "**CSA IDS**").[64] The aim of the CSA IDS was to de-emphasize the traditional focus on primary market prospectus disclosure and focus instead on a reporting issuer's continuous disclosure.[65] Under the CSA IDS, information that reporting issuers must provide to investors in both the primary and secondary markets would have been integrated under a common disclosure base.[66] An issuer's CSA IDS disclosure base would have provided investors in both markets with access to issuer-related information in a comprehensive and timely manner.[67] In addition, the CSA IDS would have allowed issuers to use an abbreviated securities offering document to respond quickly to opportunities in the capital markets.[68] This condensed document would have undergone regulatory screenings and would have incorporated by reference the issuer's CSA IDS disclosure base.[69] The CSA predicted that the CSA IDS and its streamlined offering procedures would have reduced issuers' reliance on prospectus exemptions and the related complexities of the closed system's resale restrictions for privately placed securities.[70]

Proposal

CSA IDS Eligibility

The proposed CSA IDS required an issuer to be a reporting issuer or the equivalent thereof in all thirteen jurisdictions in Canada with no specified minimum period of reporting.[71] This requirement was intended to promote uniformity with respect to Canadian distribution rules and reduce the complexity associated with reselling privately placed securities.[72] The CSA recognized that this condition would impose added costs on CSA IDS issuers in the form of filing fees.[73]

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[64] CSA Concept Proposal, *supra* note 1.
[65] *Ibid* at 633.
[66] *Ibid*.
[67] *Ibid*.
[68] *Ibid*.
[69] *Ibid*.
[70] *Ibid* at 634.
[71] *Ibid* at 634, 649.
[72] *Ibid* at 634.
[73] *Ibid*.

The other qualifications required of a CSA IDS issuer included:

- being listed on a recognized market, described to include Canadian and foreign exchanges;[74]
- having a current base disclosure document in the form of a CSA IDS Annual Information Form ("**CSA IDS AIF**"), a long form prospectus or a short form prospectus with materials incorporated by reference; and
- being in compliance with its continuous disclosure obligations.[75]

In developing the CSA Concept Proposal, the CSA additionally considered, but ultimately rejected, the imposition of a seasoning requirement (which would have required an issuer to satisfy a minimum period as a reporting issuer) and a quantitative (size) requirement for CSA IDS eligibility.[76] In addition to noting the lack of evidence of sound disclosure by more "seasoned" issuers, the CSA believed that the CSA IDS had sufficiently stringent eligibility criteria, thereby lessening the need for a prior seasoning requirement.[77] The CSA rejected quantitative measures on the basis that there is no significant demonstrable link between an issuer's size and its quality of information. The CSA noted that such a qualification could also produce unpredictability as a result of fluctuating quantitative measures.[78] Finally, the CSA was not convinced with the argument that large issuers command greater analyst following and in turn result in investor education and improved disclosure.[79] The CSA believed that this viewpoint failed to recognize the relative size and scale of the Canadian market as compared to the U.S. market, noting that in Canada, even the investors in large issuers do not typically have access to an array of independent analysis.[80] Further, the CSA felt that with technological developments providing improved public access to disclosure, investors would have the opportunity to make a more informed analysis themselves.[81]

The CSA Concept Proposal also specified categories of issuers that would have been ineligible to participate in the CSA IDS, including (i) issuers organized exclusively for issuing derivative or asset-backed securities and (ii) issuers that have no significant assets, operations or specific business plans capable of implementation in the near future or one that intends only a business combination with unidentified issuers. The restricted list would have also included a blind pool, a capital pool company,[82] and a mutual fund.[83] Issuers would have also become ineligible if there were material unresolved CSA staff comments on their disclosure filings or if there were existing circumstances that would have obligated a regulator to refuse a prospectus receipt, if the issuer were to file a prospectus.[84]

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[74] *Ibid* at 650.
[75] *Ibid*.
[76] *Ibid* at 635–636.
[77] *Ibid* at 635.
[78] *Ibid* at 651.
[79] *Ibid*.
[80] *Ibid*.
[81] *Ibid*.
[82] As defined in TSXV Policy 2.4 Capital Pool Companies.
[83] CSA Concept Proposal, *supra* note 1 at 650.
[84] *Ibid* at 651.

CSA IDS Continuous Disclosure

The CSA IDS proposed upgrading an issuer's continuous disclosure base to that of the prospectus standard of certified "full, true and plain" disclosure, as well as expediting filing due dates in some cases.[85]

An issuer's CSA IDS disclosure base would have included the CSA IDS AIF, a cornerstone document containing a yearly consolidation of information regarding the issuer's business.[86] Accompanying the CSA IDS AIF would have been a quarterly information form (a "**QIF**"), which would have been filed for an issuer's first, second and third financial quarters, and would have contained an issuer's interim financial statements and MD&A.[87] Further, on the occurrence of a triggering event during the year, such as an acquisition, the CSA IDS would have required issuers to file a supplementary information form (a "**SIF**") similar to a material change report within ten days of the event.[88]

In keeping with its goal of ensuring that an issuer's continuous disclosure base has prospectus-quality disclosure, the CSA IDS would have required CSA IDS AIFs, QIFs and SIFs to be certified by an issuer's senior management and directors attesting that the documents contained full, true and plain disclosure.[89] The CSA hoped that the CSA IDS' faster offering process would lead lawyers, underwriters, auditors and other advisors to having greater involvement in an issuer's continuous disclosure so that issuers could satisfy themselves as to the quality of the disclosure relied on by prospective investors.[90]

CSA IDS Offerings

The proposed CSA IDS required both a preliminary and final form CSA IDS prospectus, but placed greater emphasis on the preliminary prospectus.[91] A preliminary CSA IDS prospectus would have included complete disclosure regarding the offering, the offered securities, the statutory rights of investors, and potential risk factors along with documents in the CSA IDS disclosure base and all written marketing communication incorporated by reference.[92] For the prospectus to be complete, issuers would have also been required to incorporate by reference disclosure of each event which occurred after the latest CSA IDS AIF or more recent QIF, and which triggered the filing of a SIF.[93] In contrast to the preliminary CSA IDS prospectus, the CSA proposed a streamlined "checklist" version of the final CSA IDS prospectus that would have identified and incorporated by reference the preliminary prospectus and all documents

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[85] *Ibid* at 636.
[86] *Ibid* at 652.
[87] *Ibid*.
[88] *Ibid* at 652, 654.
[89] *Ibid* at 655.
[90] *Ibid* at 658.
[91] *Ibid* at 637.
[92] *Ibid* at 655–656.
[93] *Ibid* at 656.

in the issuer's disclosure base, and contained prospectus certificates.[94] The CSA clarified, however, that the brevity of the final CSA IDS prospectus would not diminish the responsibility of the issuer to ensure that the document offered full, true and plain disclosure of all necessary information.[95] The most important role of the final CSA IDS prospectus was to update the preliminary CSA IDS prospectus and function as the basis of investors' statutory rights concerning withdrawal or misrepresentation.[96]

The CSA IDS retained the existing requirement for underwriter certification of the prospectus, recognising that due diligence by underwriters provides an added layer of scrutiny that can strengthen disclosure.[97]

Regulatory Review of the CSA IDS Disclosure

The proposed CSA IDS would have enabled a streamlined regulatory role in the offering process with the shift in focus from prospectus to continuous disclosure.[98] To ensure enhanced disclosure standards, a well-developed and appropriately staffed system of continuous disclosure review would be necessary.[99] The CSA proposed undertaking measures that would have put in place a system of periodic, selective or targeted regulatory review of the CSA IDS disclosure base to ensure a high quality information base underlying a CSA IDS offering.[100]

The CSA IDS prospectuses would have gone through a regulatory screening but not a detailed review.[101] The screening process would have primarily been aimed towards assessing (i) the eligibility of the issuer, (ii) any matters that could prompt a detailed review or (iii) whether the regulator was obliged pursuant to statutory restrictions to decline to provide a prospectus receipt.[102]

Comparative Analysis of the CSA Proposal and the CSA Concept Proposal

While the purpose of both the Listed Issuer Financing Exemption under the CSA Proposal and the CSA Concept Proposal is to make accessing the public markets more cost-effective for issuers, the two proposals principally differ in their approach on the following grounds:

- *Core Document*: The Listed Issuer Financing Exemption requires continuous disclosure records to be supplemented with a short offering document containing key highlights in question-and-answer format. The proposed CSA IDS on the other hand would have

[94] *Ibid*.
[95] *Ibid*.
[96] *Ibid*.
[97] *Ibid* at 658.
[98] *Ibid* at 660.
[99] *Ibid*.
[100] *Ibid*.
[101] *Ibid*.
[102] *Ibid*.

required the CSA IDS disclosure base to be supplemented by both a preliminary and final CSA IDS prospectus. The CSA IDS preliminary prospectus would have had comparatively wider disclosure obligations.

