CSA Proposed Amendments and Changes to the Issuer Bid, Take-Over Bid and Beneficial Ownership Reporting Regimes

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Delivered to: Canadian Securities Administrators (**CSA**)

Introduction

The Canadian Bankers Association (**CBA**)[1] appreciates the opportunity to comment on the *CSA Notice and Request for Comment – Proposed Amendments and Changes to the Issuer Bid, Take-Over Bid and Beneficial Ownership Reporting Regimes* (**Proposed Amendments**).

The Proposed Amendments are intended to:

- Provide issuers with greater flexibility to repurchase their own securities
- Enhance transparency of ownership of derivative interests in specified circumstances
- Reduce regulatory burden and enhance the integrity of the issuer bid, take-over bid and early warning reporting regimes through clarifying amendments and supplemental policy guidance

In this submission, we highlight an opportunity to further advance these objectives by clarifying the treatment of certain issuer derivative transactions within the issuer bid framework under *National Instrument 62-104 – Take-Over Bids and Issuer Bids* (**NI 62-104**). We also provide targeted comments on selected elements of the Proposed Amendments.

1. Opportunity to Address the Treatment of Call Options

In our view, the current reform initiative undertaken by the CSA provides a timely opportunity to consider the treatment of certain issuer derivative transactions that raise closely related considerations under the issuer bid framework under NI 62-104. These transactions consist of physically settled call spreads and capped calls (collectively "**Call Options**"), when utilized by issuers in connection with convertible bond offerings.

Misalignment with Policy Objectives

To assess how Call Options ought to be treated under the existing issuer bid framework, it is helpful to consider the definition of an "issuer bid". Section 1.1 of NI 62-104 defines an "issuer bid", in part, as:

> an offer to acquire or redeem securities of an issuer made by the issuer to one or more persons, any of whom is in the local jurisdiction or whose last address as shown on the books of the offeree issuer is in the local jurisdiction, and also includes an acquisition or redemption of securities of the issuer by the issuer from those persons…

Section 2.8 of NI 62-104 requires that an issuer bid be made to all holders of the class of securities subject to the bid.

The objectives of these provisions are to ensure fairness, equal treatment of securityholders, and transparency when an issuer acquires its own securities.

[1] The Canadian Bankers Association is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals.

In our view, treating Call Options as issuer bids does not advance these objectives. This becomes apparent when we look at the nature of the Call Options and how they are used:

- Call Options are risk-management tools used by issuers of convertible bonds to hedge the potential for equity dilution associated with these bonds should the market price of the underlying common shares into which the bond may be converted trade above the conversion price of such bond
- Equity dilution results from the issuer issuing new shares from treasury to satisfy its obligations under the bonds upon conversion. Issuing new shares increases the total number of shares outstanding, thereby reducing the earnings per share to holders and potentially reducing dividends. This may cause downward pressure on the market value of the shares into which the bonds are convertible to the detriment of all holders. The conversion price of a convertible bond offering is driven by market demand for the convertible bonds and, for many issuers, low conversion prices present too great a potential for dilution
- The tension between the objectives of the issuer and the demands of the market can be solved via a capped call overlay. This is achieved because the Call Option obligates the Call Option provider to deliver shares to the issuer should the underlying shares trade within a price range starting at the conversion price of the bonds and ending at the cap price set out in the Call Option. The Call Option allows the issuer to essentially raise the market-driven conversion price of the bond to the cap price of the Call Option while offering a low conversion price bond to the market where it is most attractive to investors
- Equity dilution is avoided or abated because the Call Options provide the issuer a source of already outstanding shares with which to satisfy, at least in part, its obligations under the bonds upon conversion
- Banks entering into these transactions typically hedge their exposure through the purchase of previously issued shares in the open market. These open market purchases will likely cause upward pressure on the market value of the shares underlying the convertible bonds to the benefit of all securityholders.
- We note that in these transactions, the counterparty is a regulated financial intermediary, not a securityholder seeking preferential treatment

Accordingly, Call Options are not mechanisms to favour certain securityholders or influence market pricing, and as such, do not raise the concerns that the issuer bid framework is intended to address.

Treating Call Options as issuer bids imposes procedural and financial burdens without delivering meaningful investor and securityholder protection. The effect is to create regulatory friction that discourages Canadian issuers from using standard hedging practices and ultimately undermines capital-raising efficiency.

Competitive Disadvantage

The treatment of Call Options as issuer bids also creates a significant competitive disadvantage for Canadian issuers and banks relative to their counterparts in the United States (**U.S.**). In the U.S., Call Options tied to convertible bond offerings are common practice, provide tax benefits, and do not trigger tender offer rules or equivalent restrictions.

This means that Canadian issuers offering convertible bonds face higher transaction costs, longer timelines, and legal uncertainty because they must either:

- Avoid Call Options altogether, thereby increasing dilution risk; or
- Structure transactions with non-Canadian banks, reducing domestic market activity

Canadian issuers, who would like to hedge their exposure and protect securityholder value in the manner described above, must execute Call Options with banks outside of Canada otherwise they potentially breach the requirements of the issuer bid framework. By preventing Canadian banks from quoting on Call Options, the current issuer bid framework reduces competition among primary dealers, resulting in higher costs for issuers and reduced market efficiency. By increasing dilution risk, the current application of these rules hurts securityholders as well.

Finally, applying the issuer bid framework to Call Options also disadvantages Canadian banks as it can prevent them from participating in transactions that are otherwise accessible to foreign peers. This may result in lost business opportunities for Canadian participants and a shift of activity outside Canada.

