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July 12, 2013

Delivered via email

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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
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Re: Proposed changes to early warning reporting system

Canadian Bankers Association
The Canadian Bankers Association (**CBA**) works on behalf of 55 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 274,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system

that benefits Canadians and Canada's economy. The CBA also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness.

General remarks

We appreciate the opportunity to comment on the Canadian Securities Administrators' (**CSA**) notice and request for comment regarding the proposed changes to the early warning reporting (**EWR**) system, specifically, the 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* (**Proposal**). We recognize the CSA's efforts to provide greater transparency to the market about significant holdings of securities. That said, we are concerned about several aspects of the Proposal, in particular as it relates to passive investors in the alternative monthly reporting (**AMR**) system, public mutual funds and certain types of derivatives. Those and several other comments are outlined below for your review.

Reducing early warning reporting threshold to 5%

Under Canada's EWR system, investors holding 10% or more of a public company's voting securities must publicly report their ownership levels, the purpose of the transaction and any future intentions to accumulate securities, and must do so promptly after acquisition of the securities that places the investor at or above the 10% threshold. Eligible institutional investors (**EII**) who are reporting through the AMR system can report their holdings using a longer time period and do not have to provide as much information as is required under the EWR system. The CSA are now proposing to lower the reporting threshold for both the EWR and AMR systems to 5%. The intent is to increase the transparency to the market of significant investments and address the CSA's concern that the current 10% threshold does not adequately inform and protect investors other than the acquirer, especially in light of increasing shareholder activism and the ability of a shareholder holding a minimum of 5% to requisition a shareholders' meeting.

The CSA are of the view that one of the reasons a 5% threshold is appropriate in Canada is because this would be consistent with the standards adopted by several significant foreign jurisdictions. While that may be the case, it is our view that when looking to foreign standards, care should be taken to consider the unique aspects of the Canadian market, including its relatively small size. We are concerned that the reduced reporting threshold, along with the onerous reporting and disclosure obligations, could have a significant negative impact on the efficiency of the Canadian market. As well, it should be pointed out that a 5% threshold in some of those other foreign jurisdictions is accompanied by more lenient reporting obligations. For example, qualified institutional investors (**QIIs**) investing in equity voting securities registered under Section 12 of the United States Securities Exchange Act of 1934, as amended (**Exchange Act**) in the ordinary course are merely required under Section 13(d) of the Exchange Act and the rules promulgated thereunder to file short-form disclosure reports on Schedule 13G annually (rather than monthly) when surpassing the 5% threshold but holding less than 10%.[1] On this point, notably, the United States Securities and Exchange Commission (**SEC**) has not publicly expressed an intention to consider modifying the treatment of QIIs as part of its Regulation 13D modernization review.[2]

In light of the foregoing, if the CSA decide to proceed with the proposed reduction of the reporting threshold, we think it is important to provide for a certain level of flexibility in order to ensure that the Canadian market remains competitive and that market disruptions are minimized.

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[1] 17 C.F.R. § 240. 13d-1(b).

[2] See, e.g., Chair Mary L. Schapiro, *Remarks at the Transatlantic Corporate Governance Dialogue 4* (Dec. 15, 2011), available at http://www.sec.gov/news/speech/2011/spch121511mls.htm.

We are particularly concerned about the potential impact of an outright reduction of the reporting threshold to 5% on passive investors in the AMR system and on public mutual funds.

Passive Investors in AMR system

It is important to ensure that investors are informed and that their interests are protected. That said, we are concerned that the proposed requirement to report 5% positions monthly in the AMR system would have a negative impact on the liquidity of the Canadian market.[3] We are concerned that such reporting would impede the ability of Canadian institutional money managers to execute investment strategies, especially where a divestment strategy is revealed to the broader market halfway through execution. This would signal a market overhang and could have a negative impact on the interests of the institutional investor's underlying beneficiaries. Likewise, a share accumulation program may be replicated by other investors, driving the share price up before the money manager is able to take advantage of their own investment analysis and trading strategy.

