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October 8, 2021

By email:

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
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Re: Proposed Changes to Companion Policy 41-101CP *General Prospectus Requirements* (41-101CP) Related to Financial Statement Requirements and to Companion Policy 51-102CP *Continuous Disclosure Obligations* (51-102CP)

Dear Staff:

We are writing in response to your request for comment dated August 12, 2021 regarding proposed changes to 41-101CP and 51-102CP intended to clarify and harmonize the interpretation of the financial statement requirements for a long form prospectus where an issuer has acquired a business, or proposes to acquire a business, that a reasonable investor would regard as being the primary business of the issuer (Primary Business Requirements).

These comments are provided by the lawyers of Torys LLP who are signatories below, in their personal capacities, and not on behalf of the firm or any of its clients.

We appreciate the efforts of the Canadian Securities Administrators (CSA) to reduce the regulatory burden for issuers resulting from uncertainty about the interpretation of the Primary Business Requirements. However, it is not clear to us that the proposed changes, on their own, will meaningfully reduce the uncertainty for market participants or the need for consultation with Staff in connection with the interpretation and application of the Primary Business Requirements, and/or the need for exemptive relief. As we discuss in more detail below, we recommend that the CSA consider additional changes to the regulatory framework to reduce the unnecessary regulatory burden that can increase costs and/or lead to uncertainty regarding financial information requirements for certain issuers seeking to access Canadian

capital markets or, in some situations, motivate issuers to avoid raising capital in Canadian public markets.

1. Revisit Items 32 and 35 of Form 41-101F1

We recommend that the CSA revisit Items 32 and 35 of Form 41-101F1 *Information Required in a Prospectus* (Form 41-101F1) and the related guidance (and not make changes solely to 41-101CP), with a view to streamlining, consolidating, harmonizing (where appropriate) and clarifying these requirements. For example:

A. The incorporation by reference of requirements from other instruments, which are then modified for use as prospectus disclosure requirements,[1] makes these provisions unnecessarily complex and difficult to interpret. Given the complexity of Form 41-101F1 and its significance as a core instrument specifying disclosure requirements for long-form prospectus offerings, and indeed, primarily for initial public offerings (IPOs), we believe that it should be as self-contained as possible, with incorporation by reference from other instruments limited mainly to definitions and avoiding any incorporation by reference of provisions that must be read in conjunction with adapting language in Form 41-101F1.

B. 41-101CP should include a flow chart or similar diagram[2] to assist users in determining which types of issuers, and in which circumstances, are required to apply which tests or are subject to which requirements with respect to the financial information that must be included in their prospectuses. For example, if a reporting issuer to which Item 35 applies has completed one or more acquisitions and none of the acquisitions (individually or collectively) triggers any of the significance tests, does that issuer still need to consider whether a reasonable investor would consider the acquisition or acquisitions to be the issuer's primary business, so that the issuer would be expected to provide the disclosures outlined in Item 32?

C. It would be helpful to have more guidance on when the CSA is likely to believe that "a reasonable investor would regard the primary business of the issuer to be the acquired business or related businesses".

    - When an issuer acquires a business in an industry unrelated to its historic business, it can be difficult to determine whether the acquisition amounts to a change in the primary business of the issuer. Many acquisitions, such as acquisitions of complementary or related businesses or diversifications of asset portfolios, will be more challenging to evaluate than the example given in the proposed amendments to 41-101CP of a mining company effecting a wholesale transition to a cannabis business. Also, beyond clear examples of "immaterial acquisitions" (discussed further below), if an issuer acquires a business that differs to some extent from its historic business, we would encourage the CSA to consider providing additional guidance about the size of, or any other factors relating to, the acquired business (or acquired businesses) that, absent exceptional circumstances, would not be considered a primary business of the issuer.

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[1] For example, the definition of "significant acquisition" in paragraph (4)(b) of Item 35.1 (which applies to an issuer that was not a reporting issuer on the acquisition date) includes seven modifications to the definition of "significant acquisition" in section 8.3 of National Instrument 51-102 *Continuous Disclosure Obligations* (NI 51-102).

[2] See, for example, the decision tree flow chart included in Appendix A to Commentary in National Instrument 81-107 *Independent Review Committee for Investment Funds*.

- It would be helpful for the CSA to clarify that, when an acquisition does not change the issuer's historic business (e.g. a mining company buying a mining business), the acquired business would not be considered the "primary business" unless the acquisition triggered the 100% significance test.
- Finally, it would be helpful for the CSA to clarify that if an issuer already has a variety of businesses, it can be comfortable concluding that an acquisition will not be considered a "primary business" if it becomes one of many businesses owned by the issuer and does not trip the significance test at the 100% level.

