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BY E-MAIL

Alberta Securities Commission
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Saskatchewan Financial Services Commission

Request for Comments on Proposed National Instrument 41-101, Companion Policy 41-101CP and Related Amendments

We are writing in response to the request of the Canadian Securities Administrators (the "**CSA**") for comments (the "**Request For Comments**") in respect of the proposed National Instrument 41-101 *General Prospectus Requirements* (the "**Instrument**"), Companion Policy 41-101CP (the "**Policy**") and the related amendments, all as published on December 22, 2006.

We strongly support the CSA's objectives of consolidating and harmonizing the general prospectus requirements in a single national instrument and integrating such requirements with those related to the continuous disclosure regime and distributions through alternate forms of prospectus. We appreciate the opportunity to provide comments on the Instrument and Policy and note that, other than as set out below, we are generally supportive of the substantive changes that the CSA has proposed in connection with the harmonization initiative.

1. <u>Part 4: Financial Statements and Related Documents</u>

We agree that harmonization of the financial statements requirements of a long form prospectus to the two years required under a short form prospectus is sufficient for the protection of investors. However, we note that in the case of certain reporting issuers that do not currently file electronically on SEDAR, investors may not have ready access to the earlier financial statements that have been filed (but are not included in the long form prospectus). We submit that the CSA should consider whether to make the relief in section 32.4 of proposed Form 41-101F1 (the

"**Form**") contingent on such financial statements being made available on SEDAR at the time the preliminary prospectus is filed.

2. <u>Part 5: Certificates</u>

(a) General

While we appreciate that certain of the "opt-outs" in the Instrument are required as a result of differing rule-making authority across jurisdictions and that certain of the requirements are otherwise provided for in applicable provincial securities legislation, we have some concerns regarding "opt-outs" in what is purportedly a harmonized rule. As Canadian prospectus offerings typically extend beyond a single jurisdiction, we are concerned about the interaction of the applicable regimes created by the "opt-outs" under the mutual reliance review system. This possibility may become particularly problematic where a non-principal regulator has a discretionary ability to require certification of a prospectus by an additional party. If a non-principal regulator indicates that it will require an additional certificate at the comment letter stage, there would arise serious timing considerations relating to the offering as, for the offering to be completed on its previously anticipated timelines, those executing the certificate would be required to perform appropriate diligence on a severely time limited basis. We are further concerned that, as such certificate requirements would not be addressed by the principal regulator, there is the potential that an issuer would have to engage all of the other regulators in separate discussions, defeating the goals of the mutual reliance review system. We submit that if the substantive "opt-outs" are maintained in the final version of the Instrument, the CSA should provide guidance clarifying process where a prospectus is filed in multiple jurisdictions and the principal regulator has "opted-out" of a relevant provision.

In addition, in the interests of transparency, we believe that the CSA should consider indicating, whether in Policy or elsewhere in the Instrument, where a jurisdiction has "opted-out" because the applicable requirements are elsewhere in that jurisdiction's securities laws.

(b) Trust Issuers

The Instrument specifies that a certificate of an issuer that is a trust, if the trustee is a company, must be executed by, among others, the chief executive officer, chief financial officer and two directors of the trustee. We submit that where an issuer that is a trust has an independent trust company acting as its trustee, such certification requirements would not provide any additional benefits to investors and may impose additional costs upon the issuer surrounding prospectus offerings.

(c) Substantial Beneficiary of the Offering

We have serious concerns regarding the new requirement that a "substantial beneficiary of the offering" be required to sign a prospectus certificate and its potential effect on issuers and the Canadian business community in general. First, we do not agree with the stated premise that "a person or company that controls the issuer or a significant business has the best information about the issuer or a significant business". There are many examples of issuers where control persons have no additional information regarding the issuer beyond that which is available to the public. We submit that an issuer's management generally has the best information regarding the issuer or a significant business. Where a business has been recently acquired by an issuer, the issuer's management is best placed to synthesize past information regarding the acquired business (obtained from the vendor or from the issuer's due diligence) with current information about the issuer and management's intentions for the acquired business to provide disclosure regarding the acquired business in the context of the issuer as a whole.