One aspect of the Proposal is to make the AMR system unavailable to individuals who seek to use their holdings to solicit proxies and influence shareholder voting preferences. This will ensure that passive investors who report through the AMR system remain passive, and that those who intend to exert influence over shareholders or gain a voting control of the issuer are subject to the reporting requirements under the EWR system. Accordingly, we believe that the CSA's policy objective can be met without reducing the threshold in the AMR system. Maintaining it at 10%, while limiting access to the AMR system to a narrower group of passive investors, will result in greater transparency without creating the risk that the integrity and stability of the market and its actors might be compromised.

In addition, we suggest that the definition of "eligible institutional investor" be expanded to include wholly-owned subsidiaries of EIIs that do not qualify for aggregation relief under Part V of NI 62-103. The purpose of this change would be to allow these wholly-owned subsidiaries to have their holdings aggregated with their parent entity and reported under the AMR system at the 10% threshold, provided that the subsidiary is acting as a passive investor.

With respect to the access to the AMR system, we think it would be useful to provide more clarity regarding the qualification criteria, and to specify that it is not available to hedge funds and other active funds.

Lastly, we ask the CSA to consider whether the onerous reporting of equity derivatives by passive investors in the AMR system is necessary. In our view, by limiting disclosure of the use of equity derivatives to the EWR system, the key public interest goal of increased transparency around investors seeking to requisition shareholder meeting or effect a change of control transaction would be largely achieved, without imposing reporting requirements in circumstances where empty voting and hidden ownership concerns do not arise.

Public mutual funds

Public mutual funds are passive investors, subject to stringent investment restrictions under National Instrument 81-102 *Mutual Funds* (**NI 81-102**). These include control restrictions in s. 2.2 of NI 81-102 which prevent these funds from holding more than 10% of the votes attaching to the outstanding voting securities or outstanding equity securities of a reporting issuer, and from purchasing a security for the purpose of exercising control over or management of the company.

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[3] For instance, please consider that relative to the U.S. market, the Canadian market is much smaller and has a large number of small companies. A 5% investment in one of those companies would generally not be considered a large investment for an institutional investor. Thus, institutions may choose to invest the same amount in U.S. companies where the 5% threshold would not be triggered. This would in turn discourage investment in small and medium-sized Canadian companies.

Under the current reporting regime, these funds do not qualify as EIIs and cannot access the AMR system. Therefore, if the new EWR system threshold is implemented, these funds will need to report on their holdings and provide expanded disclosure once they cross the 5% threshold. Given the passive nature of their investments, funds that are subject to NI 81-102 should, in our view, continue to be subject to a 10% EWR threshold (aligned with their 10% control restriction) for as long as they remain passive.

If the new 5% EWR system threshold is implemented and an exemption is not provided for public mutual funds governed by NI 81-102, we suggest that the CSA consider the following measures:

a. Maintain the AMR threshold at 10% and include public mutual funds in the definition of EII, or otherwise allow them to rely on the less stringent and detailed reporting of the AMR system.
b. If the AMR threshold is also reduced to 5%, in addition to including public mutual funds in the definition of EIIs per (a) above, provide an exemption for public mutual funds governed by NI 81-102 to allow them to continue to rely on the threshold of 10% before a reporting obligation is triggered.

We believe that these proposed measures would allow the Proposal to meet its policy objective, while respecting the current regulatory framework under which public mutual funds function.

Enhancing content of disclosure

The CSA are of the view that the EWR disclosure is often inadequate and does not sufficiently inform investors. The CSA believe that more detailed disclosure of, for example, the intentions of the persons acquiring securities and the purpose of the acquisition would enhance the substance and quality of the EWR. We are concerned about some of the changes the CSA are proposing in view of these concerns.

In particular, we are concerned about the requirements for disclosure of the transaction terms in derivative contracts. For instance, item 4 of the proposed Form 62-103F1 *Required Disclosure Under the Early Warning Requirements* (**Form 62-103F1**)[4] requires disclosure of the nature and value of consideration paid or received by an acquirer for a transaction that does not take place on a stock exchange or other published market for securities[5]. To the extent this requires disclosure of the spread on an OTC equity equivalent derivative or borrow fees on a securities lending transaction, it is problematic given the proprietary nature of the referenced information. As well, it is both materially different from the disclosure of prices of trades that are facilitated through an exchange and of questionable utility to investors, in our view.

Also, item 6 of the Form 61-103F1[6] requires disclosure of any contracts or arrangements in relation to any securities of the issuer (rather than in relation to only the securities underlying the transaction subject to the reporting requirement) as well as the identity of the relevant counterparty. We would greatly appreciate a clarification of the intended purpose of this broad disclosure (to the extent it is not otherwise captured under other disclosure requirements of the form).