- *Offering Document Review*: The Listed Issuer Financing Exemption under the CSA Proposal eliminates review of the offering document by CSA staff. In contrast, the CSA IDS would have retained regulatory screening (however, not a traditional detailed review) of the prospectus.
- *Certification and Standard of Disclosure*: The CSA Proposal requires issuers to certify disclosure of all material facts in the offering document (and continuous disclosure for the past 12 months) and recommends a misrepresentation standard. The proposed CSA IDS, however, would have required the prospectus to be certified by the issuer and underwriters, and to contain "full, true and plain disclosure of all material facts". The CSA Concept Proposal also recommended upgrading issuers' continuous disclosure base to the prospectus standard of certified "full, true and plain" disclosure.
- *Cap on amount that may be raised*: The Listed Issuer Financing Exemption limits the dollar amount that an issuer can raise during any 12-month period. In contrast, the CSA Concept Proposal did not impose a cap.
- *Seasoning*: The Listed Issuer Financing Exemption requires an issuer to be a reporting issuer for 12 months to be eligible (imposing an indirect seasoning period), while the CSA Concept Proposal did not impose any minimum period.

Comments to the CSA Concept Proposal

Six of the 23 commenters offered general support for the CSA Concept Proposal, subject to individual concerns.[103] Those in favour of the proposal supported the CSA's efforts to shift the focus of Canadian securities regulation away from transactional offering disclosure to continuous disclosure. These commenters believed the proposal would help improve Canada's competitiveness in capital markets by enhancing investors' access to information while also assisting issuers to raise capital.

Despite support for the proposal, the CSA IDS also received criticism. Those opposed to the CSA IDS criticized the cost and administrative burden of compliance resulting from enhanced disclosure requirements.[104] They also claimed that many issuers would have likely preferred the short form prospectus and shelf distribution procedures to the CSA IDS because the CSA IDS would have introduced additional disclosure requirements without adding significant benefits.

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[103] *Notice and Request for Comment – Proposed Repeal and Replacement of National Instrument 44-101 Short Form Prospectus Distributions, Form 44-101F3 Short Form Prospectus and Companion Policy 44-101CP Short Form Prospectus Distributions,* CSA Notice, (2005) 28 OSCB 117 at 153 [Summary Comment Letters].

[104] *Ibid* at 132.

CSA IDS Eligibility

The eligibility requirements were some of the most criticized aspects of the CSA IDS proposal. None of the commenters supported the condition that would have required issuers to obtain reporting issuer status in all Canadian jurisdictions.[105] They opposed the requirement because of the increased costs, complexity and administrative burden that would be associated with obtaining and maintaining reporting issuer status in all CSA jurisdictions.[106] The requirement would have been especially onerous for smaller issuers and could have deterred them from participating in the CSA IDS.[107] Finally, certain commenters questioned the need for universal reporting issuer status when SEDAR has enabled ready access to public documents.[108]

In response to a question regarding whether a seasoning period or quantitative requirements should be imposed, no commenters supported the inclusion of eligibility requirements related to seasoning or size.

None of the commenters believed that a seasoning requirement would have added any benefit to the proposal given advances in technology and the high disclosure standard under the proposed CSA IDS. Two commenters mentioned that a seasoning period provides no certainty that the issuer will become better known in the market or develop an analyst following,[109] which one of them believed is a complex process and involves factors beyond the size and length of time an issuer has been a reporting issuer.[110]

No commenters were in favour of imposing quantitative eligibility criteria. While some commenters stated that larger issuers do generally have higher quality disclosure, they believed quality of disclosure may be enhanced by imposing higher standards. In contrast, one commenter argued that the disclosure of smaller issuers may in fact be superior because relevant details are much easier to provide.[111] This commenter mentioned that a review of recent disclosure could in fact reveal far lesser transparency from larger issuers.[112]

Full, true, plain disclosure

There were differing opinions and concerns raised by commenters in relation to the certification requirement. Six commenters questioned how certification requirements would

[105] *Ibid*.
[106] *Ibid*.
[107] *Ibid*.
[108] *Ibid*.
[109] *Ibid* at 134.
[110] Letter from the Canadian Advocacy Council of the Association for Investment Management and Research to the CSA (19 May 2000) at 2.
[111] Letter from Peter McCarter to the CSA (17 July 2000) at 2.
[112] *Ibid* at 3.

have interacted with the civil remedies proposal[113] and two of these commenters suggested deferring this requirement until finalization of such proposal.[114]

Many commenters did not believe it was feasible to impose "full, true and plain" disclosure standards on all continuous disclosure documents. They expressed difficulty in understanding how the public record could at all times measure up to a "full, true and plain" disclosure standard, believing it was unrealistic to force issuers to consider whether the standard had been met on a day-to-day basis.[115]

The commenters felt the standard would have been particularly onerous for SIFs and QIFs. They claimed that imposing "full, true and plain" disclosure requirements would not be appropriate for these forms since neither form contained prospectus level disclosure.[116] Instead, the commenters believed that implementing a "no misrepresentation" standard (or a variation of this standard) would have been a more suitable alternative.[117]

Involvement of Advisors in Continuous Disclosure

According to four commenters, it would be unreasonable to expect that advisors will be significantly involved in continuous disclosure.[118] They either cited perceived deterioration of due diligence under the prompt offering qualification system in support of their contention or suggested that the introduction of civil liability would be needed for increased advisor involvement.[119]

The Corporate Finance Committee of the Investment Dealers' Association of Canada ("**IDA Committee**") suggested that the CSA identify practices to establish competent due diligence, such as receipt of a comfort letter, favourable opinions from counsel, and discussions with management to assist underwriters under the expedited CSA IDS offering timetable.[120] The IDA Committee also proposed an alternate certification (instead of the standard of "full, true and plain" disclosure): "to the best of the underwriter's knowledge, the underwriter is unaware of any misstatement of a material fact relating to the securities offered hereby in the prospectus or disclosure documents incorporated by reference".[121]

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[113] The "Proposal for a Statutory Civil Remedy for Investors in the Secondary Market" developed and published by CSA members on May 29, 1998 was pending at the time and proposed the extension of a civil right of action to secondary market investors for misrepresentations in the continuous disclosure record. This proposal was essentially adopted as Part XXIII.1 of the *Securities Act* (Ontario) in 2002, and was proclaimed into force in 2005.
[114] Summary Comment Letters, *supra* note 103 at 142.
[115] *Ibid*.
[116] *Ibid*.
[117] *Ibid* at 142–143.
[118] *Ibid* at 143.
[119] *Ibid*.
[120] Memorandum from the Corporate Finance Committee of the Investment Dealers' Association of Canada to the CSA (22 June 2000) at 6.
[121] *Ibid* at 7.

Prospectuses

In response to the CSA's question regarding reliance of investors on a prospectus in making their investment decision, four commenters argued that recipients at best give a prospectus a cursory reading and retail investors usually rely on their brokers for investment decisions.[122] There were no strong objections to any of the disclosure items or contents of the preliminary prospectus outlined in the CSA Concept Proposal. Some commenters did suggest including supplementary documents such as the addition of a "recent developments" category where the issuer would be required to provide any information necessary to update documents incorporated by reference.[123] Another commenter strongly supported allowing issuers to incorporate by reference all of their CSA IDS base filings making it a more readable document.[124]

Reasons Why the CSA IDS Was Not Adopted

Many benefits of the proposed CSA IDS have been implemented through National Instrument 51-102 – *Continuous Disclosure Obligations* ("**NI 51-102**") and National Instrument 81-106 – *Investment Fund Continuous Disclosure* ("**NI 81-106**", together with NI 51-102, the "**CD Rules**"), National Instrument 52-109 – *Certification of Disclosure in Issuers' Annual and Interim Filings* ("**NI 52-109**") and National Instrument 52-110 – *Audit Committees* ("**NI 52-110**"), as well as through the CSA's harmonized CDR Program.

The CSA rejected the requirements for CSA IDS issuers to have reporting issuer status in all Canadian jurisdictions as it felt this was unnecessary given that the CD Rules harmonize continuous disclosure requirements across all thirteen jurisdictions in Canada.[125]

Most of the enhancements to continuous disclosure proposed by the CSA IDS are now required under the CD Rules, NI 52-109, and NI 52-110, which apply to all issuers.[126] In addition, the content requirements for the CSA IDS AIF and MD&A have been set out in the CD Rules.[127] Although the CD Rules do not require QIFs, they impose specific requirements regarding interim reporting.[128] Further, although SIFs are not required under the CD Rules, the CD Rules require issuers to file both a news release and a material change report if a material change occurs.[129] In addition, while the CD Rules do not require the certification of filings, NI 52-109 requires the certification of annual and interim filings, as applicable.[130] The CD Rules do not

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[122] Summary Comment Letters, *supra* note 103 at 144.
[123] *Ibid* at 146.
[124] *Ibid*.
[125] *Ibid* at 133.
[126] *Ibid* at 137.
[127] *Ibid*.
[128] *Ibid*.
[129] *Ibid* at 139.
[130] *Ibid* at 142.

prescribe the standard of "full, true and plain disclosure of all material facts" for continuous disclosure documents, as a result of the reasons provided by commenters.[131]

Regarding the increased involvement of lawyers, underwriters, auditors, and other advisors in an issuer's continuous disclosure, the CSA noted that the combined effect of the CD Rules, NI 52-109, and NI 52-110 would persuade issuers to obtain the guidance of advisors when creating their continuous disclosure documents.[132]

Overall, as stated above, the CSA noted that many of the advantages of the proposed CSA IDS had been adopted through the implementation of the CD Rules, NI 52-109, NI 52-110, and other CSA initiatives.

