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Re: Proposed Amendments to the Early Warning Requirements

We are pleased to provide comments regarding the proposed amendments to the early warning requirements. Please note that these comments do not necessarily reflect the views of all lawyers of the firm or of our clients.

Reporting Threshold

We expect that the reduction in the reporting threshold to 5% will greatly increase the number of early warning or alternative monthly reports required to be filed. In particular, investors in small capitalization issuers will trigger reporting obligations at relatively low levels of investment. The increased compliance costs could act as a deterrent to investment in smaller issuers. We suggest that the CSA consider retaining the 10% threshold for venture issuers to avoid this result.

The impact of increased compliance costs could be limited by retaining the 10% threshold for eligible institutional investors that are not disqualified from filing under the alternative monthly reporting system. Since this class excludes any investors that could potentially acquire the issuer (or solicit proxies, if the proposed amendments are implemented), there is a much weaker rationale for imposing reporting obligations at the lower threshold for these investors.

Subsequent Reporting Threshold

We agree that decrease reports should be required and that a 2% threshold is consistent with the current practice. We also agree that there is no need to lower the threshold for subsequent reporting below the current 2% level, since this could lead to excessive reporting. For example, at a 1% subsequent reporting threshold, a potential acquirer that is intending to maximize its position prior to launching a take-over bid could be required to file 14 subsequent reports. If the moratorium was triggered for each subsequent report, the end result appears to be significantly over-regulatory.

However, as an alternative to applying the current 2% threshold from the initial filing position for subsequent increases and decreases, we suggest that the CSA consider adopting fixed 2.5% thresholds similar to the current reporting under the alternative monthly reporting system. The rationale for the different approaches to subsequent reporting under the early warning and alternative monthly reporting systems is unclear. In our experience, this difference has resulted in considerable confusion among filers. We submit that adopting a single system for subsequent reports at consistent fixed thresholds would simplify the reporting requirements and would result in better disclosure to the market.

Mutual Funds that are Reporting Issuers

We strongly support including mutual funds that are reporting issuers in the definition of eligible institutional investor. Given that these funds do not seek to exercise control over, or become involved in the management of, investee issuers, there is no policy rationale for excluding them from the definition of eligible institutional investor. We do not see any reason to treat this class of passive institutional investor differently from others. Continuing to exclude these funds from the alternative monthly reporting system could lead to greater compliance costs, which would ultimately be borne by retail investors through higher fund expenses.

We understand that the CSA previously indicated that current exclusion of public mutual funds was motivated by the understanding that the limitation on their owning more than 10% of the an issuer's voting or equity securities would generally result in the funds not being subject to the early warning requirements. However, as a result of the partially diluted calculation of the reporting threshold, public mutual funds that hold convertible securities or other rights to acquire additional securities within 60 days may be subject to reporting under the current rules and will clearly be subject to reporting under the proposed 5% threshold. In circumstances where both the fund manager and the fund have reporting obligations, the benefits of the alternative monthly reporting system are undermined if the fund is required to file early warning and insider reports.

Accelerated Reporting During Take-over Bids

We agree that accelerated early warning reporting during a take-over bid is unnecessary. The proposed 5% threshold would require disclosure of all significant positions in a reporting issuer. We do not see any additional value in imposing a lower initial or subsequent reporting threshold if a take-over bid is made.

Distinctions between the Insider Reporting and Early Warning Regimes

Currently there is a considerable duplication in the reporting requirements under the insider reporting and the early warning regimes. The proposed amendments will increase the extent of duplication.

The purpose of the insider reporting regime is (a) to require those who have access to insider information to disclose their trades to assist regulators to detect any trading contrary to the insider trading prohibition in securities legislation and (b) to provide information to the market as to when those with the closest view of the affairs of an issuer are buying or selling securities of the issuer. That is, this regime is predicted on access to insider information.

The early warning regime was implemented to provide the market with an "early warning" as to the acquisition of a significant block of shares of an issuer, especially with respect to potential bidders for an issuer, although it also provides information as to the control of significant block of securities that may influence or affect control of an issuer. In our view, this regime is predicated on ownership or potential ownership of voting or equity securities.

