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Capital markets activity slows as regulatory changes appear on the horizon

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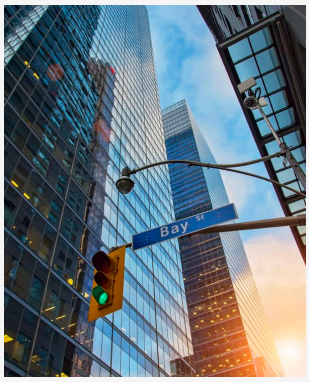

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After a frenzied 18-month period for the capital markets in Canada, 2022 saw a rapid about-face in activity levels, with initial public offering (IPO) and follow-on activity declining to the lowest level in years. Global unrest, economic uncertainty, rising interest rates, sustained inflation and disappointing results for many issuers who completed an IPO during the prior period resulted in a softening of demand and investors pulling back from making new investments. This pullback occurred even though Canadian regulatory authorities continued to take steps to reduce the regulatory burden for issuers with a view to making it easier to both raise capital and carry on business while also seeking to protect investor interests.

New changes to the application of the "primary business" rules are also likely to assist acquisitive issuers looking to go public by reducing uncertainty and simplifying financial statement requirements.

Among other developments in 2022, the Canadian Securities Administrators (CSA), the umbrella organization of provincial and territorial securities regulatory authorities, introduced a pilot project framework for a well-known seasoned issuer (WKSI) regime in Canada. The WKSI model provides an accelerated way of raising capital by allowing larger, seasoned issuers that meet the WKSI conditions to pass over filing a preliminary shelf prospectus and move straight to a final prospectus. This is intended to eliminate the regulatory review process for a prospectus. However, as we discuss below, Canada's WKSI model differs in important ways from the United States model, which may be limiting widespread adoption of the new WKSI system in Canada. Other new prospectus exemptions have been introduced that are intended to provide greater flexibility in raising capital. New changes to the application of the "primary business" rules are also likely to assist acquisitive issuers looking to go public by reducing uncertainty and simplifying financial statement requirements.

The CSA has undertaken several consultations this year, the outcome of which remain pending. The consultations relate to proposed amendments to implement an access equals delivery model for delivery of prospectuses and continuous disclosure documents for non-investment fund reporting issuers as well as a more limited access-based model for investment fund reporting issuers. The CSA is also undertaking a comprehensive review of the mineral disclosure requirements set out in National Instrument 43-101 – Standards of Disclosure for Mineral Projects (NI 43-101). Finally, the tail end of 2021 saw the introduction

of a draft *Capital Markets Act* in Ontario that is intended to replace the existing statutory securities framework in Ontario.

Here is our take on these and other notable capital markets regulatory developments.

WKSIs arrive in Canada (almost): SEC's concept for a faster track to capital comes north

On January 4, 2022, a pilot program of the CSA came into force creating a streamlined shelf prospectus process for large, established reporting issuers. The program was implemented on a (mostly) harmonized basis across CSA jurisdictions through temporary exemptions from certain base shelf prospectus requirements for qualifying WKSIs. The WKSI exemptions allow an issuer to bypass the requirement to file a preliminary base shelf prospectus and the associated regulatory review and to instead skip directly ahead to filing a final base shelf prospectus.

The WKSI exemptions also eliminate the requirement that the final base shelf prospectus state the aggregate dollar amount that may be raised under the base shelf prospectus. In addition, they provide that the inclusion of a plan of distribution, a description of securities to be offered (other than identifying the types of securities to be issued) and a description of any selling securityholders can be deferred until the prospectus supplement for an offering. A prospectus supplement is not subject to regulatory review. The pilot program is largely modeled after the frequently-used WKSI regime in the United States that has been in place since 2005, although there are certain notable differences between the pilot project and the U.S. WKSI system. It remains to be seen whether the CSA will seek to further reduce or eliminate these differences upon or prior to the expiry of the pilot program.

The WKSI pilot program is part of the CSA's ongoing initiatives to reduce the regulatory burden on capital market participants and includes changes based on the recommendation of the Ontario Capital Markets Modernization Taskforce. The pilot program is premised on the CSA's experience that base shelf prospectuses filed by large, established reporting issuers with a strong market following and up-to-date disclosure records are less likely to result in substantive deficiency comments. To date, the WKSI pilot program has proved to be popular, with large Canadian issuers filing approximately 40 WKSI base shelf prospectuses since the beginning of 2022.