Expanding reporting trigger to capture certain types of derivatives

One aspect of the Proposal is to include certain types of derivatives that affect an investor's total economic interest in a public company in order to determine the EWR threshold trigger. An investor would be deemed to have control or direction over voting or equity securities referenced

[4] Please also refer to a similar requirement in item 4 of Form 62-103F2 *Required Disclosure by an Eligible Institutional Investor Under Section 4.2* (**Form 62-103F1**).
[5] Our understanding is that the identity of the counterparty would not need to be disclosed.
[6] Please refer to a similar requirement in item 6 of Form 61-103F2 and in item 5 of Form 62-103F3 *Required Disclosure by an Eligible Institutional Investor Under Part 4.*

in an *equity equivalent derivative*, which would capture derivatives that substantially replicate the economic consequences of ownership.

Rather than focusing on the economic interest, we think that the appropriate test for defining an *equity equivalent derivative* should be primarily based on whether a party has the right to vote the referenced securities or the ability to obtain voting rights. The standard derivative contracts do not dictate the manner in which a derivative counterparty paying the equity total return (**Payor**) will hedge its exposure, and do not require it to hedge at all. As a result, the Payor may or may not hold the referenced securities. Whether or not it has hedged its exposure by acquiring the referenced securities, the standard derivative contracts do not give to the derivative counterparty that is receiving the equity total return (**Receiver**) any voting rights, or the ability to direct how the Payor will vote (assuming that the Payor hedges its exposure by holding the referenced securities). Thus, the Receiver does not necessarily have a *de facto* access to the underlying securities held by the Payor and the potential to convert its interest under the derivative into voting securities. Where a derivative counterparty does not have any voting rights with respect to the referenced securities, we do not see the need for reporting obligations. We understand that a vast majority of equity derivative transactions are in fact undertaken by parties who are looking for economic exposure only. We would argue that such transactions are therefore not appropriate for inclusion in the EWR regime.

We are concerned that a failure to make changes to the Proposal described above will lead to double counting and confusion in the market. To illustrate this point, please consider the following example. A client (**Client**) enters into a total return swap (**TRS**) to receive the positive return on a share from a dealer (**Dealer A**). Dealer A hedges its short exposure under the derivative by entering into an offsetting derivative contract with another dealer (**Dealer B**). Dealer B hedges its short exposure under the second derivative by purchasing the physical share in the market. In this example, the proposed rules may have the effect of multiplying the number of shares being reported (e.g., potential reporting of physical position held by Dealer B, and derivatives positions of Client and Dealer A). Further, this multiplication effect may become even more pronounced when additional derivatives counterparties are included in the chain of counterparties. Ultimately, we believe that this multiplication effect will create confusion for investors, with little or no added benefit, unless the reporting is limited to circumstances where the reporting party has the legal right to direct voting or acquire the referenced securities.

We do not believe that the over-reporting is justified by the explanation of the purpose of the transaction. As discussed above, the disclosure of significant deal terms will be controversial for derivatives market participants as these terms are considered proprietary by market makers and other market participants. We think that the level and type of disclosure should relate to the stated purpose of the acquisition. Full disclosure of the material deal terms should not be required if the stated purpose of the transaction does not relate to soliciting proxies, changes to the board or any other events that underlie the CSA's policy concerns.

Further, we think that rules should be clarified to ensure that they apply to principal positions only and not to trades that an institution is undertaking on behalf of a client. The reasoning is similar as above. We believe that reporting obligations should be triggered by the party's ownership position, which would exclude positions taken for a client. As well, we ask the CSA to consider providing a market-making exemption for derivatives that dealers enter into in order to provide short derivatives exposure to clients, where the dealer has hedged its long exposure under the derivative (e.g., by executing a short sale of the referenced securities or by entering into an offsetting derivative contract with a third party). In these circumstances, the purpose of the dealer's acquisition of the long derivative position under the equity derivative entered into with the client is part of its market-making business, and not the making of a take-over bid or influencing votes.