The reasons for the two different regimes should not be conflated. For example, the definition of "insider" includes any person or company who beneficially owns or has control or direction over at least 10% of the outstanding voting securities. However, such ownership or control or direction does not, in and of itself, give the holder access to insider information. Therefore 10% shareholders should be exempted from the insider reporting regime so long as the holder "does not receive in the ordinary course of its business and investing activities knowledge of any material fact or material change with respect to the reporting issuer that has not been generally disclosed" (in the words of section 9.1(1)(d) of NI 62-103.) Note that these shareholders would remain subject to the early warning (or alternative monthly reporting) regimes.

Conversely, we believe that an investor whose holdings provide it with an economic interest in an issuer, but not the ability to acquire, to vote or to cause the underlying shares to be voted, should not be subject to the early warning regime. Where the investor has entered into a derivative which provides it with the right or the obligation to acquire voting on equity securities, then we believe that it currently has an obligation to include the underlying securities in calculating its securityholding percentage and, accordingly, NI 62-103 does not need to be amended. However, where the investor holds a cash-only settled derivative, these underlying securities would not currently be included in the securityholding percentage. The concern expressed in the Request for Comments that the counterparty to the derivative, who is likely to have hedged its position by buying the underlying shares, may vote the shares as requested by the investor. Accordingly, we suggest that these positions be required to be included in an investor's securityholding percentage ONLY if it has influence on how the counterparty votes the securities. That is, we would amend the definition of "equity equivalent derivative" by adding the following words to the end of the proposed definition: "where (i) the counterparty to the derivative has, directly or indirectly, hedged its position by acquiring voting securities of the issuer and (ii) the holder exerts or intends to exert influence on how the counterparty votes those securities."

Conditions to the Insider Reporting Exemption for Eligible Institutional Investors

Derivatives and Related Financial Instruments

If the proposals regarding equity equivalent derivatives and the enhanced disclosure regarding related financial instruments involving a security of the reporting issuer are implemented, we submit that the current requirements regarding related financial instruments will be redundant.

Changes in an investor's equity equivalent derivative position will generally result in a change in both its securityholding percentage and related financial instrument position. Given that changes in securityholding percentage under the alternative monthly reporting system are tracked against fixed thresholds of 2.5% increments starting at 10% (or 5% as proposed) and a significant change in related financial instrument position is defined as a change having a similar economic effect to an increase or decrease in securityholding percentage by 2.5% or more (without reference to the fixed thresholds and whether or not the eligible institutional investor files under the early warning system), there is a potential for triggering reports for relatively small absolute changes in positions. Furthermore, the new reporting forms include disclosure regarding related financial instruments generally, so there is no reason to require disclosure as a condition of the insider reporting exemption for eligible institutional investors. Accordingly, we submit that section 9.1(1)(a.1) of NI 62-103 should be repealed if the proposed amendments are implemented.

Exclusion Based on Trading Volume

We submit that the CSA should reconsider the exclusion from the insider reporting exemption under section 9.1(4) of NI 62-103. As a result of this provision, an eligible institutional investor that exceeds the volume thresholds in a given month is required to file insider reports during the next month. We question the value of this exclusion. There is no accelerated notice to the market regarding the high volume of trading in prior month and no guarantee of continued trading in the subsequent month. However, an eligible institutional investor may be required to file multiple insider reports, whether or not it has ever filed insider reports previously. If the eligible institutional investor is holding securities on behalf of multiple accounts or funds, such trades may reflect the opening or closing of accounts or rebalancing of portfolios. Following the end of the subsequent month the investor may cease filing insider reports, potentially indefinitely. Accordingly, an investor may randomly move in and out of the insider reporting regime and the holdings reflected on SEDI may diverge substantially from those disclosed in early warning or alternative monthly reports. Although the compliance burden on the investor is clear, it is difficult to see how the additional disclosure is of any value to the market.

Requirement that the Investor has filed an Early Warning or Alternative Monthly Report

We suggest that the CSA should clarify the application of section 9.1(1)(a) of NI 62-103 to an investor during the initial month that it becomes subject to reporting under the alternative monthly reporting regime. Section 4.1 of the NI 62-103 is clear that the investor is exempt from the early warning requirements provided that it intends to file an alternative monthly report when required after the end of the month. We understand that section 9.1(1)(a) is generally interpreted as being satisfied during the initial month since no report is yet required to be filed under section 4.5 of NI 62-103. However, we also understand that CSA staff may have expressed a contrary view. We submit that there is no policy rationale to require an eligible institutional investor to file insider reports during the initial month. However, if this is the intended result, the obligation should be clarified.

