CANADA PENSION PLAN INVESTMENT BOARD

OMERS ADMINISTRATION CORPORATION

ONTARIO TEACHERS' PENSION PLAN BOARD

September 28, 2016

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8

Dear Sirs/Mesdames:

Re: Proposed OSC Rule 72-503 – ***Distributions Outside of Canada***

We are writing in response to the Ontario Securities Commission's (the "**Commission**") Notice and Request for Comment (the "**Notice**") in respect of Proposed OSC Rule 72-503 – *Distributions Outside of Canada* (the "**Proposed Rule**"), the accompanying Proposed Form 72-503F – *Report of Distributions Outside of Canada* (the "**Proposed Form**") and Proposed Companion Policy 72-503CP to *OSC Rule 72-503 – Distributions Outside of Canada* (the "**Proposed Companion Policy**").

I. THE FUNDS

Together, we manage over $500 billion in net assets and pay (or provide for the payment of) pensions to, and invest plan assets on behalf of, more than 19 million working and retired Canadians. While our individual statutory mandates are framed in slightly different language, each of us has the basic responsibility to invest in the best interests of the contributors to, and beneficiaries of, our plans with the objective of maximizing investment returns without undue risk, having regard to the requirements of our plans and the ability to meet the financial obligations under the plans. Our ability to successfully discharge our mandates is impacted by, among other things, our ability to monetize our investments. Investing in a broadly diversified global portfolio is central to our respective investment strategies and the sustainability of our respective plans. Our ability to monetize our investments through sales outside of Canada is and will continue to be crucial to our success over the coming years.

II. THE PROPOSED RULE

We continue to support the initiatives taken by the Commission to enhance Canadian investors' access to foreign investment opportunities. Recent amendments to the "wrapper" rules – which had historically discouraged foreign issuers in extending offerings to Canadian investors – have been helpful in enhancing our ability to participate in foreign capital markets. As an important complement to these amendments, it is imperative that we be able to monetize our investments in foreign markets, without facing compliance and regulatory burdens that could unnecessarily inhibit our ability to compete with our global peers and fulfill our mandates. We are therefore supportive of the Commission's initiatives to modernize and clarify the Ontario regime relating to outbound distributions and, in our view, the Proposed Rule is a step in the right direction.

The Proposed Rule helps to address the increasing incompatibility of Interpretation Note 1 (the "**Interpretation Note**") with modern capital markets activities. The historical uncertainty surrounding the Interpretation Note has too often required us to distribute securities in reliance on private placement or other exemptions from the prospectus requirement (such as section 2.14 of National Instrument 45-102 – *Resale of Securities* ("**NI 45-102**")), if available. These alternative strategies, however, are imperfect solutions for a variety of reasons, and have often required us to devote significant time and resources to ensuring we comply with their requirements, which can result in us being placed at a disadvantage relative to our global peers and potentially lead to negative consequences on our performance and, by extension, the well-being of Canadian pensioners. The creation of "bright line" prospectus exemptions for distributions outside Canada with express application to "selling securityholders" such as ourselves is therefore a change that we both welcome and support.

We also believe that the Proposed Rule is a more effective approach to the treatment of outbound distributions than those taken in certain other Canadian jurisdictions (such as British Columbia's Instrument 72-503 – *Distributions of Securities outside British Columbia*), or as proposed by the jurisdictions participating in the Cooperative Capital Markets Regulatory System (the "**CMRA**") initiative (i.e., draft Regulation 71-501 – *International Issuers and Securities Transaction with Persons Outside the CMR Jurisdictions* ("**71-501**") and draft Policy 71-601 – *Distribution of Securities to Persons Outside of CMR Jurisdictions*).[1]

Nevertheless, we have two concerns with the Proposed Rule (and the Proposed Companion Policy). First, we believe that the Proposed Rule could do more to acknowledge the status of significant shareholders such as ourselves as equal participants to issuers in Ontario's capital markets. Specifically, we believe that the Proposed Rule does not permit an appropriate degree of flexibility for selling securityholders to sell shares of foreign issuers. In our view, the policy considerations that support the disposition by selling securityholders of securities of a reporting issuer to foreign buyers without a hold period under sections 2.1 to 2.3 of the Proposed Rule also support the ability of selling securityholders to dispose of securities of foreign issuers without the

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[1] We agree with the Commission's view (as set out in the Notice) that the CMRA instruments "represent a broader approach to the application of the prospectus requirement than is Commission staff's practice today." Further, we believe that the certifications and acknowledgements that must be obtained from foreign purchasers in order to qualify for the prospectus exemption under 71-501 are difficult to obtain in practice, particularly for selling securityholders.

need for the hold period contemplated by section 2.4 of the Proposed Rule, provided that certain safeguards are implemented.