To qualify as a WKSI, an issuer must not be an investment fund issuer and must, within 60 days of filing the base shelf prospectus, either

- have outstanding listed equity securities that have a public float of $500 million, or
- have distributed at least $1-billion aggregate principal amount of non-convertible securities, other than equity securities, under a prospectus in primary offerings for cash in the last three years

In addition, among other requirements, the issuer must have been a reporting issuer in at least one jurisdiction of Canada for 12 months and have filed all continuous and timely disclosure documents required in each jurisdiction in which it is a reporting issuer. The CSA's WKSI eligibility criteria generally align with those in the United States, except that a US$700-million public float requirement applies to U.S. WKSI issuers.

While the CSA's WKSI pilot program marks a significant step forward in modernizing the public offering process for large Canadian reporting issuers, there remain certain key differences from the U.S. WKSI regime. For example, a registration statement of a U.S. WKSI

issuer is automatically effective upon filing with the U.S. Securities and Exchange Commission. This provides a critical element of certainty for transaction execution, as no SEC clearance is needed before the offering can proceed. By contrast, the CSA's pilot program does not eliminate the need to obtain a final receipt for the final base shelf prospectus before an offering can proceed. The CSA has indicated that, in the ordinary course, it would expect to issue a final receipt for a final base shelf prospectus on the date of filing if the prospectus is filed before noon (or the next business day for a final base shelf prospectus filed after noon). However, there remains the possibility that the principal regulator may deviate from the ordinary course and conduct a review, or other types of processing issues could occur, both of which can delay the issuance of a final receipt.

Another difference between the CSA's WKSI pilot program and the U.S. WKSI regime is the ability of a U.S. WKSI to use a "pay-as-you-go" approach to filing fees. Under this approach, payment of filing fees is made only at the time of an actual offering from the base shelf prospectus. Under the CSA's pilot program, filing fees that would typically accompany a preliminary base prospectus must be paid upon the filing of the final base shelf prospectus.

Furthermore, after filing their U.S. WKSI base shelf registration statements, U.S. WKSIs are required to reassess their eligibility to use the U.S. WKSI regime annually upon the filing of their Form 10-K or Form 20-F annual reports. If the issuer no longer qualifies as a U.S. WKSI at that time, the issuer must promptly convert their U.S. WKSI base shelf registration statements into an available non-WKSI registration statement format. The CSA's pilot program does not have a similar requirement.

We are hopeful that the significant market uptake of the CSA's pilot project and the CSA's ongoing monitoring of the relevant public interest considerations will serve as a springboard for the CSA to take the extra step to amend the prospectus regime in Canada accordingly. The temporary pilot project would thereby become a permanent and automatic receipt regime for WKSI issuers in Canada.

New free-trading prospectus exemption for listed issuers

The CSA implemented a new prospectus exemption for issuers listed on a Canadian stock exchange. The new exemption came into effect November 21, 2022 and is intended to make capital raising more efficient for small- and mid-sized issuers. It allows an issuer listed on a recognized exchange that has been a reporting issuer for at least 12 months and otherwise satisfies the exemption conditions to file a short offering document to supplement its disclosure record and qualify the distribution of specified types of securities. The exemption permits the issuer to raise up to the greater of $5 million or 10% of the issuer's market capitalization, to a maximum of $10 million, over a 12-month period. Shares distributed under the exemption are freely tradeable, which may assist with pricing for offerings using the new exemption as compared to other available exemptions. In contrast, where issuers sell securities to accredited investors and in reliance on certain other prospectus exemptions, the securities are subject to a four-month hold period, with investors typically seeking a liquidity discount in pricing as a result. The introduction of an additional prospectus exemption that does not require a hold period may assist some issuers, particularly smaller reporting issuers, in attracting new capital.

In response to comments received on their initial 2021 proposal, the CSA made changes to the amendments focused on increasing investor protection. Changes include imposing primary offering statutory liability in the event of a misrepresentation in the issuer's offering document or certain continuous disclosure documents. In addition, the CSA limited the types of securities that could be distributed in reliance on the listed issuer financing exemption to securities that investors are familiar with. These are listed equity securities and units consisting of listed equity securities, as well as warrants convertible into listed equity

securities.

Notably, use of the new exemption requires the issuer to reasonably expect that it will have available funds to meet its business objectives and liquidity requirements for a period of 12 months following completion of the distribution. This condition may not be an impediment to many issuers. However, it may be difficult to satisfy for certain categories of issuers – such as mining development issuers – given their intense capital requirements. While there is no minimum offering amount prescribed by the new exemption, the CSA confirmed in revisions to the Companion Policy to NI 45-106 that if, following completion of the offering, the issuer would not have sufficient available funds to meet the issuer's business objectives and liquidity requirements for a period of 12 months, the issuer must set a minimum offering amount to satisfy the condition. During the comment period it was proposed that this condition be removed. However, as the exemption allows listed issuers to distribute securities directly to retail investors, the CSA believed it to be appropriate to align some of the conditions in the new exemption with those that apply when conducting an offering under a prospectus, which include having sufficient post-offering resources for 12 months of operations.

