

OSC PROPOSES NEW RULE REGARDING DISTRIBUTIONS OUTSIDE OF CANADA

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The Ontario Securities Commission (the “**OSC**”) has proposed a new regime for distributions outside of Canada and published OSC Rule 72-503 *Distributions Outside of Canada* (the “**Proposed Rule**”) and its related companion policy and reporting form for a 90-day comment period.^[1] The Proposed Rule provides exemptions from prospectus and registration requirements for distributions of securities to purchasers outside of Canada in certain circumstances.

The Proposed Rule would replace OSC Interpretation Note 1 *Distributions of Securities Outside Ontario* (the “**Interpretation Note**”), which was originally published in 1983. The underlying principle of the Interpretation Note is generally carried through to the Proposed Rule. In particular, that the prospectus requirements under Ontario securities laws should not apply to a distribution of securities in a foreign jurisdiction, provided that “reasonable steps” are taken to ensure the securities are not redistributed in Canada and the transaction does not otherwise impair the integrity of Ontario capital markets.

The Interpretation Note was principles-based and provided guidance to market participants, but it was not securities legislation and did not grant exemptions from the prospectus requirements. In contrast, the Proposed Rule is intended to provide greater certainty by setting out specific exemptions from the prospectus requirements, and also addresses the registration requirements.

Background

In 1983, the OSC recognized that an overly broad interpretation of Ontario prospectus requirements could seriously interfere with issuers effecting financings outside of Ontario where there was no intention that the securities distributed abroad would find their way into Ontario and where there was no prospect of bringing the Ontario capital markets into disrepute. In response to this concern, the OSC published the Interpretation Note, which set out its view that, where the issuer, underwriter and other participants effecting a distribution outside of Ontario take reasonable steps to ensure that the securities come to rest outside of Ontario, a prospectus is not required under the *Securities Act* (Ontario). In order to provide guidance on the threshold of “reasonable steps”, the Interpretation Note set out a list of advisable restrictions and precautions.^[2] The

Interpretation Note also referred to other factors to be taken into consideration when determining reasonable steps, including the class and nature of the securities being distributed, the attractiveness to Ontario investors of the securities, and the likelihood that the securities would come to rest in Ontario absent appropriate restrictions or precautions.^[3]

In practice, determining whether reasonable steps have been taken to ensure that securities “came to rest” outside of Canada traditionally created uncertainty for market participants and OSC staff. In addition, recent case law has begun to adopt “substantial connection” to Ontario tests from other jurisdictions in determining the application of Ontario securities laws.

The purpose of the Proposed Rule is to remove the uncertainty encountered in applying the Interpretation Note. In addition, the OSC states that the Interpretation Note is out of date and no longer accurately represents OSC practice on provincial jurisdiction over activities outside of Canada.

Summary of the Proposed Rule

The Proposed Rule provides exemptions from the prospectus requirement for distributions outside of Canada in any of the following situations:

- If the distribution is under a public offering document in the United States or a designated foreign jurisdiction;^[4]
- If a concurrent distribution of the same securities is qualified under a final prospectus in Ontario;
- If the issuer is and has been a reporting issuer in a jurisdiction of Canada for the four months prior to the distribution; or
- In the case of all other distributions, including distributions by a private issuer, if the issuer has complied with the securities law requirements of the applicable jurisdiction outside of Canada, but subject to resale restrictions.

If an offering of securities to purchasers in Ontario is qualified under a prospectus, the issuer may also choose to qualify the securities sold to purchasers outside of Canada under the same prospectus. The prospectus should state that it also qualifies the distribution of securities outside Canada. It is interesting to note that even if there is no concurrent distribution of securities in Ontario, an issuer may still file a prospectus to qualify the securities sold to purchasers outside of Canada. In such circumstances, the issuer would not be relying on the prospectus exemptions in the Proposed Rule.

Restrictions on Resale

The Proposed Rule does not impose resale restrictions on securities distributed outside Canada if: (i) the securities are distributed under a prospectus or similar document filed in a foreign jurisdiction, (ii) there is a

concurrent distribution under a prospectus in Ontario, or (iii) the issuer is and has been a reporting issuer in Canada for at least four months. However, the OSC states that it expects issuers and underwriters to take reasonable steps to ensure the securities are not redistributed in Canada.

