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CSA Consultation Paper 51-404 — Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers

Introduction

This letter is submitted in response to the CSA Consultation Paper 51-404 — *Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers* (**Consultation Paper 51-404**) issued by the Canadian Securities Administrators (the **CSA**) on April 6, 2017. It reflects the views of a working group consisting of issuers having a combined market capitalization of more than $120 billion (the **Working Group**). Members of the Working Group believe the CSA's review of the regulatory burden on reporting issuers is an excellent initiative as such burden has an impact on Canada's ability to attract and keep public companies. We thank you for affording us an opportunity to comment on this important matter.

Public companies play a vital role in ensuring efficient capital allocation. Unfortunately, 2016 was a dismal year for the Canadian IPO market, with only three new issues on the TSX and eight new issues on all exchanges in

Canada.[1] One of the main criticisms of reporting issuers is the never-ending increase in regulatory requirements and compliance costs. In March 2017 alone, the CSA announced a project to review the disclosure of risks and financial impacts associated with climate change and published its report on social media, requesting issuers to take action to improve social media disclosure in response to issues raised during its review.

Through this letter, members of the Working Group first provide general comments on how to revamp disclosure requirements and then focus on certain questions listed in Consultation Paper 51-404. In their answers to these questions, they identify options that would have the most impact in reducing their regulatory burden. These options consist of permitting semi-annual reporting, streamlining prospectus requirements and eliminating overlap in regulatory requirements.

General comments

When considering general reporting requirements, it is important to keep in mind that compared to other world-leading economies, the Canadian stock market is primarily composed of SMEs, with a large percentage of issuers having a market capitalization of less than $500 million.[2] Despite the profile of Canadian issuers, our securities regulations are often similar to U.S. regulations designed for a market of much larger issuers. The regulatory burden of all Canadian issuers should be reduced to reflect the realities of our market. Even in the U.S., regulators recognize that the regulatory burden plays an important role in a large number of companies, including many of the country's most innovative businesses, opting to remain privately held. On July 12, 2017, the newly appointed SEC Chairman, Jay Clayton, shared his perspective on the SEC with the Economic Club of New York.[3] Mr. Clayton said that "Incremental regulatory changes may not seem individually significant, but, in the aggregate, they can dramatically affect the markets". He took a public stand against the decline in the total number of U.S.-listed public companies over the last two decades. Mr. Clayton said that "while there are many factors that drive the decision of whether to be a public company, increased disclosure and other burdens may render alternatives for raising capital, such as the private markets, increasingly attractive to companies that only a decade ago would have been all but certain candidates for the public markets". A similar phenomena is observed in the Canadian market and the CSA should be proactive in reducing the regulatory burden of Canadian issuers.

To effectively reduce the regulatory burden of Canadian issuers, the CSA should focus on facilitating useful and readable disclosure and eliminating rules creating overdisclosure. To reach this goal, CSA requirements must allow issuers to better focus on what is material to their specific business and financial conditions. Although securities regulations provide some guidance on materiality, the risk of liability for failure to disclose encourages issuers to overdisclose and adopt standardized "boilerplate" disclosure. Until the CSA addresses liability risks, many issuers will continue to follow prudent practices and include, for instance, lengthy risk factor disclosure to mitigate such liability risks. What may be perceived as an overdose of information may ultimately obscure important facts and limit the ability of shareholders to efficiently make investment decisions.

In order to properly take into account the particular circumstances of each issuer, the disclosure regime should change in some respects from a purely prescriptive, rules-based construct to a more flexible principles-based approach, relying to a greater extent on management's judgment in identifying material information. Such emphasis on principles-based disclosure requirements would reduce the amount of less relevant information disclosed pursuant to one-size-fits-all thresholds. The CSA could also consider automatic sunset provisions attached to certain new disclosure rules requiring formal action by the CSA following its assessment of the effects of or necessity for a particular requirement before its permanent adoption.[4]

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[1] Dismal 2016 the worst year for Canadian IPO market, PwC survey shows: http://www.pwc.com/ca/en/media/release/dismal-2016-the-worst-year-for-canadian-ipo-market.html

[2] Public Listing: The Weak Link in Quebec's Corporate Finance Ecosystem, A Corrective Action Plan, June 15, 2016, p. 20, online: http://quebecbourse.com/wp-content/uploads/2016/08/rapport-inscription-en-bourse_en.pdf.