D. Items 32 and 35 refer to businesses that have been acquired or are proposed to be acquired, but Item 35 and the related sections in 41-101CP use the term "probable acquisition". We recommend that the CSA clarify that the disclosure requirements in Item 32 (including those arising from a determination that a business is a primary business) apply only in respect of a proposed acquisition when the proposed acquisition has progressed to a state where a reasonable person would believe that the likelihood of the issuer completing the acquisition is high.

E. When a business acquired, or to be acquired, is considered to be part of the "primary business" of an issuer within the meaning of Item 32.1(1)(b) of Form 41-101F1, the disclosure requirements in a prospectus are more onerous than for an acquisition that falls within the definition of "significant acquisition" within the meaning of Item 35 of Form 41-101F1. Consistent with the feedback the CSA received on CSA Consultation Paper 51-404 *Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers*, we submit that two full years of audited financial statements plus the most recent comparative interim financial statements, along with *pro forma* financial information, are sufficient to enable a potential investor to understand the issuer's financial position. Unless the issuer would be left without any financial statements for the third most recent year, the third year of financial statements of an acquired business should not be required in the circumstances set out in Item 32.1(1)(b). The requirement to prepare, and obtain an audit of, pre-acquisition financial statements for the third most recent year can add significant, incremental cost and time to the preparation of disclosure, with little to no benefit to a potential investor since these financial statements will be stale and not reflective of the consolidated financial position of the issuer's business going forward. These burdens are exacerbated if there has been a change in the acquired business's management or a change in its independent auditor. These burdens can have a significant adverse effect on an issuer's ability to access capital markets on a timely basis – or at all. These are some of the reasons why, after extensive consultation with market participants, the U.S. Securities and Exchange Commission (SEC) recently adopted amendments (SEC Amendments)[3] to the financial disclosure requirements for business acquisitions and dispositions that, among other things, reduce the number of audited and interim periods for which historical financial statements must be presented if an acquisition is determined to be significant to a maximum of the two most recent fiscal years.

F. We also encourage the CSA to consider revising National Instrument 41-101 *General Prospectus Requirements* (NI 41-101) and Form 41-101F1 to include certain other changes to the disclosure regime for acquired businesses along the lines of the SEC Amendments, such as permitting

[3] See SEC, *Final Rule - Amendments to Financial Disclosures about Acquired and Disposed Businesses* (File No. S7–05–19).

abbreviated financial statements for a target business carved out of a broader entity that did not maintain separate financial statements of the target business.

G. We recommend that the CSA reconsider the requirements in Item 8.2 of Form 41-101F1 that MD&A be provided in respect of any acquired business whose financial statements the issuer is required under Item 32 to include the prospectus.

- Since the issuer did not own the business during the pre-acquisition period, management of the issuer may not be in a position to discuss the performance of the acquired business during the pre-acquisition period, and it may not be feasible to have management of the acquired business (who may no longer be involved in the business) prepare the MD&A for the pre-acquisition period. If MD&A in respect of a business for a period prior to the acquisition of the business is deemed necessary for readers to be able to understand the financial statements of the acquired business, we recommend that the requirements be streamlined (e.g. to focus on a comparison of financial results for the periods presented).
- If a third year of financial statements continues to be required in the circumstances set out in Item 32.1(1)(b), we recommend that the CSA consider either (a) deleting the requirement in Item 8.2(2) for issuers to provide MD&A in respect of that third year for financial statements included as a result of the primary business determination or (b) limiting the application of this requirement to exceptional situations that the CSA specifies in the Form 41-101F1.

H. Section 3.11 of National Instrument 52-107 *Accounting Principles and Auditing Standards* (NI 52-107) permits "acquisition statements" to be prepared in accordance with specified accounting principles (including U.S. GAAP), subject to certain conditions. Section 1.1 of NI 52-107 defines "acquisition statements" to include the financial statements of an acquired business or a business to be acquired that are included in a prospectus pursuant to Item 35, <u>but not</u> Item 32, of Form 41-101F1. We would encourage the CSA to consider whether there is a principled basis to distinguish between the requirements for acquisition statements included in a prospectus under Item 32.1(1)(b) of Form 41-101F1 and acquisition statements included in a prospectus under Item 35 of Form 41-101F1.

2. Optional Significance Test

We support the CSA's proposal to include an optional test for determining the significance of an acquisition and appreciate the CSA's acknowledgment that many companies grow during the three-year look-back period prior to filing a prospectus under NI 41-101. As drafted, however, the proposed optional test is impractical and insufficient because it would apply only if the acquired business remains substantially intact and is not significantly reorganized, and if no significant assets or liabilities are transferred to other entities. Most issuers that acquire businesses do not leave these businesses intact or maintain stand-alone financial statements. We recommend instead that the optional test permit significance to be measured based on either: (i) the most recent annual or interim financial data for the acquired business and the issuer based on internal books and records of the issuer (this assumes that the acquired business is a separate division or segment); or (ii) the most recent annual or interim financial statements of the acquired business prior to the date of the acquisition and the most recent *pro forma* annual or interim financial statements of the issuer on a *pro forma* basis contained in the prospectus.