In all other circumstances where securities are distributed outside Canada under the exemption in the Proposed Rule, the first trade of such securities must be made under a prospectus or a further exemption unless: (a) the trade is to a purchaser outside of Canada, or (b) the issuer of the securities is and has been a reporting issuer in a jurisdiction of Canada for the four months immediately preceding the trade and at least four months have elapsed from the distribution date.

Registration Requirements

To assist market participants in determining whether or not the registration requirements under Ontario securities laws apply in respect of a distribution of securities outside Canada under an exemption contained in the Proposed Rule or under a prospectus filed in Ontario, the Proposed Rule provides an exemption from the dealer and underwriter registration requirement if all of the following apply:

- the head office or principal place of business of the entity is in Canada, the United States or a designated foreign jurisdiction;
- in the case of a distribution in the United States, the entity is appropriately registered with the Securities Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA);
- in the case of a distribution in a designated foreign jurisdiction, the entity is registered in a category similar to dealer in that jurisdiction;
- subject to a limited exception, the entity does not carry on business as a dealer or underwriter from an office or place of business in Ontario;^[5]
- other than the issuer or selling security holder, the entity does not trade securities to, with or on behalf of anyone in Ontario; and
- the entity relying on the exemption is not registered as a dealer in any jurisdiction of Canada.

Report of Distributions Outside Canada

Except where securities are distributed outside Canada under a prospectus or similar document filed in a foreign jurisdiction, an issuer that relies on the prospectus exemptions contained in the Proposed Rule is required to file a report of exempt trade with the OSC in accordance with the proposed Form 72-503F on or before the tenth day after the distribution. The proposed form does not require disclosure of information regarding the purchasers of securities distributed outside Canada, but does require disclosure of any dealer or underwriter involved in the offering.

The OSC believes that the Proposed Rule will provide more regulatory certainty to Ontario market participants and reduce overall costs for Ontario issuers seeking to raise capital outside of the province.

The OSC is accepting written comments on the Proposed Rule until September 28, 2016. Please contact a member of McMillan's Capital Markets and M&A Group if you have any questions or seek assistance with the preparation of a comment letter.

by Jason A. Chertin and Vlad Duta

1 Proposed Companion Policy 72-503CP to *OSC Rule 72-503 Distributions Outside of Canada* and Proposed Form 72-503F *Report of Distributions Outside of Canada* ("**Form 72-503F**"),

http://www.osc.gov.on.ca/documents/en/Securities-Category7/rule_20160630_72-503_rfc_distributions-outside-c-anada.pdf.

2 For example, the Interpretation Note states that, in some financings, some of the following restrictions or precautions might be advisable: (1) a restriction in the underwriting agreement against the underwriters selling the securities being offered to any Ontario resident; (2) a similar restriction in the banking group or selling group agreements requiring banking group members or selling group members not to offer securities to Ontario residents; (3) an "all-sold" certificate by the underwriters that they have not, to the best of their knowledge, sold any securities to Ontario residents; (4) a statement provided in the confirmation slip sent by underwriters to purchasers of the offered securities that it is the underwriters' understanding that the purchaser is not a resident of Ontario; or (5) a provision in the transfer agency agreement between the transfer agent and the issuer requiring the transfer agent not to register securities in the name of any Ontario resident for a period of time (e.g. ninety days) from the date of closing.

3 Other factors noted in the Interpretation Note included whether a market for the class of securities being distributed or any other securities of the issuer already exists in Ontario, the likelihood of the development in the future of a market in Ontario for the securities being distributed, the way in which the distribution is proposed to be effected, the relationship between the capital markets of Ontario and the jurisdictions in which the securities are being distributed and the ease of access of one to the other, whether or not the underwriters and other participants in the distribution are, or are affiliated with, investment dealers that conduct substantial activities in Ontario, and the presence of the issuer in Ontario (whether through the conduct of business in Ontario, a number of shareholders resident in Ontario, the issuer being closely followed by Ontario investors or otherwise).

4 "Designated foreign jurisdiction" has the same meaning as in National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers* and means Australia, France, Germany, Hong Kong, Italy, Japan, Mexico, the Netherlands, New Zealand, Singapore, South Africa, Spain, Sweden, Switzerland

or the United Kingdom of Great Britain and Northern Ireland.

5 The limited exception is that the person or company may carry on business as a dealer or underwriter from an office or place of business in Ontario in accordance with Ontario Securities Commission Rule 32-505 *Conditional Exemption from Registration for United States Broker-Dealers and Advisers Servicing U.S. Clients from Ontario*.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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