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Update

Farewell, Canadian Wrappers! (and this time we might just mean it)

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There are three things that likely come to mind when you think about Canada: Extremely polite people, maple syrup and Canadian wrappers. Actually, you probably think of Canadian wrappers first. But think again, because Canadian wrappers are about to become a thing of the past – sort of.

For decades, it has been customary to extend offerings of non-Canadian securities into Canada by attaching a Canadian private placement supplement, or wrapper, to another country's prospectus or offering memorandum in order to add any necessary missing pieces. Those missing pieces included information that was required to be disclosed, information that it was thought prudent to disclose, and deemed representations and warranties regarding the purchaser's eligibility to participate in the offering.

The wrapper was a veritable multi-purpose workhorse, performing slightly different functions over the years as the different rules it was trying to satisfy kept changing. Over time, as the Canadian rules evolved, most of the functions it performed could have been achieved in other ways, until there were really only two left: A requirement of the dealers to disclose certain potential conflict of interest relationships and a requirement to describe to investors in some provinces, in a fair amount of detail, the Canadian statutory rights and remedies available for any material misstatement or omission in an offering document.

The conflict of interest relationship disclosure had to be on the first page of the offering document – what a perfect job for the wrapper! Canadian lawyers could control the contents of the first page of our own little Canadian supplement, without requiring the first page of every prospectus or offering memorandum used around the world to be modified to comply with Canadian requirements. But for every offering, we had to think about what relationships might require disclosure, and make sure they were described correctly – meaning that even the most perfect standard form Canadian wrapper still needed a fill-in-the-blanks section on the first page.

In 2013, a number of global securities dealers were successful in obtaining exemption orders from the Canadian regulators that we hoped might put an end to the need for Canadian wrappers. But as it turned out, these wrapper exemption orders did not go quite far enough. To get the benefit of an exemption from relationship disclosure, the offering document had to contain all of the relationship disclosure that would be required in a U.S. registered offering – even if the offering was not registered. So, in practice, most dealers restricted the use of the exemption orders to U.S. registered offerings and still used Canadian wrappers for Rule 144A offerings. Further, to get the benefit of an exemption from the statutory rights of action disclosure requirement, it was necessary for each dealer to provide each investor in Canada with an acknowledgement form to the effect that it was aware of its statutory rights and did not need the benefit of having them disclosed time after time, in every offering. This acknowledgement form had to be signed by the investor and returned to each dealer. Obtaining these signed acknowledgement forms and keeping track of which investors had provided them, and which had not, proved to be an onerous administrative task. Also, the exemption orders required each dealer relying on them to provide a special monthly report to the Ontario Securities Commission listing all of the offerings made during the prior month in reliance on the exemption order.

On September 8, 2015, new rules will come into effect which will go further than the 2013 exemption orders and will not require any special monthly reporting. The new rules will provide simplified ways of complying with the relationship disclosure requirement and the statutory rights of action disclosure requirement in most cases where the issuer does not have significant connections to Canada, and the only purchasers in the offering are “permitted clients” in Canada. The relationship disclosure requirement can be satisfied for offerings made in the United States with a U.S. prospectus or U.S. offering memorandum just by disclosing that an exemption from the Canadian relationship disclosure requirement is being relied upon – and this disclosure is not required to appear on the cover page of the offering document. The statutory rights of action disclosure requirement can be satisfied with a simple, short paragraph alerting Canadian investors to the fact that they have such rights. Both of these requirements can be satisfied in several different ways. One permitted approach is to make standard-form “boilerplate” disclosure in every offering extended into Canada. This can be accomplished by: (i) using a truly standard “mini wrapper” that can be exactly the same for every offering; or (ii) including a Canadian notice-to-investors disclosure section in the offering document together with the selling restrictions disclosure already included for other countries; or (iii) delivering a separate supplemental document containing the required Canadian disclosure together with the U.S. prospectus or offering memorandum. Another permitted approach is to provide a one-time disclosure statement to each Canadian investor covering all future Canadian securities offerings, with no signed acknowledgement by the Canadian investor required.

We expect that a variety of approaches may develop, as different dealers may have different preferences for how best to accommodate these requirements. Most likely, however, the standard-form disclosure document (whether part of or accompanying each offering document, or given on a one-time basis) used by most dealers will also include a number of other standard disclosures currently found in Canadian wrappers, including cautioning the investor to get its own Canadian tax advice; alerting the investor to applicable Canadian resale restrictions; obtaining a waiver of French translation requirements; and, possibly, including the permitted client notifications that an international dealer is required to provide to its Canadian clients.What does all this mean? In short, you probably won't see many Canadian wrappers after September 8, 2015, and those you do see will likely be standard forms that will be exactly the same for every offering.

