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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
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

Mtre. Anne-Marie Beaudoin
Corporate Secretary
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The Secretary
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Re: CSA Notice and Request for Comment – Proposed amendments to Multilateral Instrument 62-104 *Take-Over Bids and Issuer Bids* and to National Instrument 62-103 *Early Warning System and Related Take-Over Bid and Insider Reporting Issues*

Dear Sir and Madam:

It was with great interest that the Caisse de dépôt et placement du Québec (hereafter the "**Caisse**") took cognizance of the notice and request for comment of the Canadian Securities

Administrators (hereafter the "**CSA**") on the Proposed Amendments to Multilateral Instrument 62-104 *Take-Over Bids and Issuer Bids* and to National Instrument 62-103 *Early Warning System and Related Take-Over Bid and Insider Reporting Issues* (hereafter the "**Proposed Amendments**").

The Caisse would like to thank the CSA for the opportunity to comment on the Proposed Amendments.

About the Caisse

Under its constituting statute, the Caisse manages funds for its depositors, primarily public and private pension and insurance plans. It is one of the largest institutional fund managers in Canada and is active on domestic and international financial markets. As at December 31, 2012, its depositors' net assets under management totalled $176.2 billion.

As at May 31, 2013, the Caisse was a shareholder of more than 240 reporting issuers in Canada.

The Caisse regularly files news releases and reports in accordance with the rules of the early warning system (hereafter the "**Early Warning System**") under Multilateral Instrument 62-104 *Take-Over Bids and Issuer Bids.*

The Caisse does not avail itself of the alternative monthly reporting system applicable to eligible institutional investors under *Regulation 62-103 respecting the Early Warning System and Related Take-Over Bid and Insider Reporting Issues*.

Background and summary of the Caisse's comments

The Proposed Amendments in their current form will substantially change the Caisse's reporting practices, given its substantial holdings of securities of Canadian issuers. The Proposed Amendments will significantly increase the number of issuers for which it will have to disclose its holdings.

For example, as of June 30, 2013, the Caisse held at least 10% of a class of securities of 15 Canadian reporting issuers and therefore had to make the related disclosures required under the Early Warning System. If the Proposed Amendments had been in effect as at June 30, 2013,

the Caisse would have had to disclose its holdings of securities involving 55 issuers, namely 40 issuers more than under the current early warning rules.

Moreover, we estimate that the Caisse would have to issue about 50 news releases a year under the Proposed Amendments whereas it currently issues about 10 a year.

We therefore believe that the Proposed Amendments should subject passive investors to reduced disclosure obligations and relax the formal requirements surrounding such obligations, as does the similar U.S. system.[1]

Relaxation of the formal requirements surrounding the disclosure obligations would reduce the complexity of such obligations as well as the large amount of information transmitted to the market. This large amount of information would result from the issuing and filing of news releases or monthly reports by investors, most of which are passive investors that have no intention of exercising control or direction over the issuer or its shareholders. The Proposed Amendments should take into account the fact that most investors are passive, as does the U.S. system.

Even though we recognize the efforts to harmonize the early warning disclosure threshold with other legal systems that are similar to the Canadian market (Australia and the United States), we note that such efforts are designed mainly to respond to certain considerations related to governance.

In this regard, we believe it is essential that such efforts be reconciled with the financial and operational aspects of the Canadian market to ensure its efficiency. To that end, the Proposed Amendments should take into account certain elements specific to the Canadian market, such as its large number of small-cap issuers and limited liquidity.

As for the treatment of derivative instruments in the calculation of holdings, although we recognize the efforts to ensure harmonization with Europe, we believe that the method selected to take such derivatives into account is complex and should be clarified.

As well, taking into account the importance on the Canadian market of index derivatives, involving mainly the S&P/TSX 60, we believe that the Proposed Amendments should specify the methodology to be used to include in the calculation of holdings the return received on a security through such an index derivative.

[1] We refer you to section 13 of the *Securities Exchange Act of 1934:* http://www.sec.gov/about/laws/sea34.pdf.