Progress towards access equals delivery for all issuers

On April 7, 2022, after more than 15 years of experience with an access equals delivery model for a final prospectus in the United States, the CSA issued a notice and request for comment for a proposed access equals delivery model for non-investment fund reporting issuers. This proposal followed a 2020 CSA consultation paper on the appropriateness of implementing an access equals delivery model in Canada.

Under the proposal, non-investment fund reporting issuers will be permitted to implement an access equals delivery model for prospectuses, annual financial statements, interim financial reports and related management's discussion and analysis. Under the proposed model, the requirement to send the relevant documents would be satisfied by the filing of the document on SEDAR, the System for Electronic Document Analysis and Retrieval, and the filing and dissemination of a news release noting the availability of the document. The proposed model does not apply to rights offerings by way of prospectus or to medium-term note programs and other continuous distributions offered under a shelf prospectus. It also does not provide for access equals delivery for documents that require immediate shareholder action and participation, such as proxy-related materials and take-over bid and issuer bid circulars. Although extending an access equals delivery model to those types of documents may be considered in the future, for now the CSA believes that these documents continue to merit direct mailing or other currently permissible means of delivery to shareholders.

The comment period was open until July 6, 2022. Further action has not yet been taken on the proposal by the CSA. Subsequently, on September 27, 2022, the CSA issued a notice and request for comment (open until December 26, 2022) for a proposed access-based model for investment fund reporting issuers. The CSA proposed an alternative to delivery of financial statements, including interim financial reports, and interim and annual management reports of fund performance. This model differs from that proposed for non-investment fund reporting issuers. The CSA believes that the typical investor in a non-investment fund reporting issuer has different informational needs than the typical investor in an investment fund reporting issuer. As a result, the CSA has not proposed an access-based model for fund offering documents (Fund Facts, ETF Facts or prospectuses as applicable). The CSA is of the view that there are significant benefits to the typical investor in investment funds in receiving the relevant offering documents rather than only having access to them.

In both cases, the proposed changes are being driven by advances in technology, the

increased availability and accessibility of information, and a continued desire to reduce regulatory burdens on reporting issuers while protecting investor interests. We are likely to see a concerted push to advance electronic access in 2023.

Primary business rules clarified and finally harmonized

In August 2021, the CSA proposed clarifications to Companion Policy 41-101 [PDF] (41-101CP) that were intended to harmonize the interpretation of financial statement requirements for long form prospectuses. The CSA followed through on this proposal by implementing new changes that took effect in April 2022. The new changes largely mirror those proposed in 2021 and seek to provide consistency in the application of the "significant acquisition" and "primary business" requirements of the prospectus rules across all jurisdictions. Prior inconsistent interpretations between CSA jurisdictions in the application of these rules resulted in some issuers that had made recent acquisitions facing increased time, cost and uncertainty to clear a prospectus with the applicable principal regulator.

The new changes to 41-101CP provide additional guidance on what constitutes a primary business and what constitutes a predecessor entity for purposes of the financial statement requirements. The CSA has also included a number of helpful examples that represent the most common scenarios encountered by CSA staff. The changes are aimed at reducing the regulatory burden by harmonizing the approach taken by CSA members in assessing these requirements. We expect the changes will help clarify areas of prior ambiguity. Among other things, we hope there will need to be fewer requests for exemptive relief with respect to financial statements of an acquired business in the context of a Canadian initial public offering.

Ontario proposes a new *Capital Markets Act*

Further to the proposals of Ontario's Capital Markets Modernization Taskforce, on October 2, 2021, the Ontario government proposed a new draft *Capital Markets Act* as a next step in its commitment to modernize Ontario's capital markets. The draft legislation, commentary and table of concordance were open for comment until February 18, 2022. Although the feedback provided to the Ontario government by market participants has not been made public, a number of commenters have independently disclosed their views. Many questioned the need for wholesale replacement of the existing *Securities Act* with new legislation that could upend decades of learning by market participants – particularly in light of the stated objective of the Taskforce to reduce regulatory burden on market participants. To date, the Ontario government has yet to reply to the feedback received or address its plan for updating the statutory securities framework in the province.

SROs come together: MFDA and IIROC agree to combine

After several years of consultations and discussions, including the release of a 2020 CSA consultation paper seeking feedback on the framework for self-regulatory organizations (SROs) in Canada, a plan to combine the Mutual Fund Dealers Association of Canada (MFDA) and the Investment Industry Regulatory Organization of Canada (IIROC) was announced by the CSA in August 2021. On September 29, 2022, the members of both SROs approved the combination.