However, one of the most important functions of the wrapper was to serve as a reminder that Canada has its own unique requirements for distributing securities. The Canadian wrapper was, so to speak, only the visible tip of a very large iceberg. All of the behind-the-scenes work that went into preparing a wrapper must still be done, even though there may not be a tangible work product coming out of that process. And even the exemptions from the relationship disclosure requirement and statutory rights of action disclosure requirement won't apply in every offering, so every now and then you may need a traditional wrapper after all.

Here are twelve reasons that you will still have to worry about complying with Canadian securities laws after September 8, 2015, even if you never actually need to use a Canadian wrapper again:

1. The Dangers of Being TOO Canadian

The exemptions that come into effect on September 8, 2015 don't apply if the issuer has too many connections to Canada. You will still need a Canadian wrapper if the issuer:

- was incorporated, formed or created in Canada;
- is a reporting issuer (i.e., a publicly reporting company) in any province or territory of Canada;
- has its head office in Canada; or
- does not have a majority of executive officers <u>and</u> a majority of its directors, considered as two separate groups, who are ordinarily resident outside of Canada.

Before sending an offering document into Canada without a wrapper, someone (whether someone who works for the dealer, a Canadian lawyer or a lawyer in another country) will have to conduct the necessary due diligence to make sure these conditions are satisfied, including checking to confirm that the issuer is not a Canadian reporting issuer (which it may be as a result of having previously acquired a Canadian reporting issuer, among other things). In most cases it should be relatively easy to confirm that the issuer does not have a majority of its executive officers or directors resident in Canada, but that is still a step that will have to be taken in every offering.

There are other dangers that can come from having too many connections to Canada. If the issuer or any selling shareholder is physically located in certain provinces, or has too great a connection to certain provinces, then a Canadian prospectus exemption may be necessary for the securities to leave Canada, on the way "out the door" to be sold in the United States or other countries. Also, some secondary offerings involve a share repurchase by the issuer, which can create problems under Canada's issuer bid rules if shares are being repurchased from a shareholder located in Canada.

2. It's Tough to be Undocumented

The statutory rights of action disclosure requirement only applies if an offering document is being delivered that constitutes an offering memorandum under Canadian securities laws. However, the conflict of interest relationship disclosure requirement applies in every offering, whether or not an offering memorandum is being used. This means that in *undocumented* offerings such as block trades, where there is no prospectus, offering memorandum or similar document, it will still be necessary to prepare conflict of interest relationship disclosure under the Canadian requirements, and deliver that disclosure to Canadian investors in some other way – whether as part of a Canadian representation letter or as a stand-alone document.

It is also important to bear in mind that the exemption from the conflict of interest disclosure requirement only applies if the offering is being made *in the United States* concurrently with Canada. If for any reason the offering does not extend to the United States, then the exemption will not apply and a conventional wrapper will still be required – even if an offering document that complies with the requirements of another country besides the United States is being used in Canada.

3. It's No Fun to Be an Investment Fund (and the Feeling is Not Mutual)

Certain provinces of Canada, notably Ontario and Quebec, require the *manager* of an investment fund to become registered, or take steps to obtain an exemption from registration, if the fund has any shareholders resident in that province. The test of what constitutes an investment fund for Canadian purposes is different than the test that might be applied in other countries. In Canada, an investment fund includes both a mutual fund (whose securities are redeemable at their net asset value) and a non-redeemable investment fund. Identifying what is, and what is not, a Canadian non-redeemable investment fund can be difficult. For example, a REIT (real estate investment trust) may be an investment fund if it invests in non-controlling interests in companies that own real estate, but probably would not be an investment fund if it primarily holds actual real estate assets. Hedge funds are generally considered investment funds in Canada, but many venture capital funds are not.

Before making any sales of securities into Canada, it will be necessary to consider whether the issuer is, or might be, an investment fund as defined in Canada, and if so to take steps to register the manager (which may, in some cases, be the issuer itself) as a Canadian investment fund manager or make the filings necessary to allow the manager to rely on the non-resident investment fund manager exemption.

Aside from the fund manager registration issue noted above, the conflict relationship disclosure exemption is not available at all for any issuer that fits the Canadian definition of a mutual fund.

4. Don't Slide Over-the-Counter into Becoming a Canadian Public Company

You may remember hearing about Multilateral Instrument 51-105. That Canadian rule can cause issuers to become subject to Canadian public company reporting obligations as a result of making private placement sales in certain provinces of Canada if they are not listed on a Canadian or U.S. stock exchange and their securities trade on a U.S. over-the-counter market. That rule is still in place, and unchanged by the new exemptions coming into effect on September 8, 2015.

Fortunately, there are generous exemptions from the application of this rule in Alberta, British Columbia and Quebec, and the rule was never adopted in Ontario. So long as securities offerings are limited to those four provinces, are only made by a registered dealer or exempt international dealer, and the only purchasers are permitted clients, the issuer should not be at risk of becoming subject to Canadian public company reporting requirements. However, no securities offerings should be made to an investor in any other province (even if it is a permitted client) without conducting a full analysis of whether or not Multilateral Instrument 51-105 applies to the issuer.

