Changes to the Canadian Early Warning Reporting System

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Background

The Canadian early warning reporting system presently requires shareholders to report (by promptly issuing a press release and filing an early warning report within two business days) when their ownership, control or direction (collectively, "ownership") over voting or equity securities of a reporting issuer reaches 10%, and to further report at 2% increments thereafter, or when a material fact has changed in a previous report. Forming part of the take-over bid and insider reporting rules, the early warning reporting system ("EWR System") is intended to provide transparency when a person acquires a significant interest in a reporting issuer and requires the acquiror to disclose not only the details of the transaction and the level of the interest held, but also the intentions of the acquiror. To allow the market time to digest the information in an early warning report, the acquiror is prohibited from acquiring further securities of the reporting issuer until the expiry of one full trading day after filing the report.

Qualifying eligible institutional investors ("EIIs"), including large financial institutions and certain types of pension and mutual funds, that have no intention to make a take-over bid for securities of the reporting issuer or to propose a reorganization or business combination that would result in them having effective control over the reporting issuer or a successor to all or a part of the business of the reporting issuer, also have access to an alternative monthly reporting system ("AMR System") with less onerous reporting requirements. Rather than issuing conventional early warning reports and associated news releases, qualifying EIIs have the option to instead report their holdings, acquisitions and dispositions on a monthly basis in the form of an alternative monthly report (an "AMR Report").

Amendments

The Canadian Securities Administrators (the "CSA") have made changes (the "Amendments") to the EWR System and the AMR System, including:

- new disqualifying grounds for AMR System eligibility;
- streamlined content of early warning reports;

- a new requirement to report ownership falling below the 10% threshold; and

- guidance in the treatment of derivatives in respect of EWR System thresholds.

The CSA posits that the purpose of the Amendments is to make certain clarifications as well as to enhance and refine early warning reporting.

Summary of Changes

- The EWR System now requires reporting of decreases in ownership of 2% or greater and of a change in ownership going below 10%.
- Enhanced EWR System disclosure includes:
    - a requirement for more detailed information regarding the intentions of the acquiror and the purpose of the transaction;
    - new forms for early warning report disclosure;
    - a requirement for the filer to sign and certify the early warning report;
    - clarification of the information required in a news release filed in connection with an early warning report; and
    - clarification of the timeline to issue and file an early warning report and associated news release.
- Clarification that securities lent or borrowed under "securities lending arrangements", in which securities are temporarily transferred from one party to another in exchange for a fee, may be subject to early warning reporting, but with exemptions for:
    - lenders in securities lending arrangements who retain control over voting of the securities being transferred; and
    - borrowers in securities lending arrangements involved in short selling such securities and who do not intend to and do not vote the securities.
- Added guidance that certain derivative arrangements may be subject to inclusion for early warning and take-over bid purposes, namely when a counterparty holding the reference security would vote them in accordance with the wishes of the first party or when the first party has the ability, formally or informally, to obtain the reference security.
- The addition of a further ground of disqualification of EIIs from the AMR System and additional disclosure requirements in AMR Reports.

Disclosure of Decrease in Ownership

The current EWR System requires the acquisition of 10% ownership or greater of a class of voting or equity securities of a reporting issuer before requiring the filing of an early warning report and news release. Similar reporting obligations exist for each 2% increase in ownership after the initial report.

Pursuant to the Amendments, dispositions of securities will trigger similar reporting requirements when there is a decrease of beneficial ownership below 10% of a class of voting or equity securities, and for each disposition resulting in a decrease of 2% or more until the 10% threshold is crossed.

EIIs using the AMR System are unaffected by this change. The requirement to report a decrease in securities held by such EIIs remains the same (i.e. when ownership falls below 2.5% multiples above 10%).

Enhanced Content and Clarified Timing of Early Warning Reports and News Release

Early warning reports will continue to be required within two business days following an applicable disposition or acquisition, but must now include: (i) greater disclosure in respect of the security holder's intention to acquire further securities of the issuer; and (ii) details concerning any agreements which may be in place for the voting rights or subsequent transfer of the securities.