We submit that the costs of this additional certification requirement would be significant. As the contemplated certificate is not limited in scope to the disclosure that is relevant to the significant beneficiary of the offering, but relates to the entire prospectus, the additional signatory will need to perform due diligence on the content of the entire prospectus. Also, the additional liability imposed by new certification requirement may act as a disincentive for vendors to sell businesses to Canadian issuers that will finance the acquisition by a public offering. As a result of this additional, a potential vendor will likely either require greater consideration from an issuer that plans to access the Canadian capital markets to finance the acquisition or choose to sell to a purchaser where no additional liability will be incurred. Accordingly, we submit that the substantial costs and potential detrimental effects of requiring a prospectus to include certificates of a substantial beneficiary of the offering do not justify the limited benefits that additional certifications would yield.

We also are concerned that where a substantial beneficiary of the offering owns part of the issuer, such person becomes be responsible for the disclosure in two different ways: directly, through its execution of the prospectus certificate, and indirectly, through its ownership of an interest in the issuer. We submit that this double liability is not a fair allocation of the risk associated with a public offering. In addition, such additional liability may act as a deterrent to *bona fide* intercompany transactions, such as refinancing indebtedness of a publicly traded subsidiary to its parent. Where the parent has provided temporary funds for an issuer, it should not incur double liability merely because of its ownership relationship with the issuer. We submit the outcome of this additional certification requirement will be to discourage valid and useful intercompany financing strategies that both benefit the issuer and provide increased financing flexibility to benefit the capital markets as a whole.

Although we are uncertain of the specific policy rationale behind this additional certification requirement, and are unaware of any abuses of the market against which this requirement is designed to protect, we suspect that it may be related to trust structures. We are unsure that instituting such a rule of general application is the best course of regulation, particularly where, as a result of other legislative changes, the issue may recede in importance.

(d) Discretionary Certificate Requirements

The Instrument provides regulators, except in Ontario, with discretion to require any selling security holder or control persons or other persons to execute a certificate in a prospectus. Our related concerns are threefold. First, in respect of the certificate requirements for selling shareholders and control persons, we submit that in the interests of transparency, guidance should be provided as to when regulators intend on requiring additional certificates. Second, we have concerns regarding the unfettered nature of the certificate obligations in these two sections. We understand that section 5.16 merely preserves the unfettered right that regulators in certain jurisdictions have to require a certificate; however we submit that it should be made clear in the instrument that regulators will not exercise that right unless it is in the public interest to do so. Finally, we believe that the unfettered and discretionary nature of such certification requirements reduces the transparency and certainty in public offerings that benefits all market participants.

3. <u>Part 6: Amendments</u>

In response to question 11 in the Request For Comments, we submit that the CSA should not make changes to the rules relating to the amendment of prospectuses. Specifically we do not believe that "continued accuracy of the prospectus" is an appropriate standard for requiring an amendment to either a preliminary prospectus or a prospectus. In respect of both preliminary prospectuses and prospectuses, we anticipate that such a new lower standard would dramatically increase the number of amendments that would be required, and impose upon issuers the associated increased costs. In addition, a lower threshold for amendments increases the uncertainty of timing relating to an offering, as presumably a period for review by the regulators of an amended document would still be necessary for each amendment. Such reduced threshold for amendments may also increase confusion of potential investors in situations where there are numerous amendments. We note that there is limited, if any, informational benefit of such a reduced threshold for amendments, particularly in the case of a prospectus, where the current regime requires amendments in response to a "material change" in respect of the issuer. The proposed new standard of "continued accuracy" would require amendments where there are changes in the affairs of the business, operations or capital of the issuer that would not affect the market price or value of the issuer's securities. We question whether such a exercise is helpful to investors. We submit that making an issuer incur such additional expense for unnecessary amendments is not justified by the additional information, which we believe will be of limited value to investors.