Suggested approach

To reconcile the policy objectives of the issuer bid framework with market realities, we recommend that the CSA introduce a targeted conditional exemption or safe harbour for hedging transactions such as Call Options entered into in connection with convertible bond offerings. This exemption could be structured to apply where:

- The transaction is executed with a regulated financial intermediary
- The purpose is demonstrably risk management rather than providing selective benefits to securityholders
- Appropriate disclosure is included in offering documents or periodic filings, and
- The transaction is linked to a convertible bond offering

Addressing this issue via a blanket order or as part of the current reforms would ensure transparency and investor protection while eliminating unnecessary procedural burdens that currently prohibit Canadian issuers from using widely accepted hedging tools. By clarifying that Call Options transactions do not constitute issuer bids under NI 62-104, the CSA would support efficient capital formation and also maintain competitive parity with other jurisdictions, notably the U.S., where similar transactions are permitted without triggering tender offer rules.

2. Comments on Specific CSA Proposals

Selective Repurchase Exemption

The CBA supports the introduction of the Selective Repurchase Exemption, which is intended to, among other things, increase flexibility and liquidity, and reduce the need for exemptive relief. Below we provide our responses to selected questions posed by the CSA on this topic.

Question 2: One of the conditions of the Selective Repurchase Exemption is that securities must be acquired from not more than 5 persons in the aggregate and in not more than 5 transactions in the aggregate, within any period of 12 months. Please comment on the appropriateness of this condition. If you are of the view that a different threshold would be more appropriate, please explain why.

Given that the definition of "person" in NI 62-104 includes a syndicate, we encourage the CSA to consider including Companion Policy guidance specifying that a syndicate is treated as a single person for purposes of this condition. This would provide greater certainty and support consistent interpretation of the exemption.

Question 9: Are there foreseeable challenges, practical or otherwise, for issuers who may wish to rely on the Selective Repurchase Exemption? If so, please also explain whether and how they may be addressed or mitigated.

As a condition to relying on the proposed Selective Repurchase Exemption, section 4.6.1(1)(f) of NI 62-104 requires the board of directors of the issuer to have determined that "(i) following the completion of the bid, the market for the class of securities that is the subject of the bid would not reasonably be expected to be materially less liquid than the market that existed at the date of the bid, and (ii) the bid would not reasonably be expected to have a significant negative effect on the market price or value of the class of securities that is the subject of the bid."

We respectfully submit that such a determination is more appropriately made by management rather than by the board of directors. Directors are generally charged with managing, or supervising the management of, the business and affairs of an issuer, while such a determination is of the type that management of an issuer is responsible for making on a regular basis. We therefore suggest placing the burden of making such determinations upon the "issuer", as opposed to the "board of directors of the issuer".

Equity Equivalent Derivatives Disclosure

The CBA generally supports enhanced disclosure in the context of control transactions but would emphasize that any additional disclosure requirements should remain narrowly scoped with a focus on improving decision-useful information and avoiding potential unintended consequences.

We note that the proposed amendments would require a bidder or soliciting securityholder to disclose any past or present relationship with a counterparty to an equity equivalent derivative, related financial instrument, or other arrangement affecting the bidder's or activist's economic exposure to the issuer (or an affiliate of that counterparty) that could reasonably be perceived as affecting the counterparty's decision to acquire, dispose of, tender or vote securities of the issuer. The proposal would also require disclosing the identity of the counterparty and, where applicable, the affiliate. The accompanying proposed guidance indicates that relevant relationships may include circumstances where the counterparty or its affiliate has a material financial interest in the bidder or activist, has a material financial interest in future business with that party, acts as a financial advisor to that party, or serves as a lender or syndicate manager in connection with the transaction.

We understand that the CSA's objective is to provide securityholders with information that may be relevant to assessing a bidder's or activist's influence and leverage in a take-over bid or control contest. The CSA states that disclosure of a bidder's or soliciting securityholder's aggregate economic position is intended to provide "more balanced transparency of the totality of parties' interests in special circumstances where securityholders are induced to make tendering or voting decisions."

We are concerned, however, that requiring public identification of counterparties may produce unintended consequences that are not commensurate with the expected incremental transparency benefits. In particular, naming a counterparty may create a misleading impression that the counterparty supports, endorses or is otherwise aligned with the bidder or activist campaign. In many cases, the counterparty is simply providing a derivative product in the ordinary course of business and may have no interest in, or view respecting, the outcome of the take-over bid or proxy contest. Public disclosure of the counterparty's identity could therefore lead investors to draw conclusions regarding the counterparty's intentions, influence or involvement that are not warranted by the facts.

We are also concerned that mandatory identification of counterparties could expose dealers and other market intermediaries to unnecessary reputational risk. Derivative transactions are widely used for legitimate investment, financing and risk-management purposes. Publicly associating a dealer with a contested take-over bid or activist campaign may create negative perceptions regarding the dealer's role, notwithstanding that the counterparty may have acted solely as a market intermediary. This concern is particularly relevant given the CSA's conclusion that it does not have evidence that equity equivalent derivatives are being used inappropriately or abusively with any regularity in Canadian capital markets.

In our view, the CSA's transparency objectives could be substantially achieved through disclosure of the existence and nature of any relevant relationship, without requiring public disclosure of the identity of the specific counterparty. Such an approach would provide securityholders with meaningful information regarding any relationship that could reasonably be perceived as influencing voting, tendering or trading decisions, while reducing the risk of misleading inferences, reputational harm to market intermediaries and unnecessary intrusion into legitimate derivatives activity.

3. Conclusion

We appreciate the opportunity to provide input on the Proposed Amendments as well as the treatment of Call Options and would welcome further engagement with CSA staff on these issues.