CASLA | Canadian Securities Lending Association

July 10, 2013

Via Electronic Submission

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

Anne-Marie Beaudoin, Corporate Secretary
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The Secretary
Ontario Securities Commission
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Dear Sirs/Mesdames:

RE: Proposed Amendments to Multilateral Instrument 62-104 *Take-Over Bids and Issuer Bids*, National Policy 62-203 *Take-Over Bids and Issuer Bids* and National Instrument 62-103 Early Warning System and Related Take-Over Bid and Insider Reporting Issues (the "Proposals")

We are writing to provide comments on behalf of the Members of The Canadian Securities Lending Association (CASLA) with respect to the Proposals.

CASLA is an industry association, the members of which are Canadian banks, trust companies, other financial institutions, securities dealers and other professionals that are leaders in the securities lending business. CASLA's members include CIBC Mellon, RBC Investor Services, Northern Trust, State Street Bank and Trust Company, BMO Capital Markets, Scotiabank, RBC Capital Markets, Société Générale Canada, National Bank Financial, Desjardins Financial and the Canadian Pension Plan Investment Board. Part of CASLA's mission is to work with regulators and other industry associations to ensure an efficient and secure marketplace for securities

lending activities. CASLA advocates for the common interests of securities lending market participants, including custodian banks, beneficial owners, asset managers and broker-dealers.

We appreciate and generally support the CSA's efforts to increase market efficiency by providing further transparency about significant holdings of issuers' securities and enhanced disclosure of securities ownership positions; however we have general concerns with the potential impact that the provisions of the Proposals related to securities lending, if adopted, could have on the securities lending market in terms of competition, privacy, and liquidity.

Securities lending makes a significant contribution to enhancing market liquidity and, in so doing, it makes market transactions more efficient by increasing the number of securities that are available in the market. This allows securities borrowers to meet their delivery obligations if they do not have enough securities on-hand and gives beneficial owners more flexibility in addressing risk concentration and financing matters. As well, many beneficial owners, such as investment funds, pension plans and corporate lenders use this technique to enhance revenues and returns for their investors. While we recognize that securities lending activity may increase in the period before a shareholders' meeting, this increased activity may not be related to voting, but rather may be so securities borrowers can benefit from dividend payments. Moreover, there is very limited evidence that "empty voting" actually occurs in Canada and one may consider the opacity of the voting process, itself, to be the prevalent cause of the perception of empty voting, such that simply increasing the level of disclosure of securities lending arrangements, may not actually solve the problem of empty voting.

Increased Volume of Reporting

Lowering the threshold from 10% to 5%, and adding decreases in ownership of 2% or more of the applicable securities as an additional trigger, will require more securities lending participants to publicly disclose their holdings. This increase in the volume of disclosure may result in increased compliance and administrative costs that may cause some market participants to stop their securities lending activities. As well, the increased volume of reporting made available to the public may cause pertinent information that is material to changes in ownership to be lost in the excess "noise" in the market. While a decrease in ownership may be relevant, in certain cases, the current "material fact" test is a better standard to apply to this type of change.

Exemptions from Early Warning Reporting Requirements

We support adding an exemption for lenders in securities arrangements from the requirements, however as discussed further below, we would suggest that certain types of borrowers be granted a similar exemption and that both the definition of "specified securities lending arrangement" and "securities lending arrangement" be streamlined in order to recognize industry practice and to focus more specifically the purpose of the Proposal (namely, what types of acquisitions or transfers of securities should trigger the early warning reporting requirements).

We urge the CSA to consider which party (lender or borrower), in the context of securities lending arrangements, is ultimately the most appropriate person to do the reporting. A borrower that is borrowing securities for transactional purposes should not be subject to the same disclosure requirements as a borrower that is borrowing securities to hold as a long position. In today's market, it is most unusual for an institutional securities borrower to hold onto borrowed securities and to either vote borrowed securities or accept voting instructions from the lender. It is important to recognize that securities lending activity is generally not comprised of a single loan by a lender to an "end-user" borrower. Securities are most often

borrowed (in quantities that would trigger reporting) to cover short sales or to further on-lend (i.e. for transactional purposes). As written, the Proposal would require a borrower to report even if it has no intention of retaining the borrowed securities and/or exercising the right to vote. As noted above in respect of the change of thresholds, this may lead to duplication of non-material information and an excess of information and "noise" in the market generally thereby diverting market attention from the focus of the Proposal, namely, to alert market participants to acquisitions of substantial holdings (whether through securities lending transactions or otherwise) done with the intention of effecting the control of the issuer. We would submit that borrowers that on-lend or borrow to cover short sales are not seeking to affect control of the issuer and should therefore be exempt in the same respect as lenders are exempt under the Proposal. In this regard, it would be more efficient and effective for the reporting obligation to be given to the ultimate end-user or "holder" of the securities and not to each borrower that acquires the securities as part of securities lending arrangements, generally[1].

Definition of Specified Securities Lending Arrangement

With respect to the proposed definition of "Specified Securities Lending Arrangement", we note that it is standard industry practice for the parties to document the material terms of all securities lending arrangements under a written agreement (generally in the form of an industry-standard master agreement) which is executed by both parties. As well, lenders (either themselves or through their lending agents) maintain records and/or receive reporting from their custodians and/or agent lenders showing both securities held in their custody accounts and loaned securities. As such it is not necessary to include these requirements (as set out in paragraphs (a) and (c) of the definition of "specified securities lending arrangement") as qualifying factors for the proposed exemption.

