OSLER

2023 OSLER LEGAL OUTLOOK

Impact of transparency register requirements on financial sponsors

DECEMBER 11, 2023 8 MIN READ

Related Expertise

- Corporate Governance
- Mergers and Acquisitions

Authors: Alex Gorka, Hugo-Pierre Gagnon, Mike Proudfoot, Trevor R. Scott, Kai Sheffield, Aliza Zigler

In recent years, new requirements for private companies to disclose corporate ownership information have proliferated across Canada. All Canadian jurisdictions apart from Alberta, Yukon, the Northwest Territories and Nunavut have now adopted legislation requiring this disclosure, which is often referred to as a "transparency register." The goal of these registers is to increase corporate transparency and accountability by providing information regarding individuals with significant control (ISC), which generally refers to individuals that have a 25% or greater interest in the corporation. These new requirements are often unclear in their application to complex ownership structures and create significant compliance burdens for private equity and venture capital firms (financial sponsors).

In most Canadian jurisdictions, these registers are not currently publicly available. In many of these same jurisdictions, however, they can be accessed by bodies such as police forces, governmental tax entities or regulators. Key differences are emerging as several legislative regimes, including at the federal level and in Québec and British Columbia, are moving towards creating registers with greater public access. Federally, proposed legislation would, if enacted, impose the steepest fines in Canada for contraventions of the rules related to transparency registers.

Corporations and their owners need to be mindful of these evolving requirements both when structuring their affairs and to ensure ongoing compliance with the record-keeping obligations.

What are transparency registers?

Currently, the application of the various transparency regimes enacted in Canadian jurisdictions and the disclosure requirements they impose are broadly similar, although there are some nuanced differences, as we discuss in our detailed guide.

Generally speaking, all privately held corporations organized in the relevant Canadian

jurisdictions must maintain a transparency register of ISCs that is updated on a regular basis. For each ISC, the register is required to disclose personal identification information, details pertaining to the individual's status as an ISC and any other prescribed information. Unlike other Canadian jurisdictions, the transparency requirements in Québec apply not only to Québec corporations, but also to any corporation or other business organization that registers extra-provincially to conduct business in Québec.

Law enforcement, tax authorities, directors, shareholders, creditors and certain other regulatory bodies can access these transparency registers. However, several provinces have, or are proposing to implement, publicly accessible transparency registers. Corporations, directors, officers and shareholders may face penalties and/or imprisonment for non-compliance with these rules.

Issues in the private equity and venture capital context

Transparency register requirements raise challenging interpretative questions for clients with complex ownership structures. These challenges are faced by financial sponsors, in particular, but they also represent important considerations for many private corporations.

Complex holding structures

As a general rule, an ISC is an individual who owns, controls or directs (individually or as part of a group of related persons) 25% or more of the shares of the corporation – either by voting power or fair market value. An individual can also be an ISC by virtue of having direct or indirect influence over the corporation, despite not owning at least 25% of the shares (for example, through a unanimous shareholder agreement). The requirements in Québec are broader in several respects than the other Canadian jurisdictions. For example, they apply to partnerships, trusts and other forms of business organizations other than corporations.

The sometimes-ambiguous wording of the various statutes, together with the subtle inconsistencies across different jurisdictions, creates ambiguity that could result in the inconsistent application of applicable requirements or over- or under-disclosure on registers. In addition, certain key terms, such as “influence” under the *Canada Business Corporations Act* (CBCA) and *Ontario Business Corporations Act* (OBCA), are only loosely defined in the statutes, leading to interpretive difficulties.

Take, for example, an individual who owns 40% of the shares of a holding company that owns 80% of the voting or economic interest in a subject corporation. In the absence of special facts, would that individual need to disclose a 32% interest in the subject corporation? Or would that individual not need to be listed on the transparency register at all? That individual does not control the holding company and therefore does not indirectly control any shares of the subject corporation, notwithstanding the existence of an indirect *economic* interest in the subject corporation. And this is a simple fact pattern!

The analysis becomes much more complex, time consuming and costly if an individual or entity in the ownership chain is party to a shareholder agreement that gives it enhanced governance rights over any of the entities in the holding structure. Further complexity can arise if non-corporate entities, such as limited partnerships, trusts and limited liability companies, are included in the structure. Similarly, where there are other structures in place that could be construed as exercises of influence by an ISC, such as management agreements, other related party agreements or director and officer relationships, the application of the transparency requirements could be unclear.