D. The Taskforce Proposal

Following the CSA Concept Proposal, the last review of the capital markets regulatory framework in Ontario occurred in 2003 by the Crawford Report.[133] Almost two decades later, in February 2020, the provincial government created the Capital Markets Modernization Taskforce (the "**Taskforce**") as part of its commitment to modernize Ontario's capital markets. The mandate of the five-member Taskforce was to review the current capital markets regulations and put forward recommendations aimed at amplifying growth and competitiveness in Ontario's capital markets without diminishing investor protection.[134]

The Taskforce first published a report on July 9, 2020 (the "**Consultation Report**"),[135] for which it sought commenter feedback. Throughout the comment period, commenters provided over 130 comment letters, with submissions containing varying degrees of support, pushback, and additional suggestions for consideration. Earlier this year, on January 22, 2021, the Taskforce published its final report (the "**Final Report**")[136] consisting of 74 recommendations covering a broad set of themes. This section focuses on Proposal 7 of the Consultation Report, finalized as Proposal 16 of the Final Report, which deals with an alternative offering model of securities to enable certain issuers to issue freely tradeable securities pursuant to a prospectus exemption.

Proposal 7 of the Consultation Report

To reduce the high costs associated with preparing and filing a prospectus, Proposal 7 of the Consultation Report recommended the creation of an alternative prospectus exemption where reporting issuers would be able to offer freely tradeable securities under the following conditions:

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131 *Ibid* at 143.
132 *Ibid* at 144.
133 Crawford Report, *supra* note 19.
134 Final Report, *supra* note 28 at 1–2.
135 Consultation Report, *supra* note 1.
136 Final Report, *supra* note 28.

- the issuer must be a reporting issuer for at least 12 months;
- the reporting issuer must have securities listed on an exchange;
- the reporting issuer must have complied with its continuous disclosure obligations and not be in default;
- the securities to be issued under this prospectus exemption must be of a class that is already listed on an exchange;
- the offering must be subject to an annual maximum; and
- the issuer must file a short offering document when issuing securities to update its disclosure record and certify its accuracy.[137]

Under the proposed prospectus exemption, the Taskforce noted that investors would not benefit from the same civil and statutory protections under the short offering document as they would under a prospectus.[138]

The main policy rationale behind this proposal was to facilitate capital raising at a lower cost for smaller issuers.[139] The Taskforce relied on two assumptions in its reasoning. First, it assumed that shifting reliance to the reporting issuer's continuous disclosure record - rather than on the disclosure derived from the filing of a prospectus - would be cost effective for these companies. Moreover, that the difference in cost would be material enough to justify the creation of a new prospectus exemption.

Second, the Taskforce assumed that an annual maximum for offerings would be a sufficient mechanism to ensure that smaller issuers would be the ones benefiting from the prospectus exemption. In addition, the creation of the maximum limit was justified as a way to prevent material offerings from taking place without a prospectus filing, which it believed would further protect investors.

Commenter Feedback: Arguments

Overall, commenters showed little support for Proposal 7, however, those in support of the proposal raised the following arguments. First, the exemption would have allowed small issuers to benefit from frequent infusions of capital[140] and the ability to conduct small financings.[141] Second, the requirement for an annual maximum would have prevented material offerings from taking place under the exemption, which in turn would have

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[137] Consultation Report, *supra* note 1 at 12.
[138] *Ibid*.
[139] *Ibid*.
[140] Letter from Canadian Investor Relations Institute to Capital Markets Modernization Taskforce (7 September 2020) at 2.
[141] Letter from Prospectors & Developers Association of Canada to Capital Markets Modernization Taskforce (7 September 2020) at 4, online (pdf): <pdac.ca/docs/default-source/priorities/access-to-capital/securities/default-document-library/pdac-response-to-cmm-taskforce-consulation-september-7-2020.pdf> [PDAC Letter].

preserved the integrity of the prospectus regime[142] and limited the risks for investors. Third, the introduction of the alternative offering model would have presented an opportunity for reporting issuers to increase their liquidity in the secondary markets and "enable non-accredited parties to invest in secondary offerings by issuers that are currently inaccessible."[143]

On the other hand, many commenters were opposed to the implementation of the exemption, bringing forward four main reasons. First, the lack of investor protection was a significant issue for many commenters. Under the exemption, investors would not benefit from the same statutory and civil protections associated with a prospectus. Reporting issuers would have access to an unlimited number of investors without having any mechanism in place to ensure the investors' ability to assess the investment.[144] The commenters believed this was particularly concerning because "the most likely purchasers under this exemption will be much less sophisticated – namely, 'mom and pop' and other retail investors who are more easily misled."[145] Under this exemption, investors who are unable to assess the risk of their investments would have been more vulnerable as they would not have access to the associated process and protections[146] of a prospectus offering.

Second, the alternative offering model – where securities are issued without a prospectus – would decrease accountability, integrity and trust in the marketplace, which would have led to the loss of confidence in our capital markets. The commenters believed that our capital markets would become less competitive and attractive to investors because this exemption would (i) not have adequate investor protection, (ii) diminish the distinction between the primary and secondary markets[147] and (iii) represent a departure from best practices in international capital markets.[148] Moreover, the commenters noted that the Taskforce failed to appreciate and recognize the value provided by the prospectus process to the primary and secondary markets in their reasoning behind the proposal. This lack of acknowledgement, along with the exemption itself, could have led to a decrease in the use of prospectus offerings and a reduced role for registered investment dealers and securities regulators, which would have inevitably led to the loss of confidence in our capital markets.[149]

Third, the commenters were concerned that the alternative offering model would have allowed the issuance of securities without an independent assessment of the quality of the

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[142] Letter from Canadian Securities Exchange to Capital Markets Modernization Taskforce (7 September 2020) at 2.
[143] *Ibid*.
[144] Letter from Davies Ward Phillips & Vineberg LLP to Capital Markets Modernization Taskforce (7 September 2020) at 16, online (pdf): <dwpv.com/-/media/Files/PDF_EN/2020/Capital-Markets-Modernization-Taskforce-Comment-Letter.ashx> [Davies Letter].
[145] *Ibid* at 17.
[146] *Ibid* at 16.
[147] Letter from Torys LLP to Capital Markets Modernization Taskforce (7 September 2020) at 4, online (pdf): <torys.com/-/media/files/pdfs/letter-to-capital-markets-modernization-taskforce-consultation-report.pdf>.
[148] Letter from Echelon Wealth Partners Inc. to Capital Markets Modernization Taskforce at 3 [Echelon Letter].
[149] Davies Letter, *supra* note 144 at 17.

issuer's disclosure.[150] They believed that the lack of oversight could have increased the risk of fraud. As noted by a commenter, "although the proposed alternative offering model's small annual maximum may limit the risk to the market by dollar amount, a market's reputation is not proportionately impacted by fraud on a dollar-for-dollar basis."[151] Having multiple incidents of fraud, despite the dollar value, would have a detrimental impact on the reputation, reliability and confidence in our capital markets.

Fourth, the commenters believed that the exemption would have created further inconsistency with the regulatory framework in the U.S. These differences may become problematic for Canadian issuers wishing to raise capital in the U.S., as Canadian disclosure would be perceived as insufficient. In addition, this may have caused further issues under the Canada/U.S. Multijurisdictional Disclosure System as the Securities and Exchange Commission "may not regard Canadian continuous disclosure to be a sufficient replacement for equivalent U.S. reporting."[152] A commenter suggested that a more appropriate model to adopt would have been the U.S. Well-Known Seasoned Issuer model, as it would facilitate access to capital while providing greater investor protection and the model would be in line with the U.S. regulatory framework.[153] The commenters worried that the potential inconsistency with the U.S. and other international capital markets would have made it difficult to attract and retain capital.[154]

Taskforce Proposal

Throughout the consultation process, the commenters expressed significant opposition to the recommendation. Despite the criticism, the Taskforce adopted the alternative offering model as Proposal 16 of the Final Report with similar terms and conditions as originally recommended in the Consultation Report, along with two changes.