Lastly, we believe that the treatment of securities lending and borrowing does not take into account the reality of this market by disregarding the impact of short selling. Short selling constitutes a key element of this market, and it is essential that it be taken into account in the calculation of any position, failing which such calculation will not reflect reality.

Caisse comments

The Proposed Amendments essentially concern four aspects on which we are submitting comments:

1. **Reduce the early warning disclosure threshold from 10% to 5%**

2. **Take into account certain equity equivalent derivatives in the calculation of disclosure thresholds**

3. **Take into account securities borrowing and lending arrangements**

4. **Provide more information in reports under the Early Warning System**

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1. Reduce the early warning disclosure threshold from 10% to 5%

We support the proposed 5% threshold which appears to be in line with the thresholds prescribed by equivalent legal systems, including those of the United States and Australia. Even so, we are of the opinion that some distinctive features of the Canadian market have to be considered in the CSA's harmonization efforts. Moreover, the formal requirements surrounding the Early Warning System are unique to Canada and should be relaxed.

Concern regarding impact on market liquidity

We are concerned about the impact on the liquidity of the Canadian market of the obligation to disclose a position when the 5% threshold is reached as well as any subsequent 2% variation.

Many institutional investors, including the Caisse, have substantial resources to deploy on the Canadian market and will rapidly reach the disclosure threshold, meaning that their position in an issuer will rapidly become public knowledge. Some market participants scrutinize any disclosure by a large investor like the Caisse. After disclosures by such investors, including those by the Caisse, a significant variation in the price of an issuer's security is often observed – a variation that is sometimes unfavourable to the investor.

Disclosure of 5% and variations of 2% combined with the moratorium on transactions involving the issuer's security will hinder institutional investors' agility on the markets because it will detract from their ability to accumulate or to reduce rapidly the positions they acquire in the normal course of their investment activities.

Publication of a news release, which implies that the issuer is affected by a material fact, artificially creates an imbalance between supply and demand for the securities of such an issuer because it often drives up the price of the security, independent of the issuer's operations and financial returns. Such hindrance to the agility of large investors, which are often partners of issuers, will have a detrimental effect on such issuers.

The following table gives an indicative idea of the Canadian market restricted liquidity by showing the time currently required for the Caisse to acquire, on the Canadian market, securities enabling it to hold a 5% position in an issuer. We have also estimated the time required to go from a position of 5% to 7%:[2]

Capitalization	**Estimate of the time required to build a position from 0% to 5%**	**Estimate of the time required to accumulate another 2% or more**
• Large-cap issuer • About 250,000,000 shares outstanding	25-30 days	7-10 days

[2] The calculations assume the Caisse's transactions affect about 25% to 30% of the issuer's volume and involve block trades.

• Average daily volume more than 1,000,000 shares		
• Mid-cap issuer • About 73,200,000 shares outstanding • Average daily volume about 365,000 shares	40 days	7-10 days
• Small-cap issuer • About 25,000,000 shares outstanding • Average daily volume about 50,000 shares	90 days	15-20 days

The time required to build a position will no doubt increase because of the frequent disclosures that an investor will have to make to the market. This could even discourage some investors, which will decide not to invest beyond certain thresholds, further reducing the already-restricted liquidity for certain issuers.

Lastly, we are of the opinion that the CSA should make a study in support of the Proposed Amendments to demonstrate that they will not adversely affect the liquidity of the Canadian market.

Desirability of different measures for small-cap issuers

For the reasons cited above, we believe different measures should be considered at least for small-cap issuers.[3]

It should be noted that the Canadian market is i) characterized by small-cap issuers and ii) enjoys a strong international reputation for this small-cap market. In the case of such issuers, a 5% threshold is reached quickly; given that raising capital is crucial for them, it is important to ensure that suitable measures are taken to maintain their access to capital markets.

Relaxation of the formal requirements surrounding the Early Warning System

[3] By small-cap issuers, we mean issuers whose securities are listed on the TSXV Exchange.

In addition, we believe that the formal requirements surrounding the Early Warning System and the imposition of a trading moratorium are onerous and out-of-date.