Second, as described in greater detail below, the Proposed Rule and Proposed Companion Policy incorporate some elements of the Interpretation Note that we believe could create significant uncertainty for both issuers and selling securityholders in determining the circumstances in which the new prospectus exemptions are available. Without clarification, we believe that market participants – including ourselves – may not be comfortable relying on the exemptions (for many of the same reasons that there has historically been reluctance in relying on the Interpretation Note) thereby undermining the primary objective of the Proposed Rule in providing certainty to market participants through "bright line" exemptions.

III. REFINEMENT OF THE FOREIGN RESALE EXEMPTION

A. Regulation S – Rule 904: A Proposed Additional Exemption

We believe that the Commission should consider the implementation of a fifth exemption that would closely resemble the safe harbour provision in Rule 904 of Regulation S in the United States Securities Act of 1933 (the "**U.S. Act**"). While we believe that the Proposed Rule appropriately addresses sales of securities of Canadian reporting issuers (provided that certain other minor refinements outlined below are implemented), it does not appropriately account for sales of securities of foreign issuers, despite the "catch-all" exemption in section 2.4 of the Proposed Rule. Specifically, we believe that the existence of a hold period will continue to inhibit the ability of selling securityholders to monetize their investments, as foreign purchasers will likely demand concessions to compensate for their inability to freely trade the securities. We are of the view that, in the context of sales of securities of foreign issuers, there is an opportunity to expand the Proposed Rule to prevent these unintended consequences while still maintaining the integrity of Ontario's capital markets and reinforcing the Commission's historically territorial approach to securities regulation.

The implementation of an additional exemption in the form of a Rule 904-based safe harbour provision is, in our view, appropriate given both the similarities in the Canadian and U.S. capital markets and the historical influence of the U.S. regime on Ontario's approach to outbound distributions generally.

Like in Ontario, the Securities and Exchange Commission's ("**SEC**") 1964 Release 4708 (the "**SEC Release**") confirmed that the SEC would not intervene in distributions outside of the United States provided that the securities came to rest outside of the United States, principles which are strikingly similar to those in the Interpretation Note and the Proposed Companion Policy. The SEC Release, unsurprisingly, suffered from much of the same issues regarding uncertainty as market participants have experienced under the Interpretation Note regime. As a result, in 1990, Regulation S was introduced to codify the largely territorial approach to the distribution of securities under the U.S. regime.[2]

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[2] As the SEC's final rule adopting Regulation S states: "The registration of securities is intended to protect the U.S. capital markets and investors purchasing in the U.S. market, whether U.S. or foreign nationals. Principles of comity

The safe harbour provision adopted in Rule 904 of Regulation S is currently available in the United States where:

- the sale is made in an "offshore transaction" – that is, where an offer is not made to a person in the United States and either: (i) at the time the buy order is originated, the buyer is outside the United States or the seller and any person acting on its behalf reasonably believes that the buyer is outside the United States, or (ii) the transaction is executed in, on or through the facilities of a "designated offshore securities market,"[3] and neither the seller nor any person acting on its behalf knows that the transaction has been pre-arranged with a buyer in the United States; and

- no "directed selling efforts" are made in the United States. "Directed selling efforts" are activities undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the United States for any of the securities being offered in reliance on Regulation S.

Given the considerable influence of U.S. securities laws in Canada (and, in particular, on the early evolution of Canada's "distributions out" regime), we propose that the Commission consider incorporating a safe harbour provision similar to Rule 904 of Regulation S – one which would be limited to the sale of securities of foreign issuers – in Ontario. Please refer to Appendix "A" for an example of suggested safe harbour language.

B. Further Incremental Changes

In addition to incorporating a new fifth exemption that would mirror the safe harbour provision in Rule 904 of Regulation S, we believe that certain other incremental changes to the Proposed Rule and Proposed Companion Policy would also be helpful in improving certainty and promoting cross-border transactions.

(i) Section 2.1 – Restriction of Public Offering Exemption to the U.S. and "Designated Jurisdictions"

We welcome the prospectus exemption in section 2.1 of the Proposed Rule relating to public distributions pursuant to a U.S. registration statement or other documents similar to a final prospectus in a "designated jurisdiction." However, we wish to highlight that we commonly trade in securities of issuers that, despite having filed disclosure documents in their home jurisdictions or otherwise, may not have done so in a "designated foreign jurisdiction." We find the proposed list of "designated foreign jurisdictions" to be incomplete, given its original application to National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers* (effective 2004) and believe that the list could reasonably be expanded while maintaining the integrity of Ontario's capital markets.

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and the reasonable expectations of participants in the global markets justify reliance on laws applicable in jurisdictions outside the United States to define requirements for transactions effected offshore. The territorial approach recognizes the primacy of the laws in which a market is located. As investors choose their markets, they choose the laws and regulations applicable in such markets."

