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SECURITIES & CAPITAL MARKETS ALERT

Borden Ladner Gervais

EXPANDED EARLY WARNING REPORTING PROPOSED BY CANADIAN SECURITIES REGULATORS.

In a move that could limit the options of potential acquirors and activist investors, while significantly increasing the paper burden for institutional investors and mutual funds, the Canadian Securities Administrators have proposed a significant expansion to the early warning obligations for investors in securities of Canadian public issuers. The regulators aim to provide greater transparency and address concerns regarding hidden ownership and empty voting.

The key changes proposed include:

- Decreasing the threshold for reporting from 10% to 5% of the outstanding securities of a class.
- Equity derivative positions that are substantially equivalent to ownership and securities lending arrangements will be included in determining the securities owned or controlled.
- An eligible institutional investor that solicits, or intends to solicit, proxies from the security holders of a reporting issuer regarding the election of directors or a significant reorganization or transaction will be disqualified from using the alternative monthly reporting system.
- Reporting will be specifically required for subsequent decreases of 2% or more in holdings, in addition to the current requirements for disclosure of 2% increases or a change in a material fact contained in an earlier report.
- Disclosure will be required where holdings decrease to less than 5%.
- The disclosure requirements for early warning and alternative

monthly reports will be significantly expanded and additional instructions provided.

- The reduced threshold that applies when the reporting issuer is subject to a take-over bid will be eliminated, since the 5% threshold will apply generally.

INCREASED REPORTING

The reduction in the reporting threshold to 5% of a class of securities of a reporting issuer will significantly increase the disclosure required under the early warning system. Since the reporting threshold will now be lower than the portfolio concentration limit for mutual funds, the number of investors required to report positions will likely increase significantly. In particular, it is relatively common for investors active in the Canadian resource sector to hold positions in excess of 5% for smaller issuers.

The rationale for the increased reporting goes beyond signaling a potential take-over bid and includes the potential to influence the reporting issuer or the outcome of a vote of security holders, such as by activist investors, and address concerns regarding hidden ownership and empty voting.

HIDDEN OWNERSHIP AND EMPTY VOTING

The new concept of an "equity equivalent derivative", is defined broadly as "a derivative which is referenced to or derived from a voting or equity security of an issuer and which provides the holder, directly or indirectly, with an economic interest that is substantially equivalent to the economic interest associated with beneficial ownership of the security." Interests in equity equivalent derivatives, such as total return swaps and contracts for difference, will be treated as if the underlying securities were directly owned or controlled. However, the treatment of other derivatives and instruments will depend on the interpretation of their economic equivalence to a long position in the securities. The current requirements that deem securities that may be acquired within 60 days to be beneficially owned will also need to be considered. In addition, investors who also exceed the insider reporting threshold of 10% based on voting interests, will need to comply with the

requirement to report positions in related financial instruments related to securities under the insider reporting requirements or as a condition to the insider reporting exemption for eligible institutional investors under National Instrument 62-103 *Early Warning System and Related Take-Over Bid and Insider Reporting Issues*.

SECURITIES LENDING ARRANGEMENTS

The commentary provided by the CSA in the notice makes it clear that they consider conventional securities lending arrangement to be subject to the current early warning requirements, since such arrangements generally involve the transfer of the securities. However, the proposals include an exemption for reporting by a lender of a "specified securities lending arrangement," that provides the lender has the right to recall the securities prior to a record date for any meeting of security holders or direct the manner in which the securities will be voted. The borrower under such an arrangement will still be required to include the securities in determining whether the reporting threshold is exceeded.

COMMENTS

Comments on the proposals are due by June 12, 2013. The CSA has also included several questions regarding the proposals and the early warning system generally in the notice and request for comment, which is available **here**.[1]

Please contact the author or your usual lawyer in BLG's Securities & Capital Markets Group if you would like further information regarding these proposals.

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[1] http://www.osc.gov.on.ca/documents/en/Securities-Category6/mi_20130313_62-104_take-over-bids.pdf

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