4. <u>Part 9: Requirements for Filing a Prospectus</u>

In respect of the filing of material contracts, we support the CSA's efforts to clarify the current regime. Specifically, we believe it is helpful that the CSA has provided some guidance as to the type of contracts that it considers not to have been entered into in the ordinary course of business and we would not add any other types of contracts to the list set out at section 9.1(1). However, we are uncertain as to how the test that is set out in section 9.1(1)(b) regarding what constitutes "a contract to sell the major part of the issuer's products or services or to purchase the major part requirements of goods, services or raw materials" would be applied as a practical matter due to the lack of a common understanding of what would constitute a "major part" in such context. We suggest that the test be changed to incorporate the materiality standard used later in the paragraph such that it would read, "any continuing contract to sell the issuer's products or services upon which the issuer's business depends to a material extent or to purchase goods, services or raw materials upon which the issuer's business depends to a material extent…".

We note that in regard to the provision of the Policy setting out permissible redaction of sensitive information from a material contract for the reasons that disclosure of such information would violate confidentiality provisions, that section 3.6(3) of the Policy states "[a] boilerplate blanket confidentiality provision covering the entire contract would not satisfy this condition". We are concerned that such a change has the effect of imposing retroactively a new standard that affects the ability of contracting parties to keep information confidential. While new contracts can incorporate provisions that address the approach of the Policy, contracts drafted prior to the introduction of the Instrument do not have similar flexibility. Accordingly, the new regime provides no protection to confidential information of a counterparty to a material contract of an issuer, as there is no test for redaction that relates to disclosure that may be prejudicial to such counterparty. Further, the counterparty may not have the ability to ensure that its contracts with public issuers will be renegotiated to include the necessary specific confidentiality provisions. We ask that the CSA consider that the guidance in the second paragraph of section 3.2(3)(b) be limited to those contracts entered into after the Instrument comes into force or that some other means of protecting the confidentiality of a counterparty's sensitive information be provided.

5. Form 41-101F1 - Item 1: Cover Page Disclosure

We support the CSA's initiative in the Instrument to require that an issuer disclose a *bona fide* estimate of the range in which the offering price or the number of securities being distributed is expected to be set. We believe that such information is important to an investor in making an informed investment decision, and that such initiative will be helpful to the marketplace. Further, we support the proposal whereby disclosure in the preliminary prospectus in the consolidated capitalization table, earnings coverage ratios and *pro forma* financial information would be required to be calculated and disclosed using the mid-point of the pricing range. We believe that such information is helpful to investors in understanding the effects that the offering will have on the issuer. We also support the concept that pricing outside the disclosed ranges may be a material adverse change in respect of the issuer, and that as such may require an amendment to the preliminary prospectus be filed. We believe that such potential will serve as an incentive to issuers to consider, with the help of their advisers, a realistic set of estimates regarding an offering's pricing terms.

6. NI 44-102 – Shelf Distributions: "Novel" Specified Derivatives

(a) General

In general, we have significant concerns regarding the proposed amendments to NI 44-102 that relate to "novel" specified derivatives. First, we believe that the expansion of the definition of "novel" would materially reduce certain issuers' ability to access the capital markets and to offer to investors the opportunity to diversify their portfolios and invest in innovative investment products designed to meet investors' needs. It will also reduce product innovation and further widen the gap between Canada and the US capital markets where there exists a deep, established public market for structured notes.

In Canada, prior to the advent of the shelf system which enabled structured notes to be offered off the shelf, very few public markets derivatives securities were distributed. This was so because the conventional wisdom at the time shared among issuers and their advisors was that the time and expense involved in clearing such a product through the commissions, educating staff about the nature of the product and overcoming inherent biases against derivative-like securities simply made these products uneconomic to offer. These conditions fostered the development of the private unregulated market in bank deposit notes linked to indices, stocks and commodities ("**linked bank-deposit notes**"). A return to that regime in the guise of forcing prospectus supplements through an onerous novelty pre-clearance process can be expected to have the same chilling effect.