First, the Taskforce put forward the recommendation that the offerings under the exemption should have the same level of liability as under a prospectus offering. It justified its reasoning by explaining that offerings under this exemption would be considered a primary offering by the issuer. As a result, "investor[s] should have the right to an effective remedy against the issuer if the offering document contains a misrepresentation."[155] This change from the original proposal demonstrated the Taskforce's response to the significant pushback from commenters surrounding the lack of investor protection.

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150 *Ibid* at 16.
151 *Ibid*.
152 Letter from Investment Industry Association of Canada to Capital Markets Modernization Taskforce (10 September 2020) at 7, online (pdf): <iiac.ca/wp-content/uploads/IIAC-submits-comments-to-the-Ontario-Capital-Markets-Modernization-Taskforce.pdf>.
153 Letter from Osler, Hoskin & Harcourt LLP to Capital Markets Modernization Taskforce (7 September 2020) at 13, online (pdf): <osler.com/osler/media/Osler/Content/PDFs/Modernization-Taskforce-Osler-Hoskin-Harcourt-LLP-comment-letter-Sept-7-2020-003.pdf>.
154 Echelon Letter, *supra* note 148 at 3.
155 Final Report, *supra* note 28 at 38.

Second, the Taskforce provided concrete thresholds to determine the annual maximum for offerings under the exemption. For each annual period, the maximum amount would be set at 10 percent of the reporting issuer's market capitalization.[156] However, for smaller issuers with a market capitalization under $50 million,[157] the maximum limit would be the lesser of $5 million or 100 percent of the issuer's market capitalization.[158]

Comparative Analysis of the CSA Proposal and the Taskforce Proposal

The CSA Proposal and the Taskforce Proposal contain very similar elements, including the same policy rationale and reasoning – to facilitate capital raising at a lower cost for smaller issuers. The CSA Proposal is more developed as it provides more details and conditions in certain areas where the Taskforce Proposal was silent, for example, the restrictions concerning the use of proceeds or the type of disclosure required under the offering document.

There are two notable differences despite the overall similarities between the proposals. First, the CSA Proposal included a maximum dollar amount of $10 million within its thresholds for the annual maximum for offerings allowed under the exemption. However, the Taskforce Proposal did not contain a maximum dollar value associated for issuers with a market capitalization above $50 million – being that the limit should be set at 10% of the reporting issuer's market capitalization for each annual period.

Second, the civil and statutory protections for purchasers differ under each proposal. Under the CSA Proposal, purchasers would have a right of action under secondary market civil liability and a right of rescission against the issuer. On the other hand, the Taskforce Proposal recommended that purchasers should receive the remedies under primary market civil liability – by stating that the offering document should have the same liability as a prospectus in the event of a misrepresentation.

Part II

Despite its derogation from the fundamentals of the closed system and its inconsistency with the traditional rationale for exemptions from the prospectus requirement, in principle we support the CSA moving forward with the Listed Issuer Financing Exemption in order to respond to the financing needs of smaller issuers in a more cost-effective way than the current model allows, which we believe can be done (subject to certain suggested changes) in a way that maintains investor protection.

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[156] *Ibid* at 37.
[157] All references to dollar figures are in Canadian dollars, unless otherwise specified.
[158] Final Report, *supra* note 28 at 37.

A. Basis for the Exemption from Prospectus Requirements

In Part I, we described how the closed system works and how it came to characterize the distribution of securities in almost every Canadian jurisdiction. We outlined the traditional rationale of prospectus exemptions founded on the idea that certain investors (those to whom exemptions were made available) did not require the protections provided by a prospectus. We also described how, in recent years, new exemptions like the Crowdfunding Exemptions and the offering memorandum exemption, which can be relied upon by any investor to purchase securities, have complicated this idea and have represented a shift in policy.

It is our view that the Listed Issuer Financing Exemption, like the Crowdfunding Exemptions and offering memorandum exemption before it, is inconsistent with the closed system as it deviates from the focus on a class of investors or the protections afforded by certain transactions and instead tries to respond to the needs of a certain class of issuers, while imposing certain protections meant to address risk and investor protection. For example, although most exemptions do not prescribe point of sale disclosure (consistent with the traditional rationale that the investors to whom exemptions are available do not require such protection), both the Crowdfunding Exemptions and offering memorandum exemption do mandate that issuers provide investors with an offering document and the Listed Issuer Financing Exemption proposes to do the same. Further, unlike most other exemptions, both the Crowdfunding Exemptions and the offering memorandum exemption impose limits on how much an issuer can raise or how much investors can invest - and the Listed Issuer Financing Exemption proposes to do the same.

These compromises and the shift away from the bedrock of the closed system that they represent, does not mean, however, that the Listed Issuer Financing Exemption cannot be justified. It is critical to keep in mind that the closed system is not conducive to the raising of capital by smaller issuers. For well over two decades, the CSA, and numerous task forces and stakeholders have been adamant that the closed system simply does not work. The closed system has complexity and expense that weighs disproportionately on smaller issuers. This is particularly significant in the Canadian context, where small issuers comprise the vast majority of the market. For example, it would appear that approximately 11% of reporting issuers in Canada have a market capitalization above $1 billion, while approximately 89% have a market capitalization below $1 billion. For comparison, in the U.S., approximately 51% of issuers on NASDAQ and NYSE have a market capitalization above $1 billion, and approximately 49% have a market cap below $1 billion.[159] If nothing else, this comparison may help show that the continued focus on harmonization with the regulatory regime in the U.S. (with its fundamentally larger market) may be somewhat misguided. It is important to recognize the relative size and scale of the Canadian market as compared to the U.S. market in developing our regulations.[160] To foster fair, efficient and vibrant capital markets and grow

[159] Based on data obtained through S&P Capital IQ for equities traded on the major exchanges in Canada and the US, using screening conditions to exclude ETFs and Closed End Funds, as of September 23, 2021.
[160] CSA Concept Proposal, *supra* note 1 at 651.

our economy, our governments and the CSA are compelled to consider the financing needs of small issuers. This reality creates an inherent tension between the objectives of investor protection and the goals of market efficiency and fostering capital formation, but it is one that cannot be ignored.

We acknowledge, as others have, that the closed system is not amenable to change without a full rethinking of the system as a whole, which further exacerbates this policy tension.[161] To further compound the issue, there does not appear to be a clear alternative to the closed system, as a true "integrated disclosure system" as described in Part I, appears to be unworkable, given that any such system would require immediate disclosure of material facts. Moreover, we do not hold out any hope that the closed system will be re-examined at a macro level any time soon to address the unique features of the Canadian market and ameliorate the tension between investor protection, on one hand, and market efficiency and fostering capital formation, on the other hand.

Therefore, given the above factors, we accept that there may well be reasons why the tenets of the closed system, including the traditional rationale for prospectus exemptions, may have to be compromised in order to increase market efficiency and foster capital formation and having regard to the need to ensure that regulatory costs and restrictions imposed on issuers are "proportionate to the significance of the regulatory objectives sought to be realized".[162] We believe that the financing needs of small issuers constitute such a reason, and it is on this basis that we support the Listed Issuer Financing Exemption.

Nevertheless, as recognized by the CSA, it is particularly important to ensure that investor protection remains a key guiding principle. To achieve that goal, any new exemption must have, as a core principle, the provision of protections that simulate those afforded by the prospectus regime. As discussed below, we believe that, with some modifications, the Listed Issuer Financing Exemption can provide appropriate levels of investor protection, while also facilitating smaller issuers' access to capital.

B. <u>Investor Protection</u>

Hold Periods

Before reviewing some of the key conditions put forward under the CSA Proposal mostly to address investor protection, we address the decision to add the Listed Issuer Financing Exemption to Appendix E of NI 45-102, which would mean securities issued under the proposed exemption would be freely tradeable – and therefore not subject to a hold period. For the reasons that follow, we believe that the decision to not impose a hold period on

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[161] Small Business Report, *supra* note 1 at 105.
[162] OSA, *supra* note 10, s 2.1.

securities issued in reliance on the proposed exemption would not diminish investor protection.

It would appear that there are at least two commonly provided reasons for mandating a hold period. First, to prevent backdoor underwritings. Second, to ensure dissemination of information about an issuer.

The draft companion policy in the CSA Proposal addresses the backdoor underwriting issue directly by noting that the definition of underwriter may apply to persons that purchase securities under the Listed Issuer Financing Exemption with an intention to immediately resell the securities in the secondary market. The policy notes that if there is not a *bona fide* intention to invest in the issuer, the distribution under the exemption and the subsequent resale may be considered in substance a single distribution.

The CSA Proposal also imposes several conditions, which appear to address the need for issuers to have sufficient disclosure of information. For example, the condition that issuers must have been reporting issuers for a minimum of 12 months and are in compliance with their continuous and timely disclosure obligations. In addition, the issuer will be required to disclose all material facts at the time of the offering, and certify under a "core" document filed on SEDAR that it is subject to statutory liability. We note that 12 months' disclosure in the public markets is more than that required for securities issued under any other exemption to become freely tradeable.