The news release

In our opinion, the early warning requirements to promptly issue and file a news release (hereafter the "**News Release**") and to file on SEDAR an additional report (hereafter the "**Report**") containing substantially the same information as the News Release are redundant. We believe it would be appropriate to ease the formal requirements surrounding the Early Warning System. We do not see the relevance of double reporting (News Release and Report).

Lowering the disclosure threshold to 5% and the disclosure associated with an increase or decrease in ownership of 2% will ensure that investors such as the Caisse will have to issue and file many more News Releases and Reports. As already stated, each year the Caisse would have to issue five times as many News Releases (50 instead of 10) under the Proposed Amendments.

Moreover, the proliferation of news releases will inundate the market with information that is not always relevant.

In this regard, we are concerned about the impact of a News Release issued by an investor that has reached the 5% threshold for a class of securities of an issuer, solely for investment purposes. Such "news" in no way represents a material change for the issuer because it merely involves an investment by a passive shareholder.

For example, it is clear that the Caisse does not want to take control of or play an activist role in the 55 issuers for which it would have to disclose its holdings under the Proposed Amendments (moreover, some of the issuers are subject to regulatory restrictions regarding ownership, so that a shareholder is prevented from holding 10% or more of their securities).

Trading moratorium

We are of the opinion that the Proposed Amendments should eliminate the moratorium on trading between the date of the event triggering the Early Warning System and the business day following the filing of the Report. With the threshold lowered to 5%, the moratorium will also reduce the liquidity of the securities of the issuers concerned. As we have already stated, such liquidity is often already restricted for some issuers.

The moratorium is unique to the Early Warning System, for it is not found in comparable legal systems and it adds an unfavourable element for any investor that wants to accumulate holdings in a Canadian issuer.

Lastly, we understand that the trading moratorium is intended to give the market time to absorb information, but we believe it is no longer justified because of the speed at which information now circulates.

In United States, as with many other comparable legal systems, a report is sent to the issuer and to the regulatory authorities, which make it public. No news release is required and no moratorium, even temporary, applies.

Dual calculation methodologies under the Early Warning System and the insider reporting regime

Lastly, we strongly support maintaining the disclosure threshold at 10% under the insider reporting regime but we believe the CSA should harmonize the double methodology underlying such calculation, as provided in the Early Warning System and the insider reporting regime.[4] We have difficulty understanding the duality of the two calculation methods, which creates a level of complexity for the investors, and we are of the opinion that the CSA should take advantage of the amendments to the Early Warning System to clarify this matter.

2. <u>Take into account certain equity equivalent derivatives in the calculation of disclosure thresholds</u>

The concept of beneficial ownership, namely control or direction over securities, has always been the element to be considered for the purposes of determining when the disclosure threshold is reached under the Early Warning System.

The Proposed Amendments would equate certain "equity equivalent derivatives" to their reference securities and thus include such derivatives in the calculation of the disclosure threshold.

Deeming such derivatives equivalent to their reference securities is justified according to the CSA because it reflects i) the increasing share represented by such instruments and ii) the risks of abuse that they carry, such as the practice referred to as hidden ownership.

[4] It should be noted that, under the Early Warning System, the reporting obligation is triggered when a threshold of at least 10% of a share class is reached whereas, under the insider reporting regime, it is triggered when a threshold of more than 10% of the issuer's securities with voting rights is reached.

As for the second element, hidden ownership, we should like to point out that our observation of the market leads us to believe that this practice is marginal because derivatives are generally used for risk-management strategies.

That being said, to the extent that the CSA's objective is to ensure adequate transparency concerning ownership of securities, we believe it is justified to include such derivatives in the calculation of the disclosure threshold if their inclusion would inform the market effectively of the total financial interest that an investor may have in an issuer.

We are of the opinion that, to achieve the objectives sought by inclusion of such derivatives, the three following points should be clarified in the Proposed Amendments: the criterion for deeming derivatives equivalent, offsetting derivatives and double counting.

Criterion for inclusion of derivatives

Delta calculation

The Proposed Amendments specify that the derivatives that must be taken into account for calculation purposes are those that "substantially replicate the economic consequences of ownership". According to the Proposed Amendments, a derivative is deemed to substantially replicate the economic consequences of ownership if a market participant that took a short position on the derivative could substantially hedge its obligations under the derivative by holding 90% or more of the specified number of reference securities.

