SHRINK-WRAPPED: WHY FOREIGN ISSUERS MAY STILL REQUIRE A CANADIAN WRAPPER

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In June of this year, when Canadian securities regulators made a number of amendments[1] designed to reduce the disclosure burden on foreign issuers privately placing securities in Canada, there was celebration over the demise of the venerable Canadian 'wrapper.'

These amendments took effect on September 8, 2015. While they provide welcome relief for foreign companies privately placing their securities in Canada to permitted clients, the same cannot necessarily be said for foreign issuers who are classified as investment funds under Canadian securities law[2] and their international investment fund managers ("**IFMs**"). In a number of circumstances, including where international IFMs employ an affiliated dealer to distribute securities in Canada, a slimmed-down Canadian wrapper may still be required or advisable.

Background

In order to comply with Canadian disclosure requirements, rather than altering their existing offering documents, foreign issuers often employed a Canadian wrapper – a document that 'wraps' around a prospectus or private placement memorandum used in an offering outside of Canada to add required Canadian disclosure. Prior to the recent changes, wrappers satisfied, among other things, two key requirements: (1) disclosure of potential conflict of interest relationships between dealers and issuers; and (2) lengthy disclosure of the statutory rights of action and available remedies for material misrepresentations or omissions in offering documents as required in certain Canadian jurisdictions, including Ontario.

International dealers and international IFMs, who rely on exemptions from Canadian registration requirements, are also required to provide 'permitted client notifications' to Canadian investors. Although not required to be provided in the wrapper, the wrapper has often been a convenient place to include such notifications. As well, wrappers have typically included other disclosure relating to tax implications (advice to consult the investor's own advisors), privacy, resale restrictions and currency exchange. In some cases, wrappers have also included certain deemed representations and warranties as to the investor's status as a 'permitted client' and/or 'accredited investor' for purposes of exemptions from prospectus and registration requirements, although this

is not normally considered best practice.

New Exemptions

The new amendments provide exemptions from the previously required disclosure of dealer conflict of interest relationships and statutory rights of action.

In general, all of the following conditions must apply to rely on the exemptions:

- the offering is being conducted primarily in a foreign jurisdiction;
- the security being distributed is either:
    - issued by an issuer that (i) is incorporated, formed or created under the laws of a foreign jurisdiction, (ii) is not a reporting issuer in Canada, (iii) has its head office outside of Canada, and (iv) has a majority of its executive officers and of its directors ordinarily resident outside Canada; or
    - is issued or guaranteed by the government of a foreign jurisdiction;
- all the investors in Canada are permitted clients;
- in the case of the dealer conflict of interest disclosure exemption (the "**Conflict Exemption**"): (i) there is a concurrent distribution of the security to U.S. investors; (ii) the offering document delivered to Canadian investors contains the same disclosure as that provided to investors in the U.S. and, if applicable, complies with FINRA rule 5121; and (iii) the dealer delivers written notice to the permitted client before or during the distribution that the exemption is being relied on; and
- in the case of the statutory rights of action disclosure exemption (the "**Statutory Rights Exemption**"), the offering document or a separate notice delivered to Canadian investors contains brief prescribed disclosure of the existence of statutory rights of action.

What do these rule changes mean for international investment funds3 and their international IFMs? The answer will likely depend on whether the international IFM uses an affiliated dealer, often relying on the exemption from the dealer registration requirement available to international dealers to distribute the securities in Canada.

Distribution by Independent Dealers

If the foreign issuer uses an independent registered dealer or independent international dealer to distribute securities of the fund in Canada, then a Canadian wrapper is no longer strictly required. The foreign issuer may rely on the Statutory Rights Exemption by incorporating the new prescribed disclosure statement: (i) into the offering document itself, (ii) into a document delivered at the same time as the offering document, or (iii) in a written notice that has been delivered to the investor by the dealer and advising that the notice will apply to all future distributions.