Our concerns in this regard are amplified by the commentary in the proposed rule to the effect that the CSA views many structured products to be similar to investment funds. In its commentary, the CSA has indicated that "the CSA is also interested in having an opportunity, prior to distribution, to determine whether certain elements of the investment funds regulatory regime should apply to such offerings". It is our position that structured debt securities, or equity linked notes, of the type currently being offered by prospectus by Royal Bank or Merrill Lynch are not, in fact, similar to investment funds. The type of products currently being offered by Royal Bank and Merrill Lynch (referred to in this letter as "**Passive Linked Securities**") are linked to benchmarks such as reference indices, stocks or commodities and are not actively managed, in contrast to structured products that are linked to managed investments, such as mutual funds and closed end funds ("**Managed Linked Securities**"). It is essential for the CSA to recognize the distinction between Passive Linked Securities and Managed Linked Securities. Indeed, while we share some of the CSA's concerns about Managed Linked Securities and the disclosure issues that may arise regarding fees, "fees on fees", conflicts and governance, for example, in the Managed Linked Security context, we do not agree that the same issues arise regarding Passive Linked Securities for the simple reason that these products are not managed.

Passive Linked Securities differ significantly from investment funds in several fundamental ways. An investor in a mutual fund, for example, is entitled to receive on demand, or within a specified period after demand, an amount computed by reference to the value of a proportionate interest in the whole or in part of the net assets of the issuer. In contrast, a Passive Linked

Security is a debt obligation of the reporting issuer under which the noteholder is entitled to receive payments determined by reference to the performance of a certain benchmark. While the payout profile of a Passive Linked Security would be linked to the performance of underlying securities, commodities or reference indices, as the case may be, absent an express right to redeem the notes, a noteholder would not be entitled to receive any amount from the issuer on demand. Furthermore, the calculation of the amount to be paid to holders of such structured notes would not, unlike in a mutual fund, be based on the net asset value of the underlying securities or reference indices. Rather, it would be determined in a manner that is quantitative, formulaic and discretion free. Nor are these Passive Linked Securities akin to non-redeemable investment funds within the meaning of National Instrument 81-106, including section 1.2 of the Companion Policy, because, among other things, they do not involve the "management" of investors' funds.

For example, Merrill Lynch’s global equity accelerator product was developed to address investors’ desire for an investment product that would give them exposure to the Global Equity market without currency exposure and without the large management fees associated with managed global equity investment funds.

Accordingly, we have significant concerns regarding the suggestion that the regulators would use the pre-clearance process to apply investment fund-type requirements to issuers that are not investment funds. In addition to the fundamental differences between investment funds and issuers of Passive Linked Securities, we believe more generally that there is a risk that the proposed change would have the effect of exposing issuers of Passive Linked Securities to an uncertain, non-transparent and potentially uneven disclosure regime under which issuers could be subject to a "moving target" of disclosure obligations depending on the extent to which the regulators view such securities to be "like an investment fund" (a comparison which we believe is not helpful, for the reasons set forth above). It is not clear what it would mean practically for the regulators to consider the applicability of the investment fund regime to any given Passive Linked Security.

As a general principle, in any event, we believe that the Commission’s determination of broad questions of general application, such as the type of regulatory regime that should apply to a particular type of offering, should occur in the policy development context and not within the context of a particular transaction-related filing. One of the cornerstones of securities law is the efficient functioning of the capital markets. In order for the capital markets to function efficiently, market participants must be governed by a transparent securities law regime. The proposed approach to pre-clearance processes would impose an unwritten regime on issuers of novel specified derivatives under which such issuers could be subject to certain aspects of the investment funds regime without being able to determine, in advance of a pre-clearance application, which aspects of the investment funds regime would be regarded by the regulators as applicable. This is not, in our view, an acceptable compromise. Moreover, it is our view that the CSA's concerns regarding Passive Linked Securities have already been addressed by the requirement that any prospectus include full, true and plain disclosure about the securities qualified thereby. However, if the CSA continues to believe that it should impose additional regulatory requirements on structured products in general, and Passive Linked Securities in particular, it is our view that any such additional rules should be plainly set forth in a rule, in respect of which market participants are consulted and have had an opportunity to comment, to ensure a level playing field among and a transparent regulatory regime applying to issuers of novel specified derivatives. We urge the CSA to consult further with market participants that issue derivative securities so that a more appropriate approach to pre-clearance applications can be developed.