As well, it is important to differentiate between voting, in respect of corporate events, where the lender has a right to instruct, and receive, their chosen entitlements from the event, and an annual general meeting or extraordinary general meeting vote which the lender does not have the right to vote at during the terms of a loan. We assume that the Proposal is not intending to regulate the former situation. Sub-paragraph (d)(ii) of the definition of "specified securities lending arrangement" appears to refer to the former situation. Borrowers generally do not take instructions from lenders in the latter case as lenders are able to recall their loaned securities should they wish to vote.

We would therefore suggest consolidating both definitions into the following definition of "securities lending arrangement "

> "securities lending arrangement" means an arrangement under which (a) the lender transfers title to securities to a borrower; (b) the lender has the right to terminate the loan or to call for redelivery of equivalent securities by the borrower; and (c) the borrower is obligated to pay to the lender amounts equivalent to any interest, dividends or other distributions in respect of the loaned securities to which the lender would have been entitled to received had such securities been retained by the lender on the relevant payment date."

Should the CSA accept our proposed changes to the definitions, as outlined above, we further propose that, for the reasons mentioned earlier in our letter, you amend Section 5.5 of the Instrument (and, similarly, Section 7.3 of the Ontario Rule) to read as follows:

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[1] Note that the United Kingdom's rules on notification of the acquisition or disposal of major shareholdings are drafted on this basis. See further *Rule DTR5.1* of the *FCA Handbook* issued by the UK Financial Conduct Authority.

"5.5 Sections 5.2 and 5.3 do not apply to: (a) securities transferred or lent by a lender under a securities lending arrangement; or (b) acquired or borrowed by a borrower under a securities lending arrangement where such securities (or equivalent securities) are on-lent or otherwise transferred by the borrower within the standard settlement period for such securities and the borrower does not exercise the voting rights attached to such securities."

This amendment will have the effect of focusing the reporting obligation on the ultimate holder of the securities (and person intending to exercise the voting rights) and eliminating the excess noise before it becomes public, which we believe will be a more effective way of monitoring and exposing voting practices.

It is common practice for lenders and borrowers to allow for the substitution of securities on loan and/or securities delivered as collateral for equivalent securities during the term of the loan. We would like to clarify that substitution is a form of recall and, similarly, should not trigger the early warning reporting requirements.

Calculation of Early Warning Reporting Threshold

Following from our above comments, for the purposes of determining whether a threshold has been triggered, lenders and borrowers should be able to calculate (and report) the principal amounts of their securities holdings on net basis so that only the net percentage of securities held at the relevant time would be relevant for the calculation. We recognize that it is current practice under the AMR regime to report net positions at month-end and this should remain in the final regulations. As discussed further below in our comments on transparency, this will avoid over-reporting and saturation of the market with information that may be neither timely nor relevant.

Transparency

Finally, while we appreciate the CSA's efforts to increase transparency to investors of investment funds' securities lending and repo activities, generally, our members are opposed to the proposed public disclosure of any reportable securities lending arrangement and specified securities lending arrangements. The Proposals are not the appropriate venue for a general discussion of transparency of securities lending arrangements, overall. Moreover, securities lending agreements are commercial agreements entered into between arm's length parties which often contain confidential business and financial information. It is our strong assertion that public disclosure of these agreements, in whole or in part, will not add value or provide further clarity to investors.

In this regard, the requirement to disclose the "material terms" of any reportable securities lending arrangement and any specified securities lending arrangement that is reported in the context of another reportable transaction is too broad and subjective. This requirement should be focused on the intent and application of the Instrument (and related rules) so any disclosure should be limited to information that is relevant to the control of the issuer.

For example, consideration[2] for the acquisition of substantial shareholdings may be viewed by some market participants as a material term of a transaction. The calculation of consideration

[2] "Consideration" in the context of securities lending is generally understood to be the margin or fee charged on the relevant loan transaction.

in a securities lending transaction is generally driven by factors unrelated to the control of the issuer (e.g. arbitrage for dividend reinvestment plans), counterparty risk, deal-specific factors, duration of the loan, collateral provided and other commercial matters. As such, while consideration would be useful information for the market, generally, it does not provide useful information regarding control or ownership of substantial shareholdings.

In addition, the CSA may want to consider the general approach taken by the European Securities Markets Authority ("ESMA") to address transparency concerns in the European securities lending and repo markets. ESMA recently issued guidelines (the "ESMA Guidelines") containing enhanced disclosure requirements for UCITS funds that engage in securities lending. The ESMA guidelines address transparency in regards to the existence and material terms of securities lending arrangements through disclosure in the fund's prospectus and information documents which are the documents most readily available and relevant to investors.

As the regulatory reform process continues, CASLA would welcome further dialogue with the CSA and other regulatory authorities regarding the securities lending markets in Canada so that we can work together to ensure that your objectives are met through integration within current regulatory and market practice frameworks without imposing additional material burdens on securities lending agency or otherwise affecting market liquidity.

We thank you for taking our comments into consideration and would be pleased to discuss these issues further at your convenience.

Sincerely,

Rob Ferguson,
President