As part of the Amendments, appendixes E, F and G of National Instrument 62-103 – *The Early Warning System and Related Take-Over Bid and Insider Reporting Issues*) will be replaced with three new forms: F1 for conventional filings; F2 for EIIs switching from monthly reporting to regular reporting; and F3 for use by EIIs using the AMR System. Each new form specifies the content required when making early warning or alternative monthly disclosure. The new forms serve a similar purpose as the old forms, but add additional disclosure requirements and a requirement for the filer to certify the disclosure.

The Amendments increase disclosure for the securities covered by the report being filed in the following manner:

- whether the transaction or occurrence giving rise to the early warning report is a securities lending arrangement;
- securities lending arrangements in effect at the time an early warning report is required, even if such securities lending agreements do not trigger a reporting requirement;
- interest in a "related financial instrument" (as defined in National Instrument 55-104 – Insider Reporting Requirements and Exemptions) such as puts, calls, derivatives or other instruments that alter the economic interest of or economic exposure to the reporting issuer;
- agreements that have the effect of altering the filer's economic interest in the securities; and
- additional detailed disclosure about the purpose of a party's acquisition or disposition of the securities.

News releases required by the EWR System must now be issued no later than the open of trading on the business day following the applicable disposition or acquisition and may incorporate by reference information included in the early warning report filed by the securityholder.

Clarification that Securities Lent or Borrowed may be subject to the Early Warning System

Securities that are temporarily transferred between parties as part of a securities lending arrangement are subject to early warning requirements and may be disclosable if the transfer triggers the early warning reporting threshold or exceeds the 2% incremental threshold. The Amendments introduce an exemption to this requirement for lenders engaging in "specified securities lending arrangements" whereby, among other things, the lender retains an unrestricted ability to recall such securities prior to the record date set for a shareholders meeting, or require the borrower to vote at the direction of the lender.

Borrowers party to securities lending arrangements involved in short-selling are also now exempt from the EWR System where the borrowed securities are disposed of within three business days of being acquired, the borrower will return the securities at a later date and where the borrower does not intend to vote and does not vote the securities.

Disqualification from the Alternative Monthly Reporting System

Consistent with the policy basis that an EII who is not acting as a passive investor should be required to report under the conventional early warning reporting regime, the Amendments disqualify EIIs from using the AMR System if such person solicits proxies to contest the election of a director nominee, or a reorganization, amalgamation, merger, arrangement or similar corporate action.

Additional Disclosure Requirements for Alternative Monthly Reports

Similar to the Amendments to early warning reports, disclosure in an AMR Report will need to include the material terms of:

- any securities lending arrangement the EII or any joint actor is party to;
- any interest the EII or joint actor has in related financial instruments; and
- any other agreement or arrangement that the EII or joint actor is a party to that has the effect of altering, directly or indirectly, the EII's economic exposure to the security of the class to which the report relates.

The purpose of the transaction and any plans or future intentions of the EII that would result in a number of enumerated transactions or changes that are specified in Item 4 of Form 62-103F3 such as changes in the capitalization, business, charter documents or board of directors of a reporting issuer will also need to be disclosed.

Application of Early Warning System to Derivatives

While the Amendments do not modify the rules respecting the application of the EWR System with respect to derivatives, new guidance has been added to National Policy 62-203 – *Take-Over Bids and Issuer Bids* to clarify when derivatives may be excluded from the determination of whether an early warning threshold has been triggered. Generally, if a party holding the derivative may obtain a voting or equity security, or otherwise direct the voting of that security, such party is deemed to have ownership, and under such circumstances derivatives would be included in determining whether an early warning threshold has been triggered. Cash-settled derivatives and physically-settled derivatives, whereby the holder will not be entitled to acquire equity securities within 60 days, will generally not be included when determining if the early warning thresholds have been triggered.

Effectiveness of the Amendments

The Amendments are to come into force concurrently with the changes to the take-over bid regime on May 9, 2016, as we reported in our previous bulletin.

To discuss any aspect of the Amendments, please contact the authors.

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