DAVIES

155 Wellington Street West
Toronto, ON M5V 3J7 Canada

dwpv.com

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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
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

c/o

Me Philippe Lebel
Corporate Secretary and Executive Director,
Legal Affairs
Autorité des marchés financiers
Email: consultation-en-cours@lautorite.qc.ca

Larissa Streu
Senior Legal Counsel, Corporate Finance
British Columbia Securities Commission
Email: lstreu@bcsc.cbc.ca

Dear Sirs/Mesdames:

Re: CSA Notice and Request for Comment – Proposed Amendments to National Instrument 45-106 *Prospectus Exemptions* to introduce the Listed Issuer Financing Exemption

We are writing in response to CSA Notice and Request for Comment – Proposed Amendments to National Instrument 45-106 *Prospectus Exemptions* to introduce the Listed Issuer Financing Exemption (the "**Request for Comment**"). We strongly support capital raising initiatives that increase efficiency, reduce costs and minimize regulatory burden where those initiatives do not come at the expense of investor protection and market confidence. While we applaud the Canadian Securities Administrators (the "**CSA**") for considering a novel approach to facilitate capital raising, we have significant concerns that the listed issuer financing exemption proposed in the Request for Comment (the "**Listed Issuer**

Financing Exemption”) fails to achieve an appropriate balance between market efficiency and investor protection.

To facilitate the CSA’s review, we have structured this letter to conform to the structure of the Request for Comment, beginning with general comments regarding the Listed Issuer Financing Exemption followed by our responses to some of the specific questions identified in the Request for Comment. For ease of reference, the specific questions on which we have commented are reproduced below in bold and use the same numbering as the Request for Comment.

A. General Comments

In our view, the Listed Issuer Financing Exemption would adversely impact confidence in our capital markets due to a diminished use of prospectuses and a corresponding diminished role for registered investment dealers and Canadian securities regulators. Moreover, it would increase the risk of fraud because the issued securities would be of a listed class and freely-tradeable, and so could be sold immediately, thereby introducing new securities into the public markets without any independent assessment of the currency or quality of the issuer’s disclosure. These risks are exacerbated by the likelihood that most issuers that distribute securities in reliance on the Listed Issuer Financing Exemption would be smaller issuers that are not well-known by market participants (i.e., the issuers most in need of the diligence function performed by registered dealers and the review by securities regulators), and that investors that purchase those securities are likely to be retail investors (i.e., the investors most in need of the protections afforded by a prospectus).

The core premise underlying the Listed Issuer Financing Exemption appears to be that comprehensive continuous disclosure coupled with secondary market liability is sufficient to elicit quality disclosure and police and deter bad disclosure. This premise is reasonable in certain limited circumstances. One such circumstance is a well-known seasoned issuer (“**WKSI**”) model that would allow specified issuers to qualify unspecified amounts of different types of securities by way of an automatic shelf without prior review by any Canadian securities regulator or any other delay. Critical to the success of a WKSI model, however, is that eligible issuers must be ‘well-known’ in that they must have a wide market following and associated scrutiny of their disclosure by analysts, institutional investors and the financial community generally. It is the ‘well-known’ nature of these issuers coupled with their ‘seasoning’ from having a reporting track record that provides comfort that an automatic shelf option would not meaningfully diminish the investor protection that would otherwise be afforded by the traditional prior regulatory review of their shelf prospectus.

The Listed Issuer Financing Exemption, however, only relies on an issuer’s ‘seasoning’ and disregards any requirement for the issuer to be ‘well-known’. In doing so, it presumes that secondary market disclosure is sufficient in all circumstances such that neither a prospectus nor a hold period is necessary in order to protect the integrity of the Canadian capital markets where issued securities will become freely-tradeable upon issuance. In our view, the fundamental flaw with this premise is that the secondary market works only with the prospectus regime supporting it. The prospectus requirement and the role that registered investment dealers and CSA staff play in prospectus offerings are the regulatory cornerstones of capital raising. While the prospectus process is beneficial to direct investors participating in the offering, the benefits derived from the diligence function and regulatory review of the prospectus are just as important to the fabric of our capital markets. If applied regularly for a sufficient number of issuers, the prospectus process benefits the Canadian capital markets as a whole by providing an assurance as to the quality of secondary market disclosure. This assurance is diminished both with respect to individual issuers and reporting issuers generally by providing issuers with a way to sidestep the prospectus process indefinitely but still access the Canadian public markets for capital raising.