We understand from this reference that the CSA has opted for a delta calculation, with the delta retained being a minimum delta of 90%.

According to this method, to determine the number of securities to be taken into account, the maximum number of securities affected by the derivative is multiplied by the delta of the said derivative.

Application of the 90% ratio as a criterion for inclusion raises several difficulties because the ratio will vary as a function of the value of the reference securities. Each day it will be necessary to calculate the percentage held as a function of the variation in the ratio, which makes the calculation very complex. Moreover, an investor could reach a reporting threshold in a passive and repeated manner as a result of changes in the value of the reference securities and the delta. Such a situation would be likely to occur with a 5% reporting threshold.

For these reasons, the Proposed Amendments should specify the criterion for inclusion of derivatives and ensure that a variation in the value of the reference securities does not result in reporting obligations when the investor has carried out no transactions involving the securities,

as currently provided in the rules under the Early Warning System for equity holdings ("Issuers Actions"). In this way, investors could be exempt from reporting when they cross a disclosure threshold merely because the delta varies within a range of +/- 10%.

Calculation of securities making up an index

The method for taking into account securities composing an index or other baskets of securities is not clear and should be spelled out. Is the relative weight of the security composing the index or the basket in question to be used? Given that index swaps, especially those on the S&P/TSX 60, represent a large share of the Canadian derivatives market, clarification of this matter by the CSA is required.

We suggest taking guidance from the U.K. system, which provides that financial instruments referenced to a basket or to an equity index are not taken into account if the shares of the issuer represent more than 1% of the share class or more than 20% of the value of the securities in the basket or the index or both.

Impact of short selling

The Proposed Amendments seem to disregard the context in which derivatives transactions take place. Such transactions are most often part of risk-management strategies involving short selling that may have the effect of cancelling out an investor's economic exposure to an issuer.

As a result of such strategies, the investor's economic exposure to an issuer is nil. Because the purpose of considering derivatives equivalent to their underlying securities is to inform the market of the investor's total financial interest in an issuer, we believe that one cannot disregard a strategy that causes the investor to no longer have any economic exposure to the issuer.

We believe it is appropriate to illustrate our comment with an example:

- Investor A sells short 100 shares of XYZ Inc.
- Investor A concludes a swap whereby it receives the return on 100 shares of XYZ Inc.

⇨ Investor A has nil economic exposure to the 100 shares of XYZ Inc.

To the extent that one wishes to take into account the total financial interest that an investor may have in an issuer, as shown by the delta calculation that the CSA has opted for, to argue that Investor A has an economic interest in the 100 shares of XYZ Inc. under the swap it concluded is not consistent with reality.

To conclude otherwise would run counter to the objective of share-ownership transparency and would mislead the market if an investor in the above example were to include its economic

interest in shares for which in fact it has no economic interest or any voting rights because of its short sale.

Offsetting

It is not clear whether the Proposed Amendments cover the possibility of offsetting derivatives that provide a gross long position (position on purchase) with those that provide a short position (position on sale). Such a combination of transactions creates for the investor a nil effect on the underlying security.

We are of the opinion that an investor that takes long and short derivatives positions in the same reference security, with the same terms and conditions, should be able to offset them because it has no economic exposure to the issuer. Such offsetting would be more in line with the economic reality of the investor's exposure and would comply with the principles of the Proposed Amendments and disclosure of any hidden ownership.

Double counting

To equate derivatives to equities is in a sense to equate economic exposure to securities to legal ownership of them.

In addition to our previous comments on the need to take into account short selling and offsetting, we also submit that such equivalency implies that the securities concerned will be counted twice in the calculation of holdings for the purposes of the Early Warning System and therefore possibly reported twice: once by the holder of legal ownership of the reference securities and once by the holder of economic exposure. For these reasons, the CSA's objective of ensuring adequate transparency of securities ownership could be compromised.