[3] https://www.sec.gov/news/speech/remarks-economic-club-new-yorkhttps://www.sec.gov/news/speech/remarks-economic-club-new-york

[4] The SEC has, on occasion, adopted rules with automatic sunset provisions. See the Regulation S-K Concept Release, p. 29-30, online: https://www.sec.gov/rules/concept/2016/33-10064.pdf.

Overall, emphasis should be put on what is most important for investors, including an overview of an issuer's recent performance, development of its business and strategies to achieve long-term growth, similar to what a CEO would report to his board of directors.[5] This is consistent with what is considered by some as the "new paradigm" of corporate governance, focusing on sustainable value, long-term corporate strategies and shareholder involvement.[6]

Potential options to reduce regulatory burden

1. *Of the potential options identified in Consultation Paper 51-404, which would meaningfully reduce the regulatory burden on reporting issuers while preserving investor protection?*

(a) Permitting semi-annual reporting

Two going-private transactions involving leading companies in their fields were recently announced on the same day. Both these deals highlighted the disconnect between the creation of long-term value and the management of market expectations on a quarterly basis.[7] Faced with the prospect of having to produce extensive quarterly reports, it is understandable that many growing companies are preferring private exits to public listings. Members of the Working Group are of the view that the CSA should lift the requirement that public companies issue quarterly financial reports and allow them to report semi-annually. Moving away from what some institutional investors have called the "quarterly earnings hysteria"[8] may in many instances free significant corporate time and resources while encouraging long-term thinking. Allowing semi-annual reporting would also put Canada on a level playing field with many European jurisdictions, the United Kingdom and Australia.

Some may argue that because the United States maintains quarterly reporting, at least for now, many issuers will feel pressured to keep reporting on a quarterly basis. That may be especially true for large corporations, particularly Canada-U.S. inter-listed issuers. Members of the Working Group nevertheless believe that the option permitting semi-annual reporting should be made available and urge the CSA to work with the U.S. Securities and Exchange Commission to encourage them to follow suit.

To those concerned that reporting semi-annually may increase the risks of selective disclosure, one could respond that applicable securities laws and stock exchange rules will still require issuers to update the market on all material information, on a timely basis, and that selective disclosure of material non-public information will remain illegal.

(b) Streamlining prospectus requirements

The time and cost to prepare prospectus documentation is also an impediment to capital raising for some public companies. Members of the Working Group thus welcome the CSA's proposal to study alternative prospectus models that do not duplicate and are more closely linked to continuous disclosure documents, while providing more concise and focused information to investors. As we understand it, one of the proposed prospectus offering regimes described in the Consultation Paper is essentially the shelf system, using continuous disclosure as a substitute for the shelf prospectus. Under that regime, an issuer would only be required to produce a brief document similar to the Integrated Disclosure System prospectus model, a concept developed by the CSA in 2000, focusing on information relevant to the offering, such as a detailed description of the securities offered, the

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[5] A similar proposal made by the Committee on Financial Reporting of the New York City Bar is referred to in the Regulation S-K Concept Release, p. 98-99.