Helping smaller issuers raise capital efficiently is an important goal. However, the ends do not justify the means. Facilitating capital raising should not come at the expense of market integrity. It cannot be the case that, at a small enough deal size, it is too expensive to conduct a prospectus offering and therefore that, below that deal size, issuers should be able to avoid the prospectus process. This fails to factor in the cost to the integrity of our markets and the indirect impact on every other market participant that is harmed by bad actors that will take advantage of this exemption. Notwithstanding that the Listed Issuer Financing Exemption contemplates limits on the dollar amount that an issuer may raise during any 12-month period, a market's reputation is not proportionately impacted by fraud on a dollar-for-dollar basis, and multiple public frauds will cast doubt on the efficacy of Canadian securities regulation.

The Listed Issuer Financing Exemption will result in fewer prospectus offerings

Although the Listed Issuer Financing Exemption may not result in a meaningful decrease in the number of prospectus offerings conducted by larger issuers due to the limit on the total dollar amount that an issuer can raise, we believe that it would significantly reduce the number of prospectus offerings conducted by smaller issuers. When given a choice, smaller issuers would invariably rely on the Listed Issuer Financing Exemption because they would obtain the same pricing without the corresponding process, disclosure and other requirements of a prospectus by virtue of the securities being freely-tradable immediately upon issuance. While fewer prospectus filings appears to be the very purpose of the Listed Issuer Financing Exemption, we do not believe that fewer prospectus filings would be a positive development for the Canadian capital markets. The rigorous process and robust disclosure requirements mandated by the prospectus regime are fundamental to eliciting quality disclosure. In turn, this disclosure is critical to the efficient functioning of, and market participants' confidence in, the Canadian capital markets both for the appropriate pricing of primary offerings and for secondary market trading.

The Listed Issuer Financing Exemption will result in a diminished role for gatekeepers

Registered Canadian investment dealers are crucial players in the prospectus process due to their market and industry expertise. Among other things, these qualified underwriters, in collaboration with their legal counsel and other experts, undertake rigorous due diligence in order to certify that, to the best of their knowledge, information and belief, the prospectus contains full, true and plain disclosure of all material facts relating to the offered securities. Because the Listed Issuer Financing Exemption would permit issuers to distribute freely-tradable securities without the involvement of a registrant, we expect that most issuers would choose not to involve a dealer assuming that they can make a credible argument that they do not trip the registration business trigger. While not involving registrants may save issuers money, we believe that there would be significant costs from a market integrity perspective.

A second independent check on the accuracy and completeness of an issuer's disclosure is conducted by CSA staff that are assigned to review a prospectus. Staff frequently identify deficiencies or insist that disclosure be supplemented or clarified for the benefit of both the purchasers under the prospectus and, by extension, secondary market purchasers. By virtue of the fact that a receipt must be issued in order for the offering to proceed, issuers typically have to address staff's comments to staff's satisfaction. In the absence of such a review, we are concerned that some issuers would be more willing to cut corners and obfuscate disclosure on the basis that it is easier to ask for forgiveness than permission.[1]

The Listed Issuer Financing Exemption will increase the risk of indirect distributions and mischief in the market

For the reasons noted above, in the absence of a prospectus, there would be no independent check on the currency or quality of an issuer's continuous disclosure. Further, if investors are permitted to freely resell without any hold period, there would inevitably be more indirect distributions.[2] Each of these results individually would lead to a significantly higher risk of 'pump and dump' schemes and other mischief in the market in connection with capital raisings. Together, that risk increases exponentially.