Finally, we have taken note of the CSA's comments to the effect that some participants that acquire significant economic exposure to an issuer by means of a swap could indirectly exercise voting rights in respect of such issuer through the counterparty to the swap. We have no knowledge of such a practice on the Canadian market that would justify the CSA's taking such a position. If this practice exists, it is the exception and should not dictate the rules governing this matter.

3. <u>Take into account securities lending and borrowing arrangements</u>

The Proposed Amendments specify that the current reporting obligations already apply to securities lending arrangements and that it is not necessary to amend the criterion leading to such obligations so as to expressly include securities that are lent or borrowed as part of such transactions.

It is specified that the borrower is obliged to take into account borrowed securities for the purpose of calculating its ownership of securities for application of the early warning rules. By borrowing securities, it therefore acquires beneficial ownership of such securities for the duration of the loan.

The matter of securities lending and borrowing with a view to general meetings of shareholders is cause for concern. We are of the opinion that the practice of lending securities as such a meeting approaches for the sole purpose of influencing its outcome must be discouraged.

Even so, we would like to insist on the fact that this practice is marginal in Canada and that it should not serve as a premise for the rules put in place by the CSA. Rather, it is necessary to examine the context in which such securities lending and borrowing take place on the Canadian market.

Short selling

In most cases, securities are borrowed in the context of short selling. In such a case, the investor borrows securities that will subsequently be delivered to settle its short sale.

From statements on securities borrowing and lending in the Proposed Amendments, one infers that this type of transaction will oblige the borrower to file a report under the Early Warning System if borrowed securities take it to more than 5% of the securities of the issuer and to file another report when it delivers the securities to settle the short sale, assuming that it goes below the 5% threshold.

Moreover, the borrower will eventually purchase securities in order to return to the lender the securities covered by the securities lending arrangement. All these transactions could trigger application of the Early Warning System even though in none of these situations does the borrower benefit from voting rights on the securities and has no economic exposure as a result of the lending arrangement.

In U.K., the regulator took into account borrowing in the context of short selling by providing an automatic exemption that makes it possible to disregard securities borrowed in such a context (Disclosure Rules and Transparency Rules, 5.1.3R (6)).

We are of the opinion that the CSA should take guidance from such an exemption, otherwise there will be a proliferation of reports. Such proliferation would not provide adequate transparency of securities ownership and would inundate the market with irrelevant information that, moreover, would not make it possible to identify persons intending to exercise real control over the issuer of the securities because the threshold would be reached only temporarily.

4. Provide more information in reports under the Early Warning System

The Proposed Amendments stipulate the obligation to report securities lending arrangements in effect at the time of the transaction to be reported, even if the transaction does not involve such arrangements. Currently, a person who is obliged to file a report under the Early Warning System is usually not obliged to state the general nature or the material conditions of lending agreements.

We believe this obligation may prove to be a constraint for investors, especially if securities borrowing and lending take place in the context of structured transactions. The anonymity required for some strategies could be compromised by the disclosure obligations, which ultimately will not make it possible to inform the market of securities ownership.

Conclusion

We believe that transparent securities ownership is desirable and is a prerequisite for the integrity and efficiency of our markets. Reducing the disclosure threshold to 5% is in this sense a means of achieving it.

Even so, we believe that regulation must not constitute a burden, nor must it detract from liquidity.

Moreover, it must enable shareholders to gain a proper understanding of their reporting obligations, and what they must or must not include in their calculations of disclosure thresholds. Regulation must above all take into account the reality and sophistication of the financial markets and adopt a more pragmatic approach based on the economic reality of transactions.

From our reading of the Proposed Amendments, we believe that the CSA's efforts are intended essentially to put an end to the practices of hidden ownership and empty voting and to provide transparency for market participants, the whole from the standpoint of governance.

One must note, however, that such practices are rare. It would be unfortunate to penalize an entire industry, whether in the case of securities lending and borrowing or derivatives, because of exceptional practices that concern only a small fraction of investors. Such situations make headlines but ultimately are marginal and far from representative of what takes place on the Canadian financial market.

Yours truly,

Marie Giguère

Executive Vice-President
Legal Affairs and Secretariat