Financial sponsors and their Canadian counsel will need to give careful consideration to these issues when preparing transparency registers for their Canadian portfolio companies, especially where such registers will be publicly available.

Public company exceptions

Corporations and investors need to be mindful of the particular requirements of each jurisdiction. While many legislative regimes include an exception to the requirement to maintain a transparency register where the entity itself is a public company or where the entity is a subsidiary of a public company, the requirements are nuanced.

For example, certain jurisdictions provide an exception for corporations that are public in Canada, which would not benefit public vehicles that are partnerships or trusts, not to mention foreign public companies. As a result, a private corporation that is a subsidiary of a U.S. public company may nevertheless need to maintain a transparency register. Furthermore, in Québec, only public companies that are reporting issuers in the province can rely on the exemption. This means, for example, that a subsidiary of a public company that is a reporting issuer only in other Canadian provinces or territories would have to comply with the Québec transparency requirements.

Availability of investor information

On a practical level, it may be difficult for many financial sponsors to properly complete transparency registers even after all relevant ISCs have been identified. Some investors may not want to be disclosed as an ISC and may not be forthcoming with the necessary information. There may even be non-disclosure agreements in place with investors that prohibit the corporation or entity from disclosing this information. In cases where limitations are in place but disclosure is permitted where required by law, there may be restrictions and process requirements on any transparency disclosure.

Financial sponsors may be hesitant to risk creating friction in relationships with investors by requesting the required information and re-confirming it on an annual basis. Furthermore, the administrative burden of maintaining transparency registers – particularly for financial sponsors with complex holding structures, an extensive presence in Canada and/or a Canadian presence that spans multiple jurisdictions – will be significant.

Director and officer liability

Directors and officers of Canadian subsidiaries face potentially significant liabilities for violations of applicable transparency register requirements. For example, under recent amendments to the CBCA, a director or officer can be liable to fines of up to one million dollars or imprisonment for up to five years, or both, in connection with specified violations by the corporation. This liability can arise for a director or officer where the director or officer “knowingly authorizes, permits or acquiesces in the contravention” of transparency register laws by the relevant corporation. Personnel of financial sponsors and their portfolio companies may be less willing to serve as directors or officers of Canadian corporations in light of the severity of these penalties, particularly if they anticipate any difficulties in ensuring ongoing compliance with the transparency requirements.

Forum shopping

Some Canadian jurisdictions do not yet have ISC requirements, including Alberta, Canada's fourth most populous province. As described in our Osler Update, Alberta has also made various amendments to its *Business Corporations Act* in recent years in an effort to position itself as a more business-friendly jurisdiction. As such, at least for the time being, transparency register requirements could be avoided entirely by organizing the corporation in Alberta, whether as a newly incorporated entity or by way of continuance of an existing Canadian corporation. This assumes the corporation is not required to register to do business in Québec, which would cause it to be subject to that province's transparency register regime.

Carrying out a continuance is a quick and straightforward transaction under most circumstances, so this approach may appeal to many financial sponsors. However, there is no guarantee that Alberta or the other remaining holdout jurisdictions will not enact transparency register legislation at some point in the future, meaning that forum shopping may ultimately be a temporary solution.

In addition to the lack of transparency register legislation, there are other advantages to incorporating an Alberta corporation or continuing an existing corporation into Alberta, including the availability of corporate opportunity waivers, the ability of nominee directors to give special consideration to the interests of their nominating shareholder, unlimited liability corporations (which can be treated as a "flow-through entity" for U.S. tax purposes) and the absence of any director residency requirements.

Next steps for financial sponsors

Financial sponsors will need to assess their current structures and exposure in light of the new transparency register requirements. It will be important to consider whether any compliance issues are anticipated in light of fund ownership and control and whether there are any co-investors, non-disclosure agreements or other arrangements. It will also be important to develop a strategy for flagging and discussing these issues with key investors and to implement a process for gathering this information when bringing in new investors on a go-forward basis.

In situations where an ISC register is required, firms should take a holistic approach to ensure disclosure is made on a factually and analytically consistent basis across the entire firm and across Canadian jurisdictions.

Firms may also want to consider whether "forum shopping" is appropriate with respect to both the formation of new entities and the potential continuances of existing corporations.