However, other Canadian securities law considerations do not fall by the wayside. Some form of Canadian disclosure will still be required or advisable: in the offering document itself, in a separate notice, in the subscription agreement or Canadian investor certificate, or in a combination thereof.

Distribution by Affiliated Dealers

As is often the case for foreign investment funds offering securities in Canada, the international dealer distributing the securities of the fund may be an affiliated entity of the international IFM or the fund's portfolio manager. This would necessitate dealer conflict of interest disclosure in the offering document (including a wrapper) unless the Conflict Exemption can be relied on.

However, if there is no concurrent distribution of the fund's securities in the U.S., then the Conflict Exemption is not available and the dealer conflict of interest disclosure will be required in the offering document (including a wrapper). The disclosure requirements for statutory rights of action discussed in the section above will also apply.

If there is a concurrent distribution of the fund's securities in the U.S., the offering document will have to provide the same disclosure to Canadian and U.S. investors and, if applicable, comply with FINRA rule 5121 for the exemption to be available. Again, all the additional disclosure requirements discussed in the section above will apply.

Permitted Client Notification etc.

Notwithstanding the recent amendments, certain Canadian disclosure requirements still remain. International IFMs relying on the exemption from the requirement to be registered as an investment fund manager in Ontario, Quebec and Newfoundland and Labrador must still provide the permitted client notification. If a permitted client investor is a high net worth individual residing in Ontario, notice to and authorization from the investor regarding the collection of personal information must also be obtained. Both requirements could be satisfied in the fund's subscription agreement or Canadian investor certificate, for example, instead of a wrapper but international IFMs may prefer to provide a slimmed down wrapper that includes the permitted client notifications, notice and deemed consent to collection of personal information (for individual investors), and the new prescribed statutory rights of action disclosure statement. They may also wish to continue to provide customary disclosure on tax implications (advice to consult the investor's own advisors), privacy, resale restrictions and currency exchange.

In addition, whether foreign issuers employ an independent or affiliated dealer to distribute their securities in Canada, best practices would direct them to use a separate Canadian investor certificate or revised subscription agreement to determine the investor's eligibility as a ‘permitted client' and ‘accredited investor' –

particularly in light of recent changes that have tightened investor verification requirements.

Reporting Requirements

The new exemptions do not change the requirement to deliver the offering document (wrapped or unwrapped) to certain Canadian securities regulatory authorities, including the Ontario Securities Commission, and to file reports of trade in respect of Canadian investors.

Conclusion

Although the new exemptions will decrease the disclosure burden on many foreign issuers, foreign issuers and particularly international IFMs will need to remain cognizant of other applicable Canadian disclosure considerations. Although they can still take advantage of the Statutory Rights Exemption, the dealer Conflict Exemption may not be available. In addition, certain Canadian disclosure is still required, whether in a slimmed-down wrapper or another document. International IFMs should consult with their Canadian legal counsel to take advantage of the new exemptions allowing them to decrease their disclosure burden while continuing to comply with Canadian securities law requirements. In the meantime, existing wrapped offering documents which are otherwise current can be used.

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1 CSA Notice of Amendments to National Instrument 33-105 Underwriting Conflicts (June 25, 2015); Multilateral CSA Notice – Multilateral Instrument 45-107 Listing Representations and Statutory Rights of Action Disclosure Exemptions (June 25, 2015); Notice of Amendments to Ontario Securities Commission Rule 45-501 Ontario Prospectus and Registration Exemptions and National Instrument 45-106 Prospectus Exemptions (June 25, 2015)

2 An issuer may or may not be considered an investment fund under Canadian law regardless of its characterization in its home jurisdiction. For example, real estate investment trusts that directly hold real estate properties may not be considered investment funds for the purposes of Canadian securities law, while funds that invest in securities of real estate issuers would most likely be considered investment funds.

3 The Conflict Exemption does not apply to investment funds that are mutual funds under Canadian law (funds whose securities are redeemable on demand, or within a specified period after demand, for an amount determined by reference to NAV).

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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