That risk is exacerbated by the fact that it is smaller issuers that would be most likely to distribute securities in reliance on the Listed Issuer Financing Exemption. All else being equal, smaller issuers are more likely to have deficient disclosure than larger issuers because they have fewer resources to devote to their controls and procedures and few or no analysts or institutional investors that might otherwise police such deficiencies. It is these smaller issuers for which good, current disclosure is most critical because they may be of a speculative investment quality and their market price more susceptible to volatility based on real or perceived developments. Worse still is that purchasers under the Listed Issuer Financing Exemption are likely to be less sophisticated retail investors who are more easily misled, who are generally not in a position to protect themselves and who are in no way an

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1 A related concern is that the Listed Issuer Financing Exemption would not be available if an issuer intends to use the proceeds for a significant acquisition or restructuring transaction such that additional financial statements would be required under prospectus rules. However, there does not appear to be anything built into the Listed Issuer Financing Exemption that would prevent bad actors from distributing securities and, once the offering is complete, actually using the proceeds for a significant acquisition or a restructuring transaction. Staff could consider taking enforcement action, however we anticipate that it would be challenging for staff to prove that the issuer's intention at the relevant time was to use the proceeds for a significant acquisition or a restructuring transaction.

2 We note that the CSA has attempted to address concerns with indirect distributions in subsection 3.12(8) of Companion Policy 45-106CP *Prospectus Exemptions* by stating that "[t]he distribution under the exemption and the subsequent resale may be considered in substance a single distribution", and that "purchasers that purchase with an intention to immediately resell the securities in the secondary market should consider the definition of underwriter in securities legislation and whether they are required to be registered." Although correct, the guidance does not meaningfully reduce the risk of indirect distributions, as it will be difficult (if not impossible) for the CSA to police this in practice.

effective filter to protect the secondary markets. These factors create a perfect storm that we anticipate will result in exponentially more ‘pump and dump’ schemes and other mischief in the market.

The premise of the Listed Issuer Financing Exemption is flawed

From an initial sale perspective, the Listed Issuer Financing Exemption would allow most issuers to distribute their listed securities to anyone, provided that, among other things, the issuer has filed all timely and periodic disclosure documents and supplements its continuous disclosure with a short offering document. In this way, it affords an issuer an unlimited audience of potential investors without regard to their ability to independently assess the investment, much like a prospectus offering *but without the associated process and protections*.

Whether an initial sale or resale, the rationale for the Listed Issuer Financing Exemption appears to be that investment decisions can be made exclusively in reliance on a reporting issuer’s continuous disclosure record. Implicit in this rationale is that the only value of a short form prospectus is to update an issuer’s disclosure record and disclose the terms of an offering. As noted above, this premise is flawed, as it fails to attribute the value to both the primary and secondary markets derived from prospectus offerings and their associated processes. Again, this is particularly troubling given the nature of the issuers that are most likely to distribute securities in reliance on the Listed Issuer Financing Exemption and the nature of the investors most likely to subscribe for those securities.

If adopted, the availability of the Listed Issuer Financing Exemption should be limited

If the Listed Issuer Financing Exemption is adopted notwithstanding the concerns noted above, we submit that an issuer that has undertaken a reverse takeover (“**RTO**”) and that has not had a receipt issued for a prospectus subsequent to the completion of its RTO should be prohibited from relying on the exemption. Although RTOs are exchange-regulated processes that are common in the Canadian capital markets, they do not attract the same level of regulatory scrutiny as an initial public offering. In this regard, we are concerned by the possibility of a private company going public via an RTO with a listed shell company that has been a reporting issuer for at least 12 months and immediately distributing millions of dollars of freely-tradable securities to retail investors without a CSA member’s blessing. In our view, the ability to rely upon the Listed Issuer Financing Exemption should be restricted to issuers that the CSA has carefully vetted as opposed to those that only a stock exchange has vetted in order to mitigate the associated risks canvassed elsewhere in this letter.

B. ***Responses to Specific Questions***

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 do not believe that the proposed thresholds are inappropriate as they apply to larger issuers, although would reiterate our view that a market's reputation is not proportionately impacted by fraud on a dollar-for-dollar basis. However, we have concerns with the proposed thresholds as they apply to smaller issuers. An issuer that has listed securities with an aggregate market value of $5 million would be permitted to issue $5 million worth of freely-tradable securities without a prospectus in any 12-month period. In our view, an issuer doubling its market capitalization in this manner would be problematic given that such an issuer would have very few resources available to devote to compliance with its disclosure and other public company obligations, particularly where the purchasers are likely retail investors that are unlikely to have the expertise necessary to make investment decisions and the financial means to withstand significant losses. Moreover, an issuer of that size is much more likely to be listed on the TSX Venture Exchange or another junior exchange that may not have rules that protect against highly dilutive placements.[3] Finally, we consider it odd that an issuer that has listed securities with an aggregate market value of $50 million would have the exact same $5 million annual limit despite having considerably more resources to devote to compliance.

