

October 7, 2016

*BY E-MAIL*

The Secretary  
Ontario Securities Commission  
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Dear Sirs/Mesdames:

**Re: Proposed OSC Rule 72-503 Distributions Outside of Canada and Companion Policy 72-503 to OSC Rule 72-503 Distributions Outside of Canada (the “Proposed Rule”)**

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The Private Capital Markets Association of Canada (the “PCMA”) is pleased to provide our comments in connection with the Proposed Rule as set out below.

**What is the PCMA?**

The PCMA is a not-for-profit association founded in 2002 as the national voice of exempt market dealers (“EMDs”), issuers and industry professionals in the private capital markets across Canada.

PCMA plays a critical role in the private capital markets by:

- assisting its hundreds of dealer and issuer member firms and individual dealing representatives to understand and implement their regulatory responsibilities;
- providing high-quality and in-depth educational opportunities to private capital markets professionals; encouraging the highest standards of business conduct amongst its membership across Canada;
- increasing public and industry awareness of private capital markets in Canada;
- being the voice of the private capital markets to securities regulators, government agencies, other industry associations and public capital markets;
- providing valuable services and cost-saving opportunities to its member firms and individual dealing representatives; and
- connecting its members across Canada for business and professional networking.

Additional information about the PCMA is available on our website at [www.pcmacanada.com](http://www.pcmacanada.com).

## GENERAL COMMENTS

The focus of our comments are on the application of the Proposed Rule to prospectus exemptions within Canada since the various interpretations the OSC has applied on whether there is a distribution in Ontario and the application of Ontario securities law are the same concepts as discussed in the Proposed Rule. Accordingly, we have not provided comments on the prospectus and registration exemptions set out in the Proposed Rule as it applies to reporting issuers and cross-border transactions. Our general comments are set out below.

### **We agree there is a need for certainty with the introduction of the Proposed Rule**

We appreciate the Ontario Securities Commission (the “OSC”) clarifying certain matters set out in the Proposed Rule rather than maintaining the uncertainty with the status quo. The marketplace requires explicit exemptions that directly respond to the inherent contradictions involving whether a distribution takes place in Ontario based on the two interpretative approaches being the ‘*real and substantial connection test*’, a broad interpretative approach, versus a more narrower ‘*reasonable precautions*’ approach on whether an activity constitutes a distribution under Ontario securities law.

### **However, we also need certainty for distributions outside of Ontario but within Canada**

The title of the Proposed Rule involves distributions outside of *Canada*. We are unclear why the OSC has not taken this opportunity to extend the same concepts to distributions outside of *Ontario* into other Canadian jurisdictions. We note that Interpretation Note 1 – *Distributions of Securities Outside Ontario* (the “**Interpretation Note**”) provides guidance involving distributions outside Ontario, as stated in the title of the guidance; it is not called distributions outside Canada.

The main focus of our comment letter is to caution the OSC about the continued uncertainty involving the application of Ontario securities law by an “**Ontario-based issuer**”<sup>1</sup> to distributions of securities to investors resident in another Canadian province or territory, such as British Columbia.

The uncertainty arises in the application of certain prospectus exemptions that are not harmonized across Canada, such as the offering memorandum exemption set out in section 2.9 of National Instrument 45-106 – *Prospectus Exemptions* (the “**OM Exemption**”).

The Ontario version requires, among other things, investment limits, while this are not required under the British Columbia (“**BC**”) and Newfoundland and Labrador version of the OM Exemption.

Now applying the two approaches as noted above to distributions outside the jurisdiction, consider an Ontario-based issuer selling securities to a BC investor under the OM Exemption. Under the ‘*real and substantial connection test*’ the Ontario-based issuer would have to adhere to both Ontario securities law and BC securities law and accordingly, adhere to the higher

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<sup>1</sup> By “*Ontario-based issuer*” we mean an issuer incorporated under the Ontario *Business Corporations Act*, whose head office is registered and located in Ontario and whose officers and directors are located in Ontario.

requirements under the OM