[6] "Corporate Governance: the New Paradigm," Martin Lipton, Wachtell, Lipton, Rosen & Katz, January 11, 2017, online: https://corpgov.law.harvard.edu/2017/01/11/corporate-governance-the-new-paradigm/

[7] Canam Group Inc. and Lumenpulse Inc. both announced going-private transactions on April 27, 2017. In an interview with the Globe and Mail, Marc Dutil, CEO of Canam, said the deal was born from the conclusion that the cyclical and risky nature of the construction industry was increasingly at odds with the imperatives of public markets, highlighting a disconnect between the pace at which he saw his business going and what the markets were expecting. See Nicolas Van Praet, *Quebec's Dutil family taking Canam Group private*, Globe and Mail, April 27, 2017: https://www.theglobeandmail.com/report-on-business/quebecs-dutil-family-taking-canam-group-private/article34827891/.

[8] http://www.businessinsider.com/blackrock-ceo-larry-fink-letter-to-sp-500-ceos-2016-6

use of proceeds, the plan of distribution, material risk factors associated with the offering, etc.[9] Members of the Working Group generally agree with such proposal, which would remove duplications and simplify the process.[10] To the extent the shelf system is maintained, the length of the shelf prospectus should be increased from the current maximum of 25 months to at least 36 months, as is the case in the United States.[11]

Members of the Working Group also suggest removing the current requirement to file every version of marketing materials shown to investors in connection with an offering. Filing on SEDAR very similar documents multiple times (for instance, an indicative term sheet, a final term sheet and a blackline between the two, in English and French, and similar material for various series of notes issued concurrently) is burdensome to reporting issuers and not particularly useful to investors.

(c) Eliminating overlap in regulatory requirements

Of the issues identified in Consultation Paper 51-404, members of the Working Group believe the CSA should also prioritize the elimination of overlapping regulatory requirements. Some rules are duplicative. This is the case, for instance, for information relating to directors on bankruptcies, penalties or sanctions and biographies when they are members of the audit committee. Risk factors also need to be disclosed in various documents.

Although consolidating the MD&A, AIF and financial statements into one document as suggested in the Consultation Paper would appear to present issues under accounting rules, the CSA could allow the MD&A and the AIF to be combined. Members of the Working Group believe that this change would be beneficial to both issuers and investors, provided that the new combined document is not substantially longer than the current MD&A and that overlapping MD&A and financial statements requirements be eliminated. To the extent these overlapping requirements remain, allowing the new combined form of MD&A and AIF (unlike the current MD&A requirements) to incorporate by reference relevant sections of the Financial Statements[12] could be a good way to eliminate duplications. Some disclosure requirements related to the MD&A and AIF could also be transferred to the proxy circular, such as information on directors and officers.

(d) Other options to reduce the regulatory burden

(i) Modifying the criteria to file a business acquisition report (**BAR**)

Members of the Working Group feel that the 20% threshold applied to the significance tests for the publication of a BAR, as described in Part 8 of NI 51-102 *Continuous Disclosure Obligations*, is too low and should be increased to at least 30%, given the size of Canadian issuers. They are of the view that the CSA should also codify some of the case-by-case exemptions granted to issuers when the requirement to file a BAR does not make sense, such as in cases where important write-offs must be taken by the target company.

(ii) Enhancing the use of electronic communications

Members of the Working Group believe that corporations should be allowed to use electronic communications to provide notice of meetings to shareholders and online access to relevant documents. Working with corporate law legislators to allow reporting issuers to communicate with shareholders through emails or other electronic means, will significantly improve effectiveness and reduce costs. Eventually, blockchain technology could also

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[9] See *Canadian Securities Administrators Notice and Request for Comment 44-101, 51-401 – Concept Proposal for an Integrated Disclosure System,* January 28, 2000.
[10] As we understand the CSA's proposal, some disclosure included in the shelf prospectus such as the description of the business, consolidated capitalization, prior sales and recently completed and probable acquisitions would not be required.
[11] Section 2.2(3)(a) of NI 44-102 – *Shelf Distributions* and *U.S. Securities Act of 1933*, Regulation C, Rule 415.
[12] Including, in particular, sections on (i) contractual commitments; (ii) financial instruments; (iii) critical accounting estimates; and (iv) critical accounting policies so as not to repeat in the new combined form of MD&A and AIF disclosure that is already covered in the Financial Statements.