The consolidation is expected to become effective on January 1, 2023, subject to the conditions outlined in the combination agreement between the two SROs. At that time, the MFDA and IIROC will become one organization that will temporarily be known as the New Self-Regulatory Organization of Canada, pending a future decision of the board of the new

SRO regarding its name.

The CSA has indicated that it expects the new SRO will facilitate easier and more cost-effective access to a broader range of investment products and services for the public. The combined SRO is also generally expected to result in cost savings for dealers.

Consultation on NI 43-101: Where to go from here?

On April 14, 2022, the CSA issued a consultation paper on NI 43-101. NI 43-101 was originally adopted in 2001 to provide requirements for disclosure of scientific and technical information concerning mineral properties. Since its adoption and subsequent amendments, NI 43-101 has provided a strong regulatory framework for mineral disclosure in Canada, setting an important bar that has contributed to the strength of the mining capital markets in Canada and has served as a reference point for the development of other international mineral property disclosure regimes.

Since that time, however, several other regulatory codes regarding mineral property disclosure have been refined and adopted. These include subpart 1300 of Regulation S-K in the United States which replaced the SEC's Industry Guide 7 in 2018, as well as updates to the Committee for Mineral Reserves International Reporting Standards (CRIRSCO) template. The CRIRSCO template is now the established international standard for the public reporting of exploration targets, exploration results, mineral resources and mineral reserves.

In response to a number of factors – including sometimes volatile swings between commodity market and issuer highs and lows, issuer disclosure deficiencies identified through regulatory reviews and other developments – the CSA is seeking feedback on broad elements of NI 43-101, ranging from general conceptual approaches to disclosure to granular technical mining matters. In light of strong market feedback on the consultation, the CSA extended the comment period on the consultation from its original expiry in July 2022 to September 2022. It remains to be seen how the CSA will respond to the extensive feedback provided.

Non-IFRS (Non-GAAP) disclosure: One year in

In August 2021, National Instrument 52-112 – Non-GAAP and Other Financial Measures Disclosure [PDF] (NI 52-112) came into effect for reporting issuers, beginning with documents filed for financial years ending on or after October 15, 2021. As a result, 2022 marked the first year for compliance with the new rules for most public issuers in Canada. Although guidance previously existed, NI 52-112 imposed new mandatory disclosure requirements. Specifically, NI 52-112 created a variety of new categories of non-GAAP measures and imposed new binding disclosure requirements for non-GAAP measures. Many issuers wrestled with some of the ambiguities of the instrument, including appropriate categorization of the various categories of non-GAAP metrics.

On November 3, 2022, the CSA released CSA Staff Notice 51-364 [PDF] which outlines the results of the CSA's continuous disclosure review program for the years ended March 31, 2021 and 2022. CSA staff have identified a number of common deficiencies with respect to the application of the new non-GAAP requirements, including failures to include the required quantitative reconciliations, failure to satisfy equal prominence requirements, failures associated with comparisons of forward-looking non-GAAP measures to equivalent historical non-GAAP measures, inappropriate categorization of non-GAAP measures, and non-GAAP term labeling issues, among other deficiencies. We expect that the CSA will continue to monitor compliance with NI 52-112. Issuers should be mindful of the guidance from the CSA

with respect to their use of non-GAAP measures.

OSC service standard revisions extended

In late 2021, facing robust deal activity levels from booming Canadian capital markets, the OSC temporarily updated its service standards to extend review periods for filings and to reduce target achievement rates in respect of those standards. In particular, the prospectus review standard now contemplates the provision of a first comment letter within 15 working days of the date of receipt for a long form prospectus for "85% or more of all filings received" and within five working days of the date of receipt for a short form prospectus for "90% or more of all filings received." These standards are both longer than the "best efforts" standards in National Policy 11-202. Other standards have also been extended and have a lower target compliance standard. These exceptional service standards have been extended twice since they were initially adopted and currently expire in March 2023.

Interestingly, the OSC has noted in its 2022 Annual Report [PDF] that, throughout the 2021-2022 year, the OSC met 89% of its quarterly performance targets, with many capital markets targets being achieved at (or close to) the 100% threshold.

Expect continued change through 2023

While 2022 saw a slower pace of regulatory change than in recent years, a number of important amendments have been proposed that could, if implemented, meaningfully assist issuers and market participants as regulatory burdens are lifted or reduced. With capital markets activity slowing due to current market uncertainties, a shift by regulators to focus on regulatory changes aimed at reducing excessive red tape is likely to be beneficial in fostering capital creation in the longer term. Moreover, with a number of material changes under ongoing consideration by the CSA, 2023 is likely to be a year of important legal developments for Canada's capital markets.