3. Subsection 5.7(2) of 41-101CP – Exceptional Scenarios

Proposed subsection 5.7(2) of 41-101CP states that there may be exceptional scenarios where issuers may be required to include additional financial information, other than financial statements, in order for the prospectus to meet the requirement for full, true and plain disclosure. Subsection 5.7(2) goes on to indicate that additional disclosure might be needed and that an issuer should use the pre-filing procedures to determine what information will be required if, for example, the issuer has incurred significant growth through one or more acquisitions prior to its IPO filing resulting in "insufficient financial history of the primary business as disclosed in the prospectus" and:

- it was an IPO venture issuer that had acquired or proposed to acquire a business that result in any applicable significance test coming close to exceeding the 100% threshold in section 5.3 of NI 51-102;
- it was an issuer that had made or was proposing to make one or more acquisitions during the relevant period but financial disclosure was not triggered by Items 32 or 35 of Form 41-101F1; or
- it was an issuer that had completed a relatively large number of unrelated and individually immaterial acquisitions (that were not predecessor entities) in the relevant period prior to filing the prospectus.

We recognize that the over-arching requirement for a prospectus to meet the requirement for full, true and plain disclosure means that there may be situations where additional disclosure is required beyond what is specified in NI 41-101 and Form 41-101F1. Proposed subsection 5.7(2) (including the phrase "insufficient financial history"), however, has the potential to generate uncertainty as well as inconsistent interpretations of the requirements to provide historical financial information for acquired businesses.

4. Multiple Transactions prior to an IPO

Item 32 of Form 41-101F1 requires that financial statements and interim reports include certain financial statements of any business or businesses acquired by the issuer within three years before the date of the prospectus, or proposed to be acquired, that a reasonable investor would regard as being the "primary business" of the issuer. Although some of the examples in the proposed revisions to section 5.3 of 41-101CP are helpful, the optional test for evaluating the significance of an acquisition where an issuer has grown between the date of an acquisition and the IPO does not clearly address situations where an issuer has made multiple acquisitions within the three years before its IPO or has completed a pre-IPO acquisition and has a pending acquisition. We have set out below additional examples that we recommend the CSA address in proposed subsection 5.3(1) of 41-101CP:

- How should an issuer assess the significance of two unrelated acquisitions in different financial years, where each acquisition would meet the 100% significance threshold on its own, based on the completed financial year before the relevant acquisition, but the second acquisition would not meet the 100% significance threshold if significance is measured using more recent financial statements of the issuer or on a *pro forma* basis giving effect to the first acquisition?
- An issuer acquired two businesses prior to the IPO and, based on the most recent audited financial statements, each business represented exactly 50% of the assets of the issuer's business. Would each business be considered a primary business for purposes of the IPO prospectus (because each acquisition would trip the 100% significance test)? What if neither business represented 50% or more of the issuer's business based on the most recent financial statements

(because the issuer has other operations and neither acquired business would trip the 100% significance test)? Would neither business be considered a primary business?

5. Meaning of the Term "Immaterial"

The proposed amendments to 41-101CP use the term "immaterial" in two of the examples[4] without explanation. We recommend that the CSA provide guidance about the meaning of the term "immaterial" and its relationship to other terms in Form 41-101F1 and 41-101CP that classify transactions in terms of their significance. For example, if CSA Staff have established thresholds or parameters in the context of prior applications for exemptive relief concerning the Primary Business Requirements that they consider representative of "immaterial" acquisitions, it would be helpful to reflect these thresholds or parameters in 41-101CP or establish exclusions in Form 41-101F1 from the Primary Business Requirements in respect of past or pending acquisitions falling below these thresholds.

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Once again, we appreciate the opportunity to comment on the Proposed Amendments and would be happy to discuss any of our comments set out above with you by phone or by email.

Yours truly,

Janet Holmes
Glen R. Johnson
Daniel Masliyah
Karrin Powys-Lybbe
Rima Ramchandani

[4] Example 3 in proposed subsection 5.4(1) of 41-101CP describes a situation where an issuer that expected to acquire four real estate properties concurrent with the closing of its IPO would be expected to include audited financial statements (and related MD&A) for each of those properties but if one or more of the properties was "immaterial", the issuer should use the pre-filing procedures in National Policy 11-202 *Process for Prospectus Reviews in Multiple Jurisdictions*. Subsection 5.7(2) of 41-101CP indicates that additional financial information may be required if, for example, an issuer completed a relatively large number of unrelated and individually immaterial acquisitions (that are not predecessor entities) in the relevant periods prior to filing the prospectus.