Notwithstanding that the reasons for the imposition of hold periods have been addressed under the CSA Proposal, we expect that there will be significant unease with this reasoning. In effect, issuers will be allowed to engage in broad distributions without the required involvement of dealers or regulators, which may raise concerns with respect to systemic risk, particularly where investors may be unsophisticated and are not existing shareholders of the issuer. We also note that the rationale for why a hold period is not required could be extended to other types of financings.

Objections to Proposal 7 of the Consultation Report

In reviewing whether the Listed Issuer Financing Exemption adequately addresses investor protection, we first review the objections made in the comment letters to Proposal 7 of the Consultation Report, which is substantially similar to the Listed Issuer Financing Exemption.

Investors would not benefit from the same statutory and civil protections associated with a prospectus. This argument focuses on the fact that the proposed exemption would allow for the issuance of freely tradeable shares without being subject to the prospectus regime. We note, however, that other prospectus exemptions are subject to Appendix E of NI 45-102, which in effect results in shares issued thereunder being freely tradeable. We expect that the real concern is whether the proposed exemption provides sufficient protection to investors.

Under the proposed exemption, investors who are unable to assess the risk of their investments would be more vulnerable as they would not have access to the associated process and protections of a prospectus offering. Certain commenters believed this was particularly concerning because the most likely purchasers under this exemption would be unsophisticated retail investors. However, numerous restrictions and limitations are built into the CSA Proposal. We discuss below certain suggested changes to these restrictions, and limitations to address the investor protection concerns.

It is also important to note that retail investors participate in the much larger secondary market and, under the proposed exemption, they would have the benefit of having the issuer certify that there are no undisclosed material facts. In effect, investors would have available to them a truly integrated disclosure system, where an issuer is certifying that its disclosure record is substantially similar to prospectus level disclosure. We also note that the associated process and protections provided by a prospectus offering appear increasingly less relevant as more companies become reporting issuers through capital pool companies, special purpose acquisition companies and reverse takeovers than through initial public offerings.[163]

Statutory liability would also apply for misrepresentations; however, we do believe that more should be done regarding this condition. See our response to question 8 in Part III.

The Listed Issuer Financing Exemption – where securities are issued without a prospectus – would decrease accountability, integrity and trust in the marketplace, which would lead to the loss of confidence in our capital markets. It is argued that the proposed exemption could lead to a decrease in the use of prospectus offerings and a reduced role for registered investment dealers and securities regulators, which would inevitably lead to the loss of confidence in our capital markets. We believe that for small issuers, the use of prospectuses is already on the decline. Also, we expect that dealers could still play a role in financings under the proposed exemption. No one can deny that the use of a prospectus generally provides better disclosure and can better detect fraud and abuses, even if it is true that few investors actually read a prospectus before making an investment.[164] This argument, however, fails to address the key concerns that are the genesis of the proposed exemption, namely, the fact that the closed system is likely having a significant negative impact on capital formation for small issuers.

It has also been correctly suggested, as noted above, that the limits on dollar amounts proposed under the exemption cannot address the fact that "a market's reputation is not proportionately impacted by fraud on a dollar-for-dollar basis." Having multiple incidents of fraud, despite the dollar value, would have a detrimental impact on the reputation, reliability and confidence in our capital markets. Nevertheless, no evidence is put forward to show that

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[163] Of 518 new listings (excluding ETFs & Closed-End Funds) on the TSX, TSXV, CSE, and NEO from January 2020-July 2021, our calculations show that approximately 47% involved the filing of a prospectus, while approximately 53% of new listings over this period did not.
[164] CMA Proposal, *supra* note 1 at 10.

incidences of fraud would increase as a result of the proposed exemption, especially if certain conditions are strengthened as we propose below.

The truth is that statements made regarding loss of confidence in our capital markets are not entirely persuasive and hard to disprove. Nevertheless, we would suggest that the CSA consider whether the proposed exemption should be reviewed within 12 or 18 months.

The proposed exemption would create further inconsistency with the regulatory framework in the U.S. It was suggested that these differences may become problematic for Canadian issuers wishing to raise capital in the U.S. as Canadian disclosure would be perceived as insufficient. We would note that the Listed Issuer Financing Exemption would be optional. Also, as noted above, there are significant differences between the U.S. and the Canadian markets and we need to consider that carefully if we are to continue to improve market efficiency and foster capital formation.

Are the Conditions to the Listed Issuer Financing Exemption Sufficient?

In reviewing the conditions to the Listed Issuer Financing Exemption we start with the proposition, as previously articulated, that the proposed exemption is a fundamental aberration from the closed system, but from a policy and economic basis may be very important. The fact that the closed system has been subject to criticism for over 25 years and has been undermined for a similar period of time may suggest that in this case the policy and economic issues are more important; however, nothing should be more important than investor protection if the CSA is to remain focused on systemic risk.

The following conditions, already imposed in the proposed exemption, appear to go a long way to addressing investor protection and creating a framework similar to a prospectus regime:

- *The issuer is and has been a reporting issuer in at least one jurisdiction of Canada for the past 12 months*: The imposition of an indirect 12 month seasoning period could be viewed as excessive in light of the fact that the seasoning period under NI 45-102 is 4 months; however, in the circumstances we believe this may be appropriate to ensure that a reporting issuer using this exemption has a full year of disclosure which would include audited financial statements and a management information circular. This may be increasingly important as we expect more companies to become reporting issuers outside of the prospectus process.
- *Certification of disclosure record for period covering the earlier of 12 months before the date of the offering and the date that the issuer's most recent audited annual financial statements were filed*: This condition provides investors with the assurance that all material facts have been disclosed and it addresses one of the goals of a true integrated disclosure system.

- *Imposition of statutory liability*: Statutory liability serves as a deterrent and also as a means to compensate investors if there are misrepresentations.
- *Address the risk of backdoor underwriting*: We believe the comments in the draft companion policy regarding the intention to apply the underwriter definition to prevent backdoor underwritings by someone claiming to purchase with investment intent are particularly helpful.
- *Listed on a stock exchange*: This requirement ensures oversight over the issuance of listed shares and additional regulation.
- *Restriction on use of proceeds*: The restriction ensures that the offering document is straightforward and that additional complications brought about by complex transactions or a change of business would not be part of the financing.

Nevertheless, we believe that certain changes would better balance the tension between fostering fair, efficient, and vibrant capital markets and investor protection, without diminishing the benefits to be derived from the Listed Issuer Financing Exemption, including:

- *Limit the proposed exemption to small issuers*: It is acknowledged by the CSA that the Listed Issuer Financing Exemption will be of most benefit to small issuers. It is not clear why it should be available to large capitalization issuers, especially since it may be viewed as undermining the closed system. This would further limit the risk of the proposed exemption.
- *Impose prospectus liability*: Please see our response to question 8 in Part III.
- *Limit the proposed exemption to listed equity securities or a unit consisting of a listed equity security and a warrant to acquire such listed equity security*: Please see our response to question 4 in Part III.
- *Remove need for 12 months of liquidity*: It appears entirely counterintuitive to provide the proposed exemption to small issuers to improve liquidity and then prescribe that the proposed exemption cannot be used unless the financing will be sufficient to meet liquidity for 12 months. We would strongly encourage that this condition be dropped and instead require bold face disclosure of current and post-liquidity position, assuming the financing closes. See for example, the disclosure required in respect of the rights offering prospectus exemption in Form 45-106F14 and Form 45-106F15. We would suggest that the concerns that this condition seeks to address could easily be satisfied with appropriate mandated disclosure.
- *Remove need for report of exempt distribution*: Please see our response to question 2 in Part III.

C. Summary

In summary, we support the CSA moving forward with the Listed Issuer Financing Exemption, subject to the recommended changes set out directly above.

Although the proposed exemption is not consistent with the traditional rationale of the closed system, that does not mean it cannot be justified. Other exemptions, including the Crowdfunding Exemptions and offering memorandum exemption, which can be relied upon by any investor and prescribe point-of-sale disclosure, are also not consistent with the tenets of the closed system and yet were introduced in recent years as responses to the capital raising needs of issuers. For decades, the closed system has been criticized as being too costly, especially for small issuers. In a market like ours, which is largely comprised of small issuers, it is imperative that the financing needs of small issuers are addressed if the CSA is to foster fair, efficient and vibrant capital markets. The Listed Issuer Financing Exemption is a real response to the needs of smaller issuers, after years of proposals that have not gotten us any closer to a workable alternative to the closed system. If the concern of some is that the Listed Issuer Financing Exemption does not contain adequate protection for investors, we believe that with our suggested modifications, and potentially other reasonable modifications, these concerns will be alleviated. We are also not opposed to a review of the proposed exemption after 12 to 18 months to ensure that the goals and objectives of the Listed Issuer Financing Exemption are being met.