Examples of instruments the CSA intend to include within the definition of *equity equivalent derivative* under the Proposal include TRSs, contracts for difference and other derivatives that provide the party with the notional *long* position with an economic interest that is substantially equivalent to the economic interest that party would have if they held the securities directly. We would appreciate more details regarding the types of derivatives that would be captured by the *equity equivalent derivative* concept. For instance, would a cash settled equity future or forward be captured? Would a TRS written on an index or on a suitably large basket of securities be captured? If such trades are not intended to be captured, how broad does the underlying index or basket need to be before it no longer constitutes an *equity equivalent derivative*? Also, if the party holding the notional long position on a swap, for example, is fully hedged, either by way of holding the notional short position on an off-setting equity derivative, or through shorting the underlying securities on the market, are the positions to be netted? Finally, if the motivation behind the Proposal is to reveal hidden ownership, we ask the CSA to consider exempting exchange-traded derivatives and derivatives that are centrally cleared from the aggregation requirements, as hidden ownership concerns arguably do not arise in those circumstances.

Securities Lending Arrangements
The CSA note that they are not proposing an exemption for persons that borrow securities under securities lending arrangements because securities borrowing may give rise to empty voting situations for which disclosure should be prescribed under the EWR regime.

In this regard, we think it is important to note that not all legal terms of every securities lending arrangement are identical. As shown in recent proxy battles, the industry uses a variety of standard form contracts which can differ in their treatment of voting rights. Certain standard form contracts, including the Global Master Securities Lending Agreement, are clear that a borrower gains the voting rights attached to the loaned securities and a lender gains similar rights with respect to collateral securities. That said, s. 4(B)(vi) of the form of Overseas Securities Lending Agreement provides that each party "*will use its best endeavours to arrange for the voting rights attached to [loaned or collateral] securities to be exercised in accordance with the instructions of the Lender or Borrower (as the case may be)*". Additionally, any of the standard form contracts can be amended by the parties that enter into them to suit their specific needs. Accordingly, we do not agree that securities lending arrangements always entail the potential for empty voting.

The comparable EWR regime in the United States focuses on whether a person holds beneficial ownership of securities. Beneficial ownership under the Exchange Act is defined as the ability to exercise, directly or indirectly, voting power and/or investment power. Our suggestion to the CSA would be to adopt a similar approach in determining whether a borrower of securities must include such securities for early warning purposes. Since the policy goal of the proposed amendments is to avoid empty voting situations, we would suggest that, at a minimum, an exemption be provided for borrowers who do not hold the voting rights attached to loaned securities. If reporting is required, it would be useful to clarify which party is responsible for reporting.

We are concerned that the absence of exemptions for borrowers will lead to double counting of shares for purposes of calculating parties' interests in an issuer. This could lead to distorted or inaccurate information being presented in early warning filings, particularly in situations where a borrower does not actually hold any voting rights under the terms of its securities lending arrangement.

We also think that the Proposal should clarify that borrowings and loans should be offset against one another in any calculation of any holdings, and that a securities borrowing/loan that has not been completed due to a failed settlement should be treated as if it has settled in respect of its aggregation treatment. The purpose of the exemption for a failed settlement is to address the situation where a dealer has borrowed securities in order to immediately lend them out as part of

its normal course securities borrowing and lending business, and the on-lending transaction fails. As a result, the dealer temporarily holds the securities on its books for a short period of time (for up to 1 to 2 days). An exemption for this temporary position would be based on the intention to on-lend the securities.

Otherwise, we generally agree with the proposed exemption for lenders from the early warning requirements for securities transferred or lent pursuant to specified securities lending arrangements.

Transition period

We reiterate the view that by limiting disclosure of the use of equity derivatives to the EWR system, the key public interest goal of increased transparency would be achieved, without imposing reporting requirements in circumstances where empty voting and hidden ownership concerns do not arise. In the event that the CSA decide to proceed with the Proposal, we think it is essential to include a specific provision dealing with the transition process, including the length of the transition period. If amendments are adopted in the present form, banks will need to do a significant amount of work on their existing systems, particularly with regards to tracking securities lending and equity equivalent derivative reporting requirements. We estimate that it would take them at least a year to have a complete solution for the changes. Therefore, we would suggest a minimum of one year for the transition period.

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Thank you for the opportunity to comment on this important matter. If you have any questions or concerns regarding our comments, we would be pleased to discuss them with you in further detail.

Sincerely,