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You Say You Want Evolution? Well...Canadian Securities Regulators Are Now Reshaping Yesterday's Rules

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No longer content to just "let it be," Canadian securities regulators are now proposing to reshape yesterday's rules to work for today's modern capital markets and practices. Over the past few years, the Ontario Securities Commission (OSC) and other members of the Canadian Securities Administrators (CSA) have assessed, and are just now starting to propose, a wide range of initiatives to reduce regulatory burden for issuers, registrants and other market participants. The OSC published the latest update on these initiatives in November 2019 in a report titled Reducing Regulatory Burden in Ontario's Capital Markets (OSC Report).

Davies has played a lead role in these burden-reducing initiatives. A majority of the public company specific initiatives in the OSC Report adopted Davies' recommendations to, or respond to the concerns that we raised with, Canadian securities regulators. We have also proposed a number of other meaningful changes to modernize and streamline securities regulation that could be addressed in a future round of burden-reducing initiatives. Are these proposed initiatives revolutionary? No, we won't go that far (not even for a better headline). However, these initiatives do mark the beginning of an evolution to a modern Canadian securities regulatory regime.

Background

For the past few years Canadian securities regulators have focused on identifying ways to alleviate regulatory burden without compromising investor protection. The CSA got the burden-reduction ball rolling in 2017 with CSA Consultation Paper 51-404 (CSA Consultation Paper). From this consultation, the CSA identified six policy projects for reducing regulatory burden on reporting issuers (other than investment funds) under Canadian securities legislation (CSA Burden Reduction Update). This was followed in January 2019 by OSC Staff Notice 11-784 *Burden Reduction* (OSC Consultation Paper), the OSC's own public consultation for burden-reducing initiatives. The resulting feedback – from 69 comment letters, three public roundtables and over 30 consultations with industry associations and advisory committees – informed the OSC Report's recommendations. The OSC Report was also informed by the CSA's concurrent burden-reduction initiative. Notably, the OSC Report is only the beginning and only part of Ontario's five-point Capital Market Plan. To further support this plan, the Ontario government has also announced plans to modernize the securities regulatory framework to make it responsive to innovation and changes in a rapidly evolving marketplace. Ontario's Capital Markets Modernization Taskforce is to provide its recommendations on this next step in fall 2020.

In this article, we focus on the OSC Report because it is the most recent and most comprehensive reference for the Canadian securities regulators' progress and plans for burden reduction. Although focused on Ontario's capital markets, the majority of the recommendations in the OSC Report have national application. Further, many of these recommendations overlap with the CSA's previously announced burden-reducing policy projects. With over 100 potential initiatives, the OSC Report provides a deeper dive into the types of initiatives that are possible within and outside of those policy projects. However, for each recommended initiative, the OSC Report provides little detail, leaving us to guess whether and how these initiatives will be implemented.

Overview of the OSC Report

The OSC Report includes a mix of initiatives designed to streamline Canadian securities regulation and make Canadian capital markets more efficient. Some of these are specific to the OSC's rules and processes and Ontario's capital markets that the OSC has decided to implement (referred to as "decisions"). The balance are initiatives that the OSC has recommended, or will recommend, to others; these are referred to as "recommendations" because agreement and action by other CSA members (or the Ontario government) are necessary for their implementation. Although a few of these "recommendations" are Ontario-specific, most of the recommendations aim

to change securities regulation that is (or should be) harmonized across the country – and so require the rest of the CSA to "come together" and "work it out."

In total, the OSC Report makes over 100 decisions and recommendations for potential initiatives. These are organized by the affected stakeholder group – public companies; investment funds; registrants; markets, trading and clearing; and derivative participants. There is also a general category for initiatives that affect multiple market participants and that relate to the OSC generally. We have limited our comments in this article to initiatives – both general and specific – that would affect public companies; most of these initiatives have a target implementation date before the end of this year.

One critical by-product of the OSC's burden-reduction initiative is its refined approach to assessing its rules. In analyzing which regulatory burden concerns should be addressed, and how best to address them, the OSC was guided by the fundamental principle that the cost and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objective sought to be realized. Specifically, regulation should be

- balanced (i.e., its burden is commensurate with its anticipated benefit);
- tailored, by avoiding a one-size-fits-all approach where appropriate, taking into account how it may affect entities of different sizes or business models;
- flexible, recognizing that there can be multiple ways to achieve regulatory objectives, and incorporating stakeholder input to arrive at an optimal solution; and
- responsive, through frequent updates that support innovation and dynamism in Ontario's capital markets, while still being mindful of the purposes of the Ontario's *Securities Act* (i.e., investor protection, market efficiency, confidence in the market and financial stability).