Ultimately, we believe that the CSA should examine holistically the costs and benefits of changing the closed system with a view to developing a new regime which better meets the needs of the Canadian capital markets. The current piecemeal approach whereby new exemptions are constantly proposed by regulators is intellectually lazy and risks creating confusion and market inefficiency. Regulators need to review the regulatory system as a whole to determine what systemic changes are most effective. The better approach may be a modified integrated disclosure system combined with a more robust CDR Program. The Listed Issuer Financing Exemption could actually serve as a basis for such a model. In any event, we recognize that a rethinking of the closed system would be a monumental task and, although we have significant doubts as to whether this will ever be undertaken, we would be pleased to assist with any such effort.

Part III

Response to CSA Request for Comments:

1. **Under the Proposed Amendments, the total dollar amount that an issuer can raise using the Listed Issuer Financing Exemption would be subject to the following thresholds:**
    a) **the greater of 10% of an issuer's market capitalization and $5,000,000**
    b) **the maximum total dollar limit of $10,000,000**
    c) **a 100% dilution limit.**

Are all of these thresholds appropriate, or should we consider other thresholds?

We believe these thresholds are reasonable in the circumstances, but we would suggest that the CSA revisit these thresholds within the next 12-18 months and assess whether they are appropriate in light of the objectives of the proposed exemption. In addition, the CSA may wish to consider limiting the use of the proposed exemption to small-cap issuers, which could be achieved by allowing only venture issuers or issuers of a certain size (from a balance sheet perspective, or a certain market capitalization measured over an appropriate period of time) to use the proposed exemption.

2. **In order for the CSA to measure and monitor the use of the Listed Issuer Financing Exemption, we propose that issuers would be required to file a report of exempt distribution within 10 days of the distribution date, as with most capital raising prospectus exemptions. However, issuers would not be required to provide the detailed confidential purchaser information required in Schedule 1. We are not proposing to require the completion of the purchaser-specific disclosure required under Schedule 1 because there are no limitations on the types of investors who may purchase under the exemption and we do not expect to require this information.**

a. **Are there other elements of the report of exempt distribution that we should consider relaxing for distributions under the exemption?**

It seems unclear why the exempt trade report in Form 45-106F1 ("**Exempt Trade Report**") is being contemplated. Much of the information that is collected under the Exempt Trade Report appears not to be particularly relevant with respect to the Listed Issuer Financing Exemption. For example:

- as companies that will seek to rely on the proposed exemption will be a reporting issuer in at least one jurisdiction of Canada, certain issuer information in the Exempt Trade Report will not be relevant - particularly, Items 5 d) to h) and the director and officer information in Item 9;
- as an offering document is required to be completed, certified and filed on SEDAR, much of the information in Item 7 appears unnecessary; and
- the notice regarding the collection of personal information is not relevant as no purchaser information will be required to be collected for reporting purposes.

As securities regulators continue to focus on burden reduction, we believe that to the extent information needs to be gathered, this can be done in a different and more efficient manner.

b. Would the requirement to file the report of exempt distribution in connection with the use of the exemption be unduly onerous in these circumstances? If so, why?

Yes. If the purpose of a report[165] would be "to obtain structured data on the offering including type and amount of securities issued",[166] we believe this could be achieved in a simpler and more cost effective manner, as outlined below.

c. Should we consider an alternative means of reporting distributions under the exemption, such as including disclosure in an existing continuous disclosure document, such as Management's Discussion and Analysis or a specific form or report that is filed on SEDAR?

Given the goals of reducing regulatory burden and having efficient reporting systems, we suggest that to the extent that information in addition to that set out in the offering document is required that the following alternatives be considered:

- our first preference is that additional information be required to be inserted into a reporting issuer's annual MD&A;
- our second preference is that the CSA require a press release to be issued on the closing or abandonment of a financing under the proposed exemption with mandated disclosure; and
- finally, a simplified report could be required that contains limited information as set out in question 2(d) below.

d. If alternative reporting is provided, what information should issuers be required to disclose, in addition to the following:

- **the number and type of securities distributed,**
- **the price at which securities are distributed,**
- **the date of the distribution, and**
- **the details of any compensation paid by the issuer in connection with the distribution and the identity of the compensated party?**

We believe the information noted above should be sufficient.

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[165] The purpose of the original Form 20 (predecessor to Form 45-501F1 which is the predecessor to the existing Exempt Trade Report) has been described as being used primarily to allow regulators to monitor compliance on a distribution by distribution basis with statutory "hold periods". McCarthy Tétrault LLP, "One Form, More Information: Significant Changes to Canadian Report of Exempt Distribution Coming in June" (24 April 2016), online: <mccarthy.ca/en/insights/articles/one-form-more-information-significant-changes-canadian-report-exempt-distribution-coming-june>.

[166] *CSA Notice and Request for Comment – Proposed Amendments to National Instrument 45-106 Prospectus Exemptions to introduce the Listed Issuer Financing Exemption*, CSA Notice, (2021) 44 OSCB 6625.

e. If alternative reporting is provided, how frequently should reporting be required?

Irrespective of how the reporting is required, it should be as minimal as reasonably possible. Other than the offering document disclosure, we would propose either (i) if disclosure is to be set out in the MD&A, disclosure be made in the annual MD&A, or (ii) if disclosure is to be set out in a press release, within one business day of the closing or abandonment of a financing with specified mandated disclosure, or (iii) if disclosure is to be set out in a simplified report, within 45 days of the end of each calendar year.

3. For jurisdictions that already charge capital market participation fees, would the imposition of an additional filing fee for a report of exempt distribution under the Listed Issuer Financing Exemption discourage use of the exemption?

We would strongly encourage the CSA not to impose additional fees or to impose relatively nominal fees if it determines to require a formal report for the Listed Issuer Financing Exemption.

4. We propose that the securities eligible to be distributed under the Listed Issuer Financing Exemption would be limited to listed equity securities, units consisting of a listed equity security and a warrant exercisable into a listed equity security, or securities, such as subscription receipts, that are convertible into a unit consisting of a listed equity security and a warrant. These are securities that most investors would be familiar with and which are easier for an investor to understand. This list would allow for the Listed Issuer Financing Exemption to be used to distribute convertible debt. Are there reasons we should exclude convertible debt from the exemption?

We believe that convertible debt should be excluded from the Listed Issuer Financing Exemption because it may run contrary to the goal and rationale of limiting the exemption to securities that most investors would be familiar with and which are easier for investors to understand. Convertible debt instruments can and do often contain features that may not be easily understood by an average investor (such as make whole payments), or other unusual terms which are not frequently seen. Additionally, the disclosure typically required in connection with a convertible debt offering, such as comprehensive risk factors, may not be adequately covered by the short offering document proposed under the Listed Issuer Financing Exemption or by an issuer's disclosure record, especially if it has not filed an annual information form. To expand the "brief document" to cover such disclosure would be inconsistent with the goal of keeping it simple and easy to understand.

5. We designed the Listed Issuer Financing Exemption contemplating that it would be used, from time to time, for discrete private placements, with a single closing date. Do you expect issuers would want to use the exemption to

provide continuous, non-fixed price offerings as well? If so, what changes would be necessary to permit continuous distributions under the exemption? Do you see any concerns with permitting continuous distributions?

We are not certain that many issuers would wish to use the proposed exemption for continuous non-fixed price offerings. The new concise form of offering document with no regulatory review proposed under the Listed Issuer Financing Exemption already offers similar prompt-market-access advantages as shelf prospectus offerings. Issuers may find the benefit of a Listed Issuer Financing Exemption for continuous, non-fixed offerings to be limited especially with a limited validity period. The proposed maximum dollar amount of $10 million that an issuer can raise during a 12-month period may also not be significant enough to justify the costs associated with preparing supplemental disclosures.

6. **Over the last several years, the CSA has tried to address various capital raising challenges by introducing a number of streamlined prospectus exemptions targeted to reporting issuers with listed equity securities, including the existing security holder exemption and the investment dealer exemption. The use of these exemptions has been limited. We have heard from market participants that the existence of these rarely used prospectus exemptions may contribute to the complexity of the exempt market regime. If we adopt the proposed Listed Issuer Financing Exemption, should we consider repealing any of these other exemptions?**

We believe that the existing prospectus exemptions do not contribute to the complexity of the exempt market regime. Rather, the introduction of new exemptions – such as the Listed Issuer Financing Exemption – in a piecemeal manner creates a greater degree of confusion. For this reason, we do not believe that the repeal of the existing prospectus exemptions is an effective method of streamlining the exempt market regime if regulators continue to implement new exemptions.

To simplify the exempt market regime, we recommend that the CSA and other regulatory bodies work together to examine "the issue holistically, carefully weighing the costs and benefits of changing the current model."[167] Regulators should review the regulatory system as a whole to determine what systemic changes are most effective to streamline the exempt market regime. In doing so, it would be effective to conduct a thorough study to consider the implications of the current exemptions, the capital raising process and the existence of the closed system. This includes examining the policy rationales behind the closed system and prospectus exemptions to decide whether their removal or change is justifiable. A broader and more holistic examination of the regulatory system would allow regulators to streamline the exempt market regime effectively. This would require a shift away from the current piecemeal approach of the constant introduction of new exemptions by regulators.