[3] These include exchanges specifically designated in Regulation S (of which there are numerous), or any other exchange designated by the SEC.

(ii) Uncertainty of the Proposed Rule

While we believe that much of the uncertainty surrounding the application of the Proposed Rule largely arises as a result of the discussion of the "reasonable steps" test in the Proposed Companion Policy (as discussed below), there are also certain components of the Proposed Rule itself that we believe would benefit from further clarification.

(a) <u>Distribution of Securities to a Person Outside of Canada</u>

One requirement underlying each of the new exemptions in the Proposed Rule is that the distribution of securities be "to a person or company outside of Canada." While the identity of a purchaser may be known in a sale to a foreign purchaser pursuant to a private placement exemption, many of our trades are executed on the facilities of foreign exchanges where the identity of the buyer is unknown and may not be ascertainable. Requiring selling securityholders to analyze trading patterns of the securities being sold over these exchanges to ultimately gain comfort that the sale was made "to a person or company outside of Canada" would be unduly burdensome and could result in the type of inefficiency in cross-border transactions that the Proposed Rule seeks to alleviate. We therefore propose – regardless of the Commission's decision regarding a proposed fifth exemption – that the Proposed Rule clarify that trades executed on the facilities of foreign exchanges that are not pre-arranged would be deemed to be trades to a person or company outside of Canada.

We propose that the Proposed Rule could therefore apply to "distributions to a person or company outside of Canada or through the facilities of the principal offshore securities market (or another substantial offshore securities market) for the securities being sold, provided that neither the seller nor any person acting on its behalf knows that the transaction has been pre-arranged with a buyer in Canada."

(b) <u>Jurisdictional Issues</u>

Some uncertainty arises in the context of the Proposed Rule with respect to how the Commission envisions the rule's co-existence with existing national instruments, in particular NI 45-102. For instance, we frequently acquire securities pursuant to the accredited investor exemption. In contrast to section 2.5 of NI 45-102 – which deems the first trade of a security distributed under the accredited investor exemption a "distribution," unless certain conditions are met – the Proposed Rule provides simply that a distribution of these securities made to a foreign purchaser is exempt from the prospectus requirement. We expect that distributions made in reliance on the Proposed Rule would not be subject to requirements of section 2.5 of NI 45-102 – in other words, just as securities are freely tradeable within the "closed system" without meeting the requirements in NI 45-102, we anticipate that a sale pursuant to the exemptions in the Proposed Rule would similarly be exempt from those requirements. Nevertheless, we believe it would be beneficial to expressly clarify this point in the Proposed Rule or, alternatively, in the Proposed Companion Policy.

(iii) Uncertainty of the Proposed Companion Policy – The "Reasonable Steps" Test

The Proposed Companion Policy continues to import much of the Interpretation Note's historical focus on the "reasonable steps" test. As we understand this concept, a sale of securities outside

of Canada (which, depending on the "connecting factors" to Ontario, may be considered a "distribution" under the *Securities Act* (Ontario)), need not be qualified by a prospectus where the issuer or selling securityholder has taken "reasonable steps" and implemented "reasonable precautions and restrictions" designed to ensure that the securities do not flow back into Canada. As noted in the Interpretation Note:

> *In light of the outlined provisions of the Act, including the broad definition of "trade", and depending on the connecting factors with Ontario, a distribution of securities outside Ontario by Ontario or non-Ontario issuers might also be considered to be a distribution of securities in Ontario requiring compliance with the prospectus provisions of the Act or a exemption therefrom.*
>
> *However, where a distribution of securities is effected outside of Ontario by Ontario or non-Ontario issuers and where reasonable steps are taken by the issuer, underwriter and other participants effecting such distribution to ensure that such securities come to rest outside of Ontario, the Commission takes the view that a prospectus is not required under the Act, nor is an exemption from the prospectus requirements necessary.* [emphasis added]

A similar view appears to be set forth in the Proposed Companion Policy under Part 1, "Statement of Principle":

> *…[T]he Commission does not interpret the prospectus requirement as applying to a distribution of securities outside of Canada that is made in compliance with the securities laws of the foreign jurisdiction in which the investor is located, provided that the issuer, underwriters and other participants in the offering take reasonable steps to ensure that the securities come to rest outside of Canada and are not redistributed back into Canada. The issuer, underwriters and other participants in the offering would be expected to implement reasonable precautions and restrictions designed to ensure that the entire distribution process results in the securities being held by or for the benefit of foreign investors, as opposed to intermediaries in the distribution chain holding securities for resale to investors in Canada.* [emphasis added]