Key Initiatives Affecting All Market Participants

The OSC Report contains 13 decisions and recommendations that would, if implemented, affect all market participants. These initiatives focus on (1) making compliance less time-consuming, expensive and confusing; (2) reducing the time and cost of regulatory review and approval processes; (3) improving the rule-making process; and (4) allowing market participants to access relevant information more quickly and easily.

Apply a rigorous assessment of proportionality to future rule-making

Key among the OSC's decisions is to extend its more rigorous assessment of proportionality to all of the OSC's future rule-making. This is coupled with an OSC decision (and recommendation to the CSA) to improve clarity and consistency in drafting future rules, policies and guidance. Although only conceptual in nature, these changes to future rule-making should ultimately yield the most burden reduction in the long run. We agree with the OSC's view that the ideal regulatory approach involves combining and balancing principles-based rules, prescriptive rules and guidance. Of course, as a practical matter, finding the right balance is difficult.

Afford the OSC blanket order authority

Following another of the OSC's recommendations in its Report, the Ontario government recently amended Ontario's Securities Act to authorize the OSC to issue exemptive relief in respect of an entire class of persons or securities, among others. Davies had suggested this "blanket order" authority in our comments on the OSC Consultation Paper (the Davies Comment Letter). Having the authority to issue blanket orders (as opposed to orders in respect of a single market participant) is a game-changer and puts the OSC on even footing with other Canadian securities regulators that already have this authority. Where rule changes are appropriate, there is a long timeline to effect those changes in the law. This new authority enables the OSC to be more flexible and responsive by issuing blanket orders as an interim relief measure as those changes are codified.

Key Initiatives Affecting All Market Participants

The OSC Report contains an additional 13 decisions and recommendations specific to public companies. These are intended to address underlying concerns of regulatory burden relating to prospectus reviews; reports of exempt distribution; cease-trade orders; exempt market capital raising; continuous disclosure documents; electronic delivery of documents; and prospectus offering requirements. Six other general regulatory burden concerns were identified through the OSC's consultation process; however, the OSC is not addressing any of these concerns at this time.

Most of these public company specific initiatives have the potential to provide substantial benefits to the Canadian capital markets. Two of these initiatives are already the subject of formal rule proposals – one to allow for "at-the-market" (ATM) offerings (without prior exemptive relief) and the other to reduce the circumstances in which reporting issuers must file financial statements for acquired businesses. Another of these initiatives already has been implemented (pre-filing confidential review of mining technical disclosure). Although the OSC Report provides little detail about the balance of its public company specific initiatives, a few are still noteworthy at this stage.

Allow confidential pre-filing review of a prospectus

The OSC is proceeding with a program to allow for the confidential review of a prospectus prior to the announcement of an offering. The target date for implementing this confidential review process is summer 2020. Notably, the confidential pre-filing review would not be restricted to initial public offerings (IPOs) or to any particular type of issuer or prospectus content. As a result, it would significantly expand the more limited process for pre-filing confidential review of mining technical disclosure that the OSC adopted in summer 2019.

This initiative is partially responsive to our concern as to the potential for delay and uncertainty, and therefore execution risk, resulting from the prospectus review process. To address this risk, we suggested (among other things) a confidential pre-filing review for disclosure for which there may be a real risk of delay. We are encouraged that the OSC has adopted this recommendation. However, we think there is still room for additional improvement through a more streamlined short form prospectus review process, focused on disclosure specific to the particular offering and not focused on the issuer's existing continuous disclosure record (absent manifest error). Further details this proposal are included in the Davies Comment Letter.

Make it more cost effective for issuers to conduct a prospectus offering

Work on this initiative to make the prospectus offering process more cost-effective started in fall 2018, and implementation is targeted for fall 2020. While no particular course of action is specified, the six suggestions highlighted as possibilities are instructive as to the potential breadth and impact of this initiative. Most of these suggestions are "low-hanging fruit," such as streamlining prospectus disclosure requirements and simplifying administrative filing requirements. However, the following two suggestions may involve more fundamental changes to Canadian practices regarding the marketing and execution of public offerings:

- **Introduce an "automatic shelf" prospectus procedure.**[1] Similar to the "automatic shelf" that "well-known seasoned issuers" may use to register U.S. public offerings, this would allow specified issuers to qualify (without prior review by regulators or any other delay) unspecified amounts of securities by way of a shelf.
- **Expand the Canadian "testing the waters" exemption**. A recent expansion of the equivalent U.S. exemption permits any issuer to communicate with institutional accredited investors to determine whether those investors would have an interest in a public offering prior to filing a registration statement (prospectus) for that public offering. In contrast, the current Canadian exemption allows testing of the waters only in connection with IPOs.[2]

Modernize delivery requirements for issuer documents

The CSA elaborated on this initiative in January 2020, publishing a consultation paper on a potential "access equals delivery" model. This model would deem public access to a prospectus or other relevant document as sufficient for satisfying prospectus and other documentary delivery obligations under Canadian securities legislation.[3] The CSA notes this model could be used for the delivery of various types of documents; however, as an initial step, it is considering whether to prioritize implementation of this model only for the delivery of prospectuses and financial statements and management's discussion and analysis (MD&A).

Notably, it was Davies that first recommended an "access equals delivery" model for prospectus delivery, in July 2017, in our comments on the CSA Consultation Paper.[4] If implemented, this model would be a substantial step forward in modernizing the way documents are made available to investors, saving time and significantly reducing the cost to issuers and the environment.

Avoid duplicative or unnecessary disclosure requirements for AIFs and MD&A

Aside from an implementation target date (fall 2020), no further detail is provided for this initiative to avoid duplicative or unnecessary disclosure requirements for annual information forms and MD&A. However, the objective is obvious. Although simple in concept, this initiative is long overdue and, if implemented properly, would be well received by the Canadian capital markets. In the Davies Comment Letter, we suggested a number of disclosure requirements that were ripe for elimination. We also suggested further streamlining the burden of reporting by allowing for cross-references to financial statement notes, to the extent relevant, to provide context to discussion in an issuer's MD&A.

What Is Missing

Also noteworthy by their absence are a number of potential burden-reducing initiatives that were previously raised – either by CSA members or by market participants in their suggestions for potential burden-reducing initiatives - but are not included in the OSC Report.

Many of these omitted initiatives fall under one of the six categories of underlying concerns that the OSC has said it will not address at this time, but may revisit in the future following further review. For example, Davies' recommendation that the CSA identify alternative, modern mediums for an issuer to "generally disclose" material facts – current CSA policy refers only to a press release for this purpose, a practice that is out of step with U.S. practice. The OSC is considering whether updated guidance is necessary; however, it doesn't expect to complete this review before the end of 2021.

There are, however, a large number of additional concerns raised by stakeholders for which the OSC has not yet committed to any further review. Although most of Davies' suggestions were adopted by the OSC, some were not. These included suggestions to

- fix impractical and unnecessary requirements of the Canadian marketing rules;
- fix the increasing misalignment of the offering processes and practices in the United States and those in Canada;
- eliminate or limit reports of exempt distribution;
- reduce and simplify insider reporting filing requirements; and
- eliminate other antiquated filing requirements that no longer serve a valid purpose.

Although not the subject of the OSC's decisions and recommendations in the OSC Report, we are hopeful that many or all of these topics will be addressed in a future round of burden-reducing initiatives. Imagine a Canadian securities regulatory regime that is ultimately among the most modern in the world. You may say we are dreamers, but hope we're not the only ones.

[1] In response to the CSA Consultation Paper in 2017, Davies was the first and only firm to recommend an "automatic" shelf procedure to the CSA. In our view, an automatic shelf procedure would be an attractive alternative to the current Canadian shelf procedure because it would mitigate adverse pricing pressure from the market overhang associated with a traditional unallocated shelf prospectus.

[2] Expanding the Canadian testing the waters exemption would resolve issues stemming from the application of Canada's overly rigid marketing rules in cross-border offerings (where there is an obvious, and sometimes problematic, disconnect with the more modern approach under U.S. securities laws) and in domestic Canadian offerings (where, except in the context of an IPO, Canadian pre-marketing limitations severely restrict "wall-crossing" or "soft-sounding" efforts).

[3] Specifically, delivery would be considered effected once (i) the document has been filed with the applicable Canadian securities regulators and posted on the issuer's website and (ii) a news release is issued indicating the document is available electronically and that a paper copy can be obtained on request.

[4] In support, we noted that requiring physical delivery of a prospectus is an arbitrary requirement and an unnecessary burden given the high level of Internet access in Canada. Further, a physical delivery requirement is inconsistent with the principles of the short form prospectus system, whereby substantially all of the critical issuer information is contained in documents that are incorporated by reference and never delivered to an investor.

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