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SECURITIES DISTRIBUTIONS OUTSIDE OF CANADA

Summary of the Ontario Securities Commission's Proposed OSC Rule 72-503 Distributions Outside of Canada and Companion Policy 72-503CP to OSC Rule 72-503 Distributions Outside of Canada

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The line designating when the Ontario Securities Commission (OSC) will regulate a distribution of securities is being redrawn. The current "rule", Interpretation Note 1 *Distributions of Securities Outside Ontario* under a repealed OSC Policy 1.5 (**OSC Interpretation Note 1.5**) has been around since 1983. It applies a fairly simple principal that if securities are sold outside of Ontario and reasonable steps are taken to ensure the securities come to rest outside Ontario,

the OSC will not regulate them (ie. no prospectus or prospectus exemption is required). This has worked well for Ontario issuers, originally because the majority of securities sold by them outside Ontario would come to rest in the U.S. that has lots of regulation of its own, and now due to globalization. Other Canadian jurisdictions have taken different approaches. There has been a continuing tension between the need for capital formation and wanting to ensure our capital markets do not fall into disrepute. This manifests as an issue of whether there should be extraterritorial application of Canadian regulation – how far do we go?

Efforts have been made to formalize OSC Interpretation Note 1.5 over time, including through the 2000 creation of the draft Multilateral Instrument / OSC Rule 72-101. It never became effective. The August 2015 draft of regulations for the provincial and territorial *Capital Markets Act* (CMA) included CMRA Policy 71-601 *Distribution of Securities to Persons Outside CMR Jurisdictions*, which provided that an issuer making a distribution to a person outside the CMR Jurisdictions would have to comply with the prospectus requirement or rely on an exemption in making

a distribution to a person outside the CMR Jurisdictions if (1) a distribution was from a CMR Jurisdiction (e.g. an Ontario-based issuer) and (2) an indirect distribution into a CMR Jurisdiction (e.g. by a non-CMR-based issuer where the securities come to rest in a CMR jurisdiction). NI 45-102 resale rules would apply. This proposal was quite opposite to how things are done in Ontario right now. Every time regulators have tried to create regulation in this area, the business community has pushed back, and the CMA draft regulations have been no exception. We await a new draft of those regulations.

Meanwhile the OSC on June 30, 2016 put forward a draft replacement for Interpretation Note 1.5 in the form of Proposed Ontario Securities Commission Rule **72-503 Distributions Outside of Canada (Proposed Rule)** accompanied by a companion policy and form. Over time, OSC staff have come to the conclusion that the implementation of the principles of Interpretation Note 1.5 is problematic. They say uncertainty has arisen concerning the scope of the application of prospectus and registration requirements to cross-border distributions to investors outside Canada and

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the Proposed Rule attempts to address this by making it clearer as to whether a prospectus is to be filed or whether an exemption must be relied upon. However, regardless of this, the exemptions provided in the Proposed Rule are not solely determinative in establishing whether Ontario securities law is applicable in the situation. Issuers still have to take reasonable steps to ensure the securities come to rest outside of Canada.

The Proposed Rule lists exemptions from the prospectus requirements applicable to the distribution of securities to a person or company outside of Canada (in compliance with local laws) in the following scenarios:

1. distribution under a 1933 Act registration statement in the U.S. or a document similar to a final prospectus in a designated foreign jurisdiction
2. distribution qualified under a final prospectus in Ontario made concurrently outside Canada
3. distribution by a Canadian reporting issuer that has been a reporting issuer for the four months immediately preceding the distribution
4. other distributions with the resale proviso that the first trade is a distribution unless either
 - (a) the first trade is to a person or company outside Canada or
 - (b) both
 - (i) the issuer has been a reporting issuer for 4 months before the trade, and
 - (ii) 4 months have elapsed from the distribution date

The Proposed Rule also provides exemptions from the dealer and underwriter registration requirements with respect to the distribution of securities to a person or company outside of Canada where

- head office or principal place of business is in U.S. or designated foreign jurisdiction or Canada

- for distribution to purchaser in the U.S. – registered as a broker-dealer with the SEC; member of FINRA; complies with all US rules on distribution
- for distribution to purchaser in designated foreign jurisdiction – foreign registration equivalent to that of a dealer in Ontario; complies with all the foreign jurisdiction rules on distribution
- not a dealer/underwriter in Ontario except under OSC Rule 32-505 *Conditional Exemption from Registration for U.S. Broker-Dealers and Advisers Servicing U.S. Clients from Ontario* or the Proposed Rule
- other than under the Proposed Rule, doesn't trade securities with or on behalf of person or company in Ontario, except under another exemption from registration
- not registered in Canada as a dealer

There will be a simple electronic filing form for use of this rule. Hopefully it will give the regulators useful data for future consideration of cross-border distribution issues.

Creating a good successor to OSC Interpretation Note 1.5 is important because of the risks associated with cross-border transactions and the overall costs. The OSC is hoping the Proposed Rule will help

- ✓ reduce the costs of analyzing the new exemptions and guidance provided to determine whether or not an Ontario prospectus or reliance on another prospectus exemption is required.
- ✓ reduce the costs of complying with Ontario prospectus requirements in any circumstances that may have been previously covered by OSC Interpretation Note 1.5, but are not covered by the Proposed Rule or Proposed Companion Policy, and
- ✓ reduce the cost of preparing and filing the proposed form for outbound private placements.



Alternative solutions of maintaining or updating Interpretation Note 1.5 were considered, including comments on the Cooperative Capital Markets Regulatory System proposals, but the OSC determined that an “updated ‘distributions out’ regime” is needed for Ontario capital markets participants to be able to conduct cross-border capital raising efficiently.

The OSC is pretty clearly acknowledging that this is not the path all Canadian jurisdictions would prefer, but that it is the one needed for Ontario markets.

This is one of a number of areas where capital markets are willing to accept that there can be some different rules in different parts of the country, while still moving forward with a more efficient Co-operative Capital Markets regulatory system. We can hope that federal and provincial government officials are coming to understand this.

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