We find that continued reference to the notion of "reasonable steps" serves only to increase the uncertainty of the Proposed Companion Policy – and, by extension, the Proposed Rule – particularly when contrasted with the Commission's creation of "bright-line" exemptions in the Proposed Rule. Most notably, the Proposed Companion Policy, under Part 2, "Resale," suggests that "reasonable steps" must continue to be taken, even when relying on an explicit exemption:

> *Nothing in the Rule prohibits or restricts the resale of the securities distributed under an exemption from the prospectus requirement in section 2.1, 2.2, or 2.3 of the Rule. Nevertheless, the Commission expects the issuer, underwriters and other participants in the offering will have taken reasonable steps to ensure that the securities come to rest outside of Canada and are not redistributed back into Canada in a manner that constitutes an indirect distribution in Ontario.*
>
> *Securities distributed under an exemption from the prospectus requirement in section 2.4 of the Rule may be subject to resale restrictions.* [emphasis added]

This language suggests that the foregoing obligation to take "reasonable steps" to ensure that securities come to rest outside Canada applies where issuers or selling securityholders are relying

on the exemptions in sections 2.1, 2.2 or 2.3 of the Proposed Rule.[4] If that were the case, it could significantly limit (if not eliminate) the potential utility of the Proposed Rule, since reliance on the "bright-line" exemptions would require the same uncertain analysis that currently underlies the Interpretation Note. Moreover, if such reasonable steps are taken and the flow back risk addressed, there would be no prospectus requirement under Ontario securities laws in the first instance, rendering reliance on an exemption unnecessary. It seems clear to us that the exemptions in sections 2.1, 2.2, and 2.3 are premised on the existence of factors that are intended to mitigate any potential harm to investors in Ontario of the securities distributed flowing back into Ontario markets.

In our view, in order to enhance the overall certainty of the Proposed Rule, the "reasonable steps" language in the Proposed Companion Policy – including in both of the references above – should be removed entirely to avoid any confusion about the circumstances in which the new exemptions are available.

It may be that the proposed continued reliance on this aspect of the Interpretation Note is meant to serve as a quasi "anti-avoidance" measure aimed at avoiding potentially undesirable consequences associated with such a sudden transition away from the Interpretation Note. The Commission's role in maintaining the integrity of Canadian capital markets while seeking to provide increased certainty in cross-border transactions is a delicate balancing exercise of which we are supportive. Nevertheless, we believe that the Commission could continue to ensure that market participants do not circumvent the spirit of the Proposed Rule pursuant to its existing public interest jurisdiction. Alternatively, we believe that an anti-avoidance mechanism could be incorporated into the Proposed Rule without imposing an uncertain and onerous obligation on capital market participants.[5] Please refer to Appendix "B" for an example of suggested anti-avoidance language.

Please do not hesitate to contact us if you would like to discuss any of the matters outlined in this letter.

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[4] While not expressly mentioned, we interpret the omission of section 2.4 in this section to be reflective of the Commission's view that the existence of a hold period in section 2.4 provides sufficient certainty that securities will "come to rest" outside of Canada.

[5] For example, the United States' Regulation S also contains an anti-avoidance mechanism such that the safe harbour provisions are unavailable where a transaction, although in technical compliance with the rules, is part of a plan or scheme to evade the registration provisions of the U.S. Act.

Yours very truly,

CANADA PENSION PLAN INVESTMENT BOARD

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APPENDIX A
PROPOSED SAFE HARBOUR EXEMPTION

The proposed safe harbour exemption (new Section 2.5) would mirror the safe harbour rule in Rule 904 of Regulation S. The exemption would be available for the resale of foreign securities where:

- the sale is made in an "offshore transaction;" and
- no "directed selling efforts" are made in Canada.

A proposed definition of "offshore transaction and "directed selling efforts" would closely mirror those in Regulation S, as follows:

> "**offshore transaction**" means an offer not made to a person in Canada where either:
>
> > (i) at the time the buy order is originated, the buyer is outside Canada or the seller and any person acting on its behalf reasonably believes that the buyer is outside Canada, or
> >
> > (ii) the transaction is executed in, on or through the facilities of a principal offshore securities market (or another substantial offshore securities market) for the securities being sold, and neither the seller nor any person acting on its behalf knows that the transaction has been pre-arranged with a buyer in Canada.
>
> "**directed selling efforts**" mean activities undertaken for the purpose, or that could reasonably be expected to have the effect, of conditioning the market in Canada for any of the securities being offered for resale in reliance on the exemption.

APPENDIX B
PROPOSED ANTI-AVOIDANCE PROVISION

The prospectus exemptions in sections 2.1 through 2.5 of the Proposed Rule are not available with respect to any transaction or series of transactions that, although in technical compliance with the Proposed Rule, is part of a plan or scheme to evade the prospectus requirements in connection with a distribution to one or more Canadian residents.