[167] Letter from TMX Group to Capital Markets Modernization Taskforce (7 September 2020) at 10.

7. Investment dealers and exempt market dealers may participate in an offering under the proposed Listed Issuer Financing Exemption; however, there is no requirement for dealer or underwriter involvement. In addition, no exemption from the registration requirement is provided for acts related to distributions under the exemption, so any persons in the business of trading in securities will require registration or an available registration exemption for any activities undertaken in connection with distributions under the exemption.

a. If adopted, do you anticipate that issuers would involve a dealer in offerings under the exemption?

We expect that while many issuers may not need the assistance of dealers in raising funds, others may involve dealers in their offerings under the Listed Issuer Financing Exemption in order to gain access to investors. In particular, smaller issuers without a wide following may benefit from the involvement of smaller dealers who would be able to assist in locating investors.

b. If not, how do you expect issuers will conduct their offerings, for example, via their own website?

We expect issuers to conduct offerings through their websites, specialized offering portals and dealers. It is possible that a "ticketing" type sales document may develop in coordination with transfer agents or dealers, but we expect that for the immediate future the proposed exemption will resemble a private placement subscription process using an agreement.

One point of clarification that may require additional guidance is whether there can be a situation where an issuer that makes multiple small distributions over a period of time without the involvement of a dealer (for example, an issuer that conducts ten $0.5 million offerings in 12 months) could be considered to be in the business of trading in securities, and as a consequence be required to register as a dealer. We believe it would be helpful to provide additional guidance to issuers on any maximum thresholds in this regard.

8. We propose that distributions under the Listed Issuer Financing Exemption would be subject to secondary market liability and provide original purchasers with a contractual right of rescission against the issuer. We propose secondary market liability because the exemption is premised on the reporting issuer's continuous disclosure and limited to distributions of listed equity securities that are traded on the secondary market. Although the exemption provides for the distribution of freely tradeable securities to any class of purchaser, similar to a prospectus offering, the quantum of liability is more limited than it would be for a prospectus offering.

As discussed below, we do not agree that secondary market liability, based on the issuer's continuous disclosure record (and the offering document), with its more limited damages, strikes the appropriate balance between investor protection, public confidence in the market and assisting smaller issuers in raising capital.

a. Does the proposed liability regime provide appropriate incentives for issuers to provide accurate and complete disclosure under the exemption and adequate investor protection or should we consider imposing prospectus level liability?

We interpret "prospectus level liability" to refer to: (a) an issuer's certification that its offering documents make "full, true and plain" disclosure of all material facts; and (b) the statutory remedies available to purchasers in the primary market.

In reviewing the liability regime, we start with the proposition that statutory liability does not usually attach to securities issued pursuant to a prospectus exemption under NI 45-106 or other exempted trades. The exceptions are for: (i) rights offerings;[168] (ii) the existing security holder exemption;[169] (iii) control person sales under section 2.8 of NI 45-102;[170] (iv) certain exempt takeover bids and issuer bids;[171] and (v) sales by way of an offering memorandum.[172] Items (i) to (iv) have secondary market liability either because the sales are to existing shareholders or the distribution is in circumstances where a person on the other side of the trade usually does not know that the purchaser or seller is purchasing or selling under a prospectus exemption.[173] Where an investor purchases securities under the offering memorandum exemption, NI 45-106 specifically provides that the offering memorandum must provide for contractual remedies of rescission or damages for misrepresentation, unless similar provisions are provided under applicable provincial securities legislation, thereby creating a liability regime similar to prospectus liability.[174] Similar provisions, such as section 130.1 of the OSA create a liability regime similar to prospectus liability whenever an offering memorandum is used in connection with a distribution.[175]

Investors in the primary market and those purchasing securities in the secondary market have different statutory claims and remedies and there is no compelling reason why purchasers under the Listed Issuer Financing Exemption should be treated differently than

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[168] NI 45-106, *supra* note 8, ss 2.1(3), 2.1.4.
[169] See for example, *CSA Multilateral Notice 45-313 – Prospectus Exemption for Distributions to Existing Security Holders,* CSA Notice, (13 March 2014) (in jurisdictions other than Ontario and Newfoundland and Labrador) and *Ontario Prospectus and Registration Exemptions,* OSC Rule 45-501 (as consolidated 30 June 2016), s 2.9(6), online (pdf): *Ontario Securities Commission* <osc.ca/sites/default/files/2020-09/rule_20160630_45-501_unofficial-consolidation.pdf> [Ontario Exemptions].
[170] NI 45-102, *supra* note 7, s 2.8.
[171] NI 45-106, *supra* note 8, s 2.15-2.16; NI 45-102, *supra* note 7, s 2.11.
[172] NI 45-106, *supra* note 8, s 2.9.
[173] Issuers relying on the existing security holder exemption must nevertheless give a "no misrepresentation certification" in the subscription agreement. See Ontario Exemptions, *supra* note 169, s 2.9(3).
[174] NI 45-106, *supra* note 8, ss 2.9(7), 2.9(8), 2.9(13), 2.9(16). See also OSA, *supra* note 10, s 130.1. We note as well that similar contractual remedies must be provided to purchasers under an ATM distribution under the shelf prospectus rules in NI 44-102, *even though these purchasers will not receive a copy of the ATM prospectus* and may not even know whether their securities are purchased under the ATM distribution or on the secondary market.
[175] OSA, *supra* note 10, s 130.1.

other purchasers in the primary market. The focus of the Listed Issuer Financing Exemption on assisting issuers with raising capital must be balanced against those issuers' duties to investors. Otherwise, the Listed Issuer Financing Exemption potentially undermines decades of deliberate policy choices in the creation of remedies for investors who purchase securities from issuers and those who purchase on the secondary market and larger concerns with balancing efficiency for issuers against systemic risk.

Existing statutory remedies available to investors for misrepresentation are not simply interchangeable claims for negligent misrepresentation at common law. Rather, the statutory remedies have different foundations in common law and serve different policy objectives. To simply rationalize limiting the remedies for purchasers of securities under the Listed Issuer Financing Exemption to those available to purchasers on the secondary market, because these purchasers are left to rely primarily on the issuer's continuous disclosure record, is problematic. At the least, it must be acknowledged that under the Listed Issuer Financing Exemption investors will be treated differently from nearly all other investors in the primary market who do purchase securities from an issuer of which they are not already a shareholder.

The two statutory remedies have different common law foundations:

- Primary market civil liability:
  - the remedies available to investors in the primary market are based on causes of action for contractual misrepresentation, whether fraudulent or innocent. The remedies for a party who enters into a contract on a misrepresentation include a right to rescind the purchase or damages limited to the purchase price of the securities;
  - liability and compensation are based on the theory that, had the investor known the true state of all material facts about the issuer, the investor would not have purchased the securities. Given the misrepresentation, the investor is entitled to rescission and where rescission is no longer available, damages are available as an alternative remedy; and
  - under either remedy, the issuer is required to return the benefit that it improperly gained through its misrepresentation of material facts – up to the whole of the proceeds of the offering.

- Secondary market civil liability:
  - the remedies for purchasers in the secondary market are based on negligent misrepresentation. The harm to the secondary market purchaser is caused when the misrepresentation is disclosed through public correction and the market's response (which is usually a downward price correction). Damages are calculated based on the difference between the price paid and the trading value of the shares once the misrepresentation is corrected;[176]

[176] See for example, OSA, *supra* note 10, s 138.5.

- the issuer does not directly benefit financially from the misrepresentation of material facts or failing to disclose a material change. Therefore, there is no contract to rescind or proceeds to return;
- the issuer and others who are defendants under the statutory secondary market remedies, however, owe duties to ensure that public disclosure is not misleading in relation to material facts and that all material changes are disclosed;
- the key objective of the statutory cause of action is deterrence and not compensation.[177] Accordingly, investor remedies are potentially (and likely) under-compensatory, because issuer liability is capped (as is the liability for others responsible for the issuer's continuous disclosure record, except in cases where the defendant knew of the misrepresentation)[178] and liability of all defendants is proportionate and not joint and several (except where two or more defendants, other than the issuer, authorized, permitted, or acquiesced in the making of a misrepresentation, in which case such defendants will be jointly and severally liable to a plaintiff);[179] and
- investors do not have standing to bring claims for damages as of right, but must seek leave of the court, which stands as a gatekeeper, to commence the proceeding.[180]

Convenience to issuers, therefore, is not a rational policy reason to deprive investors, who purchase securities under the Listed Issuer Financing Exemption, of access to rescission rights or compensatory damages for the issuer's misrepresentation.