We recognize that the purpose of the Listed Issuer Financing Exemption is to facilitate capital raising for smaller issuers. However, the universe of smaller issuers is vast; an issuer at one end of that spectrum has little in common with an issuer at the other end. Accordingly, if the Listed Issuer Financing Exemption is adopted, we would recommend that it only be available to issuers that have listed securities with an aggregate market value above $10 million. While we recognize that this would exclude certain legitimate issuers that take their compliance and disclosure responsibilities seriously, we believe that a cut-off is necessary in the interests of investor protection and market confidence.

Related to the above-noted thresholds, subsection 5A.2(2) provides that "the aggregate market value of an issuer's listed securities is calculated by multiplying the total number of listed securities outstanding, by the closing price of the listed securities on the exchange in Canada on which the class of listed

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[3] The TSX Venture Exchange Corporate Finance Manual contemplates shareholder approval for an issuance that results in the creation of a new control person or that constitutes a non-exempt related party transaction for purposes of Policy 5.9 *Protection of Minority Security Holders in Special Transactions*, however we do not expect that it would be difficult for an issuer to avoid these requirements by distributing securities to a sufficiently large number of arm's length purchasers.

securities is principally traded." We would instead propose a volume-weighted average price (either 5- or 20-day) or, at a minimum, a 20-day simple average (see e.g., section 1.11 of National Instrument 62-104 *Take-Over Bids and Issuer Bids*), either of which would help to smooth out any daily volatility in an issuer's share price. If the CSA decides not to make this change, we believe that the provision should at least be clarified so that aggregate market value is calculated by multiplying the total number of listed securities outstanding by the closing price of the listed securities *on the last trading day on which there was a closing price* on the exchange in Canada on which the class is principally traded.

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?

In our view, issuers should not be permitted to distribute convertible debt in reliance on the Listed Issuer Financing Exemption. Most investors are familiar with listed equity securities and warrants. With certain limited exceptions, such as issuers with dual class share structures, the rights that attach to these securities do not typically vary significantly from issuer to issuer. That cannot be said for convertible debt, which has multiple variables including with respect to interest rate, maturity, mandatory and optional conversion features, covenant packages and implications upon a change of control transaction. We do not believe that a significant majority of non-accredited, retail investors would be familiar with convertible debt, nor do we believe that they would take the time to carefully review the indenture or other governing instrument. In light of the fact that there are no restrictions on the universe of people that would be able to acquire securities under the Listed Issuer Financing Exemption, more complex securities such as convertible debt should be excluded.

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.

(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 do not believe that the proposed liability regime for the Listed Issuer Financing Exemption provides appropriate incentives for issuers to provide accurate and complete disclosure. We would instead recommend imposing prospectus level liability.

We understand that the rationale for imposing secondary market liability is due to the fact that the Listed Issuer Financing Exemption is premised on the accuracy of an issuer's continuous disclosure and limited to distributions of listed equity securities. However, this is equally true for short form prospectus offerings, which attract prospectus level liability. Leaving aside the absence of the critical procedural protections discussed above, the Listed Issuer Financing Exemption resembles a watered-down version of the short form prospectus process in terms of the qualification criteria and the requisite disclosure in the applicable offering document. Given such similarities, we do not believe that there is a sufficiently good reason to impose a lesser standard in connection with an offering conducted in reliance on the Listed Issuer Financing Exemption.

We also note that the Request for Comment provides that "[s]econdary market civil liability puts purchasers under the Listed Issuer Financing Exemption on the same footing as investors in the secondary market." While true, it is not clear *why* such purchasers should be put on the same footing as secondary market purchasers given that they are not purchasing in the secondary market, but are rather participating in a treasury issuance.

As a practical matter, the existence of proportionate liability and liability limits under the secondary market liability regime are such that it is rarely worthwhile for a security holder to bring an action against a smaller issuer for an alleged misrepresentation. As discussed in the Request for Comment, the Listed Issuer Financing Exemption was designed specifically for smaller issuers that cannot afford the costs of completing a short form prospectus offering. It follows that the imposition of secondary market liability would provide no meaningful protection or recourse for subscribers in the majority of offerings conducted in reliance on the Listed Issuer Financing Exemption. Given the significant investor protection-related concerns with the Listed Issuer Financing Exemption discussed above, these are precisely the types of offerings for which meaningful safeguards are required.

> **(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?**

We do not believe that imposing prospectus level liability would have a significant adverse impact on the objectives of the Listed Issuer Financing Exemption. Given that the offering document would have to contain disclosure of all material facts about the issuer and the securities being distributed, it is not clear why or how prospectus level liability would necessitate *more* disclosure by an issuer and a longer offering document for investors to read. To the extent that prospectus level liability would have any impact on an issuer's decision making process vis-à-vis its disclosure, we would expect that it would simply result in issuers providing *better* disclosure by being more careful with respect to any potential misrepresentations.

Even if imposing prospectus level liability would make offerings under the Listed Issuer Financing Exemption slightly more expensive for issuers and result in marginally longer disclosure documents for investors, such costs are more than offset by the corresponding benefits from an investor protection perspective. Given the inherent risks of a regime that permits almost any issuer to distribute freely-tradable securities to unsophisticated retail investors without any independent check by registered dealers or securities regulators, enhanced protections are critical in order to mitigate the potential for frauds on the market. While prospectus level liability is not sufficient in this regard, it at least provides a small measure of comfort that investors may have some meaningful recourse when these risks crystallize.

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

In our view, it is the absence of registered dealers and the important gatekeeping role that they play that will lead to lower standards of disclosure rather than the absence of statutory liability for dealers. We do not expect many small issuers that choose to distribute securities in reliance on the Listed Issuer Financing Exemption to retain a dealer in connection with their offerings. Accordingly, absent mandatory dealer involvement for such offerings, we do not believe that the absence of statutory liability for dealers will further lower issuers' disclosure standards.

(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 do not believe that it would be unduly burdensome for issuers to enter into agreements with purchasers. We would expect that such agreements would quickly develop into standard form contracts with little or no variation as between purchasers. As such, the costs to the issuer from a legal perspective should be minimal.

C. ***Conclusion***

In our view, the benefits to be derived from the Listed Issuer Financing Exemption are trivial when compared with the decidedly negative impact that it could have from an investor protection and market confidence perspective. As noted above, the premise of the Listed Issuer Financing Exemption is fundamentally flawed because it fails to attribute adequate value to the prospectus process. As with any capital raising proposal that allows for the sale of freely-tradeable securities without a qualifying prospectus, consideration must always be given as to how significantly it could impair confidence in our capital markets due to a diminished use of the prospectus regime and a diminished role for registered investment dealers and Canadian securities regulators.

We recognize and appreciate that it can be expensive and time-consuming for smaller issuers to raise capital by way of a prospectus. However, the solution should not be to allow issuers to circumvent the prospectus process entirely and jeopardize the efficacy of Canada's closed system. Rather, the solution ought to be to examine how the existing elements of the prospectus regime can be modified to make the process cheaper and more efficient while still maintaining adequate safeguards against poor disclosure and fraud. In our view, the benefits of the Listed Issuer Financing Exemption are far outweighed by its immense costs and we would strongly recommend that the CSA not proceed with its adoption.

If the CSA nevertheless insists on moving forward with the Listed Issuer Financing Exemption, we recommend that the CSA make a number of changes to the exemption in the interests of investor protection. Specifically, the CSA should impose prospectus level liability and should not allow the exemption to be used in connection with offerings of convertible debt, by issuers that have listed securities with an aggregate market value below $10 million or by issuers that have undertaken an RTO and that have not had a receipt issued for a prospectus subsequent to the completion of the RTO.

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The following lawyers at our firm participated in the preparation of this comment letter and may be contacted directly should you have any questions regarding our submissions.

Robert S. Murphy	David Wilson	Jordan Lavi
416.863.5537	416.863.5517	416.367.7624
rmurphy@dwpv.com	dwilson@dwpv.com	jlavi@dwpv.com