help to disseminate information, allow more automated corporate record-keeping and make shareholder voting more efficient and accurate.[13]

(iii) Removing information that is no longer useful or that is easily accessible to investors in real time

Some regulatory requirements are no longer useful and should be removed. Furthermore, certain information is now accessible to investors online in real time. For instance, members of the Working Group are of the view that the trading information disclosed in the AIF[14] should not be required as investors can find more customized information online, in real time. Similarly, disclosing the summary of quarterly results for each of an issuers' last eight quarters in the MD&A[15] and describing how a company has developed over the last three financial years in the AIF[16] are not as useful as they used to be. Businesses evolve so quickly nowadays that what happened a few years ago may not be material anymore and information on these matters can be found in an issuer's past continuous disclosure documents. In addition, instead of attaching the audit committee charter to the AIF,[17] an issuer should have the option to refer to its website where the document would be made available to investors. More generally, the CSA should provide more flexibility to issuers in determining what should be disclosed on their business activities, based on materiality.

(iv) Allowing a single filing to satisfy more than one obligation

Although a lower priority, there may be an opportunity to reduce the regulatory burden of issuers by allowing a single filing to satisfy more than one obligation. For example, the material change report is in many cases only a cover sheet for the more detailed news release required to be filed under Section 7.1 of NI 51-102. A news release that includes the disclosure required by Form 51-102F3, that could be filed as a material change report and be incorporated by reference in an offering document, would reduce this duplication.

(v) Amendments to ATM Offerings

Finally, the Working Group is of the view that the exemptive relief granted for ATM offerings should be codified in securities legislation. To require issuers and associated agents to apply for exemptive relief (which relief has historically always been granted and, one expects, would continue to be granted) each time that an ATM offering is launched, adds an unnecessary layer of regulatory burden to ATM offerings in Canada.

Conclusion

In conclusion, cost-effective access to capital for issuers of all sizes plays an important role in our national economy. The cost of disclosure increases the cost of raising capital and is time consuming. It is no wonder that the never-ending increase of regulatory requirements is often mentioned as a factor contributing to going-private transactions. Members of the Working Group therefore applaud the CSA's initiative to place the review of the regulatory burden on reporting issuers as one of its key initiatives for 2016-2019 and look forward to the CSA's next steps in this regard.

Many of the options identified in Consultation Paper 51-404 would have the effect of reducing the regulatory burden of reporting issuers. As outlined above, members of the Working Group believe that disclosure requirements should focus on material information and be more principles-based. They are also of the view that

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[13] On March 27, 2017, the Delaware State Bar Association approved amendments to the Delaware General Corporation Law to permit blockchain maintenance of corporate records. The proposed amendments will be introduced in the Delaware General Assembly for consideration and could become effective by the end of the summer. They can be found here: http://www.rlf.com/files/14257_Council%202017%20Proposals%20in%20Bill%20Form%20(5).pdf
NASDAQ is also currently developing a solution enabling issuers to digitally represent share ownership using blockchain technology. Their goal is for this solution to eventually become a distributed ledger. For more information, see "Building on the Blockchain: NASDAQ's Vision of Innovation", online: http://business.nasdaq.com/Docs/Blockchain%20Report%20March%202016_tcm5044-26461.pdf

[14] See Section 8 of Form 51-102F2 – *Annual Information Form*

[15] See Section 1.5 of Form 51-102F1 – *Management's Discussion & Analysis*

[16] See Section 4.1 of Form 51-102F2 – *Annual Information Form*

[17] See Form 52-110F1 – *Audit Committee Charter Required in an AIF*

permitting semi-annual reporting, streamlining prospectus requirements and eliminating overlap in regulatory requirements would have the most impact. In order for our public markets to remain appealing to Canadian and foreign companies, the costs associated with regulatory requirements should be balanced against regulatory objectives and their real value to investors.

Yours very truly,

(signed) Norton Rose Fulbright Canada LLP