5. Dealer or No Dealer?

The changes to the Canadian wrapper requirements do not affect the requirement that a foreign securities dealer either become registered as a securities dealer in Canada or make the necessary filings and take the other necessary steps to become qualified as an international dealer eligible to sell securities of non-Canadian issuers, and in limited circumstances securities of Canadian issuers, to a category of investors known as permitted clients. A non-Canadian dealer that has not previously made the necessary filings must not sell securities into Canada without first obtaining Canadian legal assistance to become qualified as an international dealer.

In addition, investment fund managers selling hedge fund or private equity funds into Canada may be "in the business of trading in securities," and either have to become registered as a securities dealer in Canada or qualified as an international dealer (if already registered as a securities dealer in their home country). Alternatively, they may have to engage a Canadian securities dealer to act as their distributor or selling agent.

6. Getting Rights Offerings Right

Canada's rules regulating rights offerings are quite different from the rules in most other countries. A prospectus exemption is required for the *distribution of the right* to any existing shareholders of the issuer that are located or resident in Canada. The exercise of the right also requires a prospectus exemption, but there is an automatic exemption for the exercise of previously granted rights. Before an issuer distributes rights to any shareholders in Canada, it should obtain legal advice regarding the three compliance alternatives that are available: (i) excluding Canadian shareholders from receiving any rights; (ii) adopting procedures that will exclude Canadian shareholders from receiving rights initially, but then allow eligible Canadian shareholders to claim and exercise their rights subsequently; or (iii) making the necessary filings with the Canadian securities regulators to allow all Canadian shareholders to receive and, if they so desire, exercise their rights, without the need for any additional restrictions or procedures.

In many cases, a Canadian wrapper will *still* be required to extend a rights offering into Canada.

7. Limited Partnership Limitations

Sales of securities of a limited partnership in Ontario, Prince Edward Island, New Brunswick or Saskatchewan require the issuer to register in those provinces as an extra-provincial (foreign) limited partnership. Do not sell limited partnership securities in those provinces without engaging Canadian counsel to make the required registrations first.

8. Issuers You Can Bank On (and Insuring Success)

A direct sale of debt securities of a bank or other financial institution, or a sale through a placement agent, may be viewed as a deposit-taking activity by the issuer and would trigger the application of Canadian banking regulatory requirements. Also, "catastrophe bonds" and similar instruments may be viewed as insurance products, and selling them in Canada may cause the issuer to be in contravention of Canadian federal or provincial licensing requirements for the sale of insurance. These regulatory compliance issues should be considered before offering securities of a financial institution into Canada or securities that by their nature could be viewed as insurance products.

9. When Once Isn't Enough

Some offerings of securities involve more than one distribution. For example, in a Rule 144A offering where registration rights are granted, there will be a second distribution of securities into Canada that takes place at the time of the exchange offer. The issuer will need Canadian legal advice to ensure that the exchange offer also complies with all applicable Canadian requirements.

An automatic prospectus exemption is available in Canada for the conversion of securities of an issuer into other securities of the same issuer, but it is not available when the securities are being exchanged for securities of a different issuer. As a result, the issuer will be required to obtain its own Canadian legal advice regarding the compliance requirements that will apply at the time of an exchange of the original securities if the new securities are issued by a different issuer – even if the exchange occurs on an automatic basis.

10. A Reserved Attitude (and Using Your Resources Wisely)

Canada prescribes requirements for the public disclosure of reserve and resource estimates by mining companies, even if they are not public companies (reporting issuers) in Canada. In private placement offerings into Canada by mining companies, special steps may have to be taken to limit the extent of the disclosure of this information.

11. Directly on Point

Extending a directed share program or "friends and family" program into Canada is problematic because the purchasers are unlikely to meet the necessary Canadian prospectus exemption requirements, and are also unlikely to qualify as permitted clients of an international dealer. However, there is an exemption available for sales of securities to Canadian employees of the issuer or its affiliates which can generally be used to accommodate employee purchase plans.Canadian legal advice will always be required for any offering that is not limited to permitted clients as defined, generally meaning institutional investors and very high net worth individuals (with a minimum of Cdn. $5 million in investment assets).

12. Those Trade Reports Won't File Themselves

Wrappers may no longer be required (or at least not very often), but nothing has changed regarding the requirement to file Canadian private placement trade reports with the applicable securities regulatory authorities following the closing of sales to Canadian investors. We expect that most dealers will continue to rely on assistance from their Canadian counsel with these reporting requirements.

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For more information about the implications of the rules coming into effect on September 8, 2015, or for assistance with private placements of securities into Canada before or after that date, please contact Rob Lando in Osler's New York office at (212) 991-2504 (e-mail rlando@osler.com), or the Osler lawyer you regularly work with.