What is the appropriate disclosure standard? In our view, *full* and *true* disclosure of material facts is functionally equivalent to a "no misrepresentation" standard in the civil remedies for secondary market purchasers. This is because "misrepresentation" is defined in relation to "material facts" and consists of either making "an untrue statement of material fact" or "an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it is made".[181] However, the issuer's obligation to ensure that it has made *plain* disclosure of all material facts requires the issuer to present the material facts in an understandable manner, not buried or scattered throughout the disclosure, requiring the investor to piece together the significance of what has been disclosed.

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[177] Committee on Corporate Disclosure, Allen Committee, *Final Report — Responsible Corporate Disclosure: A Search for Balance* (Toronto Stock Exchange, 1997) [Allen Committee]; *CSA Notice 53-302 – Proposal for a Statutory Civil Remedy for Investors in the Secondary Market and Response to the Proposed Change to the Definition of "Material Fact" and "Material Change"*, CSA Notice, (2000) 20 OSCB 7383 at 7385–86.
[178] See for example, OSA, *supra* note 10, s 138.7.
[179] See for example, OSA, *supra* note 10, s 138.6.
[180] See for example, OSA, *supra* note 10, s 138.8.
[181] OSA, *supra* note 10, s 1(1).

We suspect that one of the primary reasons for not imposing prospectus liability under the proposed exemption is the concern that the imposition of "full, true and plain" disclosure would compel issuers to retain underwriters or other third parties to assist with due diligence and provide the directors of the issuer with sufficient comfort, which additional cost is the very thing the proposed exemption is seeking to avoid. Based on comments made with respect to the CSA IDS, we expect that this would be especially challenging if such certification extended to an issuer's disclosure record for the preceding 12 months.[182] Although, we believe the proposed exemption would meet its goals and objectives if "full, true and plain" certification was required – even if expanded to the continuous disclosure record of issuers using the proposed exemption – on balance we believe that a "no misrepresentation" certification is adequate and strikes an appropriate balance. The difference between the two standards is not enough to justify the risk that the imposition of a "full, true and plain" certification may significantly diminish use of the proposed exemption, particularly if primary market statutory lability is imposed on a "no misrepresentation" standard.

What is the proper basis for recovery of damages? If the "no misrepresentation" standard is not met, purchasers should be entitled to a choice of remedies that includes a right of rescission or fully compensatory damages against the issuer and its directors and to do so without first seeking leave of the court. We see no reason why purchasers under the Listed Issuer Financing Exemption should not have the same rights to elect rescission and obtain the return of the purchase price for the securities purchased as other investors who purchase securities directly from an issuer. We note purchasers under the offering memorandum exemption as well as those who, by happenstance, purchase securities under an at-the-market ("**ATM**") distribution have alternative contractual rights to rescission or damages.[183] There is no reason why similar remedies should not be extended to investors who purchase under the Listed Issuer Financing Exemption (especially since these investors will receive an offering document, whereas, for example, purchasers under an ATM distribution will not).

The Listed Issuer Financing Exemption is from our perspective one of the most sweeping prospectus exemptions ever proposed, particularly since its policy rationale is not founded strictly on the principles underlying the closed system. Without prospectus level liability, purchasers under a Listed Issuer Financing Exemption would be placed at a unique disadvantage and will be undercompensated in damages. In balancing market efficiency and fostering capital formation against investor protection, we believe that recovery of damages under prospectus liability is a minimum requirement. Accordingly, we would suggest that "prospectus liability" similar to that in respect of offering memoranda under section 130.1 of the OSA be provided to investors under the proposed exemption, with modifications to ensure that investors purchasing securities would also have recourse for damages when there is a

[182] See Part I-C, *above*, for the discussion on the 2000 CSA Concept Proposal for an Integrated Disclosure System.
[183] NI 45-102, *supra* note 7, s 9.3(h).

misrepresentation against (i) the directors of the issuer, (ii) promoters of the issuer, (iii) influential persons, (iv) experts and (v) every person who signs the offering document.[184]

b. Some of the key objectives of the exemption include reducing the costs to an issuer of accessing the public markets and providing investors with a briefer document that they are more likely to read. Would imposing prospectus-level liability impact the objectives of the exemption?

While we do not believe that imposing prospectus-level liability and providing purchasers with rescission rights and compensatory damages will impact the objectives of the Listed Issuer Financing Exemption, we share the concern expressed by other industry participants that "full, true and plain" certification may lead issuers to spend significant funds to follow a process similar to that used for a short form prospectus. We believe that such an expense would not provide additional protection to investors, at least not enough to justify any negative impact on the use of the proposed exemption.

c. Would the absence of statutory liability for dealers lead to lower standards of disclosure?

Not necessarily. We believe that the primary onus for ensuring adequate disclosure rests with the issuer and its directors and officers.

d. One of the conditions of the exemption is that the issuer must provide a contractual right of rescission in the agreement to purchase the security with the purchaser. Would a requirement for the issuer to enter into an agreement with purchasers be unduly burdensome?

We expect that the requirement to enter into subscription agreements may be cumbersome, and ultimately, would be unnecessary. Statutorily imposed liability would eliminate the need to require issuers to provide a contractual right of rescission in an agreement to purchase the security.

Response to Annex E Request for Comments:

1. If the CSA were to adopt a semi-annual reporting regime should we consider excluding issuers who report semi-annually from using the Exemption?

If the CSA were to adopt an optional semi-annual reporting regime, issuers that choose to report on a semi-annual basis should not be allowed to use the Listed Issuer Financing Exemption. This view aligns with the Taskforce's recommendation in the Final Report.[185]

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[184] Similar to the changes suggested to section 130.1 of the OSA in the recently proposed *Capital Markets Act*. See Ministry of Finance, *Capital Markets Act - Consultation Draft* (2021), online: *Ontario's Regulatory Registry* <www.ontariocanada.com/registry/showAttachment.do?postingId=38527&attachmentId=51026>.
[185] Final Report, *supra* note 28 at 35.

As described in Part I, Section D of this comment letter, the Taskforce proposed and ultimately recommended the introduction of an alternative offering model to enable reporting issuers to issue freely tradeable securities under an exemption similar to the Listed Issuer Financing Exemption.

The Taskforce also proposed introducing an optional semi-annual reporting regime.[186] In Proposal 6 of the Consultation Report, the Taskforce noted that the significant costs associated with quarterly reporting requirements can be a significant burden, in particular for smaller issuers.[187] The Taskforce suggested that an option for semi-annual reporting could be appropriate for such issuers, as they may not experience significant changes to their operations that would be reflected in their financial statements over three-month intervals.[188]

Only one commenter answered the Taskforce's question on whether to exclude those issuers who choose to report on a semi-annual basis from using the proposed alternative offering model exemption.[189] This commenter noted that the target of both the semi-annual reporting proposal and the alternative offering model proposal was the same, smaller issuers. Thus, it was their view that to ask smaller issuers to choose between whether to report on a semi-annual basis or whether to use the alternative offering model was counterproductive. Instead, it was suggested that if an issuer reporting on a semi-annual basis had not filed financial statements in more than a quarter, then such issuer should be required to supplement their financial disclosure at the time of proposed use if they want to rely on the alternative offering model exemption.

In its Final Report, the Taskforce recommended allowing certain reporting issuers to voluntarily report on a semi-annual basis if the issuer:

- had developed a continuous disclosure record of at least 12 months after filing and obtaining a receipt for a final prospectus or filing a filing statement in the case of a reverse takeover or capital pool company;
- had an annual revenue of less than $10 million, as shown on the audited annual financial statements most recently filed by the reporting issuer; and
- was not currently, and had not recently been, in default of its continuous disclosure obligations.[190]

However, in making this recommendation, the Taskforce said that issuers that adopt semi-annual filing would not be eligible to take advantage of the Taskforce Proposal.[191]

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[186] *Ibid* at 35–36.
[187] Consultation Report, *supra* note 1 at 11.
[188] *Ibid*.
[189] PDAC Letter, *supra* note 141 at 7.
[190] Final Report, *supra* note 28 at 35.
[191] *Ibid.*

We support this recommendation with respect to the Listed Issuer Financing Exemption as well, given the similarities between it and the Taskforce Proposal. The Listed Issuer Financing Exemption relies heavily on the continuous disclosure record of issuers. Semi-annual reporting inherently cuts in half the amount of disclosure available about an issuer, as compared to an issuer reporting on a quarterly basis. In turn, the persuasiveness of the argument for relying on an issuer's continuous disclosure record is greatly diminished.

If you wish to discuss any aspect of this letter, we would encourage you to contact any one of the following lawyers who would be pleased to speak to you at your convenience:

Charlotte Conlin [redacted]

Paul Davis [redacted]

Troy Hilson [redacted]

Michelle Ho [redacted]

Leila Rafi [redacted]

Ouvedi Rama Naiken [redacted]

Sandra Zhao [redacted]