Eligible Institutional Investors Controlled by Individuals

It is not uncommon for an investment manager that is an eligible institutional investor to be owned or controlled by a single individual or a small group of individuals. If these individuals are considered to share control or direction over the securities controlled by the investment manager by virtue of their control of the investment manager, arguably they could be subject to early warning and insider reporting in connection with such securities. We submit that this interpretation would undermine the purposes of allowing the investment manager to use the alternative monthly reporting system and result in unnecessarily duplicative reporting.

We note that section 9.1(5) of NI 62-103 provides an insider reporting exemption to directors and senior officers of an eligible institutional investor. We submit that this exemption should extend to shareholders of the eligible institutional investor and that a similar exemption to the early warning requirements should be provided in Part 4 of NI 62-103.

Issuer Actions

The exemption provided under Part 6 of NI 62-103 is more narrowly drafted than the comparable issuer event exemption under National Instrument 55-104 *Insider Reporting Requirements and Exemptions* because it does not necessarily extend to an amalgamation, reorganization, merger or other similar event. Since these transactions can cause an investor's securityholding percentage to change without any action on its part, we submit that the issuer action exemption should be extended on the same basis as the insider reporting exemption for issuer events.

Definition of "Securityholding Percentage"

The term "securityholding percentage" is used as the total number of shares that is to be reported by an investor under the early warning or alternative monthly reporting regime. We believe that if the proposed amendments are to be implemented, it is intended that the provisions of proposed sections 5.1 and 5.5 of NI 62-104 are to be taken into account and therefore (together with the expanded amendments to the Ontario *Securities Act*) should be added to Appendix D.

Initial Early Warning Report

There has always been an uncertainty as to how the early warning reporting regime applies to a shareholder of an issuer that already holds 10% of a class of voting or equity securities of the issuer when it becomes a reporting issuer (or when it first became subject to the early warning regime). For example, say shareholder A holds 15% of the outstanding common shares of issuer B at the time it completes its initial public offering. In that case, A hasn't acquired any securities that would trigger an early warning report under section 102.1 (1) of the *Securities* Act (Ontario) or section 5.2(1) of NI 62-104. If it subsequently acquires an additional 2% of the common shares of B, then it would not technically be caught by section 102.1(2) of the *Securities* Act (Ontario) or section 5.2(2) of NI 62-104, because these subsections apply only to those that have been required to file under subsection (1). It may be that if A acquires 1 share, then it is caught by subsection (1), but we do not think that such an interpretation is consistent with the policy rationale of the early warning regime.

Accordingly, we suggest that section 5.2 of NI 62-104 and section 102.1 of the *Securities Act* (Ontario) be amended by adding subsection (1.1) as follows:

> "An acquirer who, at the time an issuer first became a reporting issuer in a jurisdiction in Canada, had beneficial ownership of, or control or direction over, voting or equity securities of a reporting issuer or beneficial ownership of, or control or direction over, securities convertible into voting or equity securities of a reporting issuer that constitute 5% or more of the outstanding securities of the class and disclosure of such ownership or control or direction was made in a prospectus, information circular, listing statement or other public document, then such acquirer shall be deemed to have made disclosure under subsection (1)"

Subsection (2) should then commence "An acquirer who made or was deemed to have made or was required to make disclosure under subsection (1) …"

Transition

The proposed amendments do not deal with the immediate reporting requirements for any investor who, on the effective date of the amendments, had a securityholding percentage of greater than 5% (and did not have a securityholding percentage greater than 10% under the existing rules). Proposed subsection 5.2(1) of MI 61-104 would not be triggered. If the CSA expects those investors to file, then there should be a separate requirement to file within a specific timeframe, which we suggest should be generous considering that some substantial investors may have multiple reports to file. We do not think that the news release or the moratorium requirements should apply to this initial report. This provision or subsection (2) should be drafted to make it clear that acquirors who have made or are required to have made this initial report would thereafter be subject to section 5.2(2) of NI 62-104 and section 102.1 of the *Securities Act* (Ontario).

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If you have any questions concerning these comments please contact David Surat at dsurat@blg.com or 416.367.6195 or Paul Findlay at pfindlay@blg.com or 416.367.6191.

Sincerely,

"Borden Ladner Gervais LLP"