(b) Definition of "novel"

We are of the view that the expansion of the definition of "novel" as proposed by the CSA is unnecessary because it would have the effect of requiring issuers to pre-clear supplements qualifying the issuance of types of securities that have been previously issued (in some cases, on a number of occasions) by different issuers. We believe that there is little rationale to support such a change; if the market is already familiar with a certain type of structured product, we see no reason to increase the time, costs and regulatory burden associated with offering such products on other issuers by imposing on such issuers a pre-clearance process.

In addition, the proposed change could, in fact, aggravate an inequality that may exist under the current regime. The rule currently in effect requires issuers to pre-clear prospectus supplements that qualify the issuance of specified derivatives that have not been publicly offered to date in Canada. As the CSA may be aware, a number of issuers issue a wide range of structured products to investors (i.e., linked bank deposit notes issued under Schedule III banks under *National Instrument 45-106 – Prospectus and Registration Exemptions*) pursuant to information statements. In contrast, reporting issuers that wish to issue derivatives under a shelf prospectus are subject to significantly more onerous disclosure requirements (in the form of prospectus-level disclosure) regarding the securities, as well as the pre-clearance regime, with respect to any type of product that has not been publicly issued to date. We understand that the rationale for pre-clearing novel specified derivatives is to allow the regulators to consider appropriate levels of disclosure in prospectus supplements in light of the fact that such securities may be unfamiliar to investors. However, we question the utility of the pre-clearance process with respect to structured products with which the market has already become familiar, such as linked bank deposit notes.

The proposed change to the definition of "novel" would create a similar problem in that the rule would give issuers that have already issued a certain type of derivative security easy access to the capital markets while imposing a burdensome pre-clearance process on issuers that have not to date offered such a product, even if the securities proposed to be issued are identical to a type of security that has already been publicly offered numerous times by other issuers. This would give issuers with a history of publicly offering derivatives a significant advantage over other issuers, with little apparent benefit to investors. We are of the view that, in light of the increasing familiarity of the market with structured products, there is no need to impose such an uneven regulatory regime on market participants. In fact, we would further suggest that the definition of novel be narrowed, rather than broadened, so that issuers would not be required to pre-clear prospectus supplements qualifying the issuance of derivatives that have been offered pursuant to an information statement under a prospectus exemption. Any issuers offering specified derivatives are required to include in their prospectus supplements full, true and plain disclosure regarding such securities; we are of the view that this basic requirement governing prospectus disclosure is sufficient to protect investors where the market is already familiar with the type of product being offered.

(c) Reduction of review period

We appreciate that the reduction of the review period from 21 days to 10 working days represents an attempt to address market concerns regarding the ability of issuers to take advantage of perceived market opportunities. However, we do not believe that the reduction in the review period would sufficiently address the concerns that market participants would have in this regard. First, the 10 working day period applies only to the initial comment letter of the regulators and would not, in fact, provide issuers with any certainty as to the time period within which they would be able to offer a novel specified derivative after submitting the relevant pricing supplement for pre-clearance.

Second, the rule as currently in effect does not set out the parameters that would govern the regulators' review under a pre-clearance application. We are of the view that the pre-clearance process should apply only to those aspects of a particular derivative security that are, in fact, novel. Because there is little guidance in the rule regarding the manner in which prospectus supplements will be reviewed, there is the possibility that the pre-clearance regime could be used to visit or revisit issues relating to aspects of the novel product that are not novel. It is our view that any review process that addresses aspects of a product beyond its novel features would be contrary to the spirit in which the pre-clearance procedure is intended. Therefore, we would suggest that the proposed rule be revised to provide that the review of any novel specified derivative would be limited to (i) the aspects of the securities that are novel and (ii) a consideration of the disclosure requirements directly applicable to the pricing supplement in question. In our view, the time periods should be no less favourable than those applicable to short form prospectus review under National Instrument 43-201. Furthermore, we would ask that the CSA consider adding an additional requirement that any comment letters beyond the initial comment letter sent to an issuer also be subject to a review period of 5 working days.

Please do not hesitate to contact Rob Murphy (416.863.5537) or Brooke Jamison (416.367.7477) if you wish to discuss any of our comments.

Yours very truly,

(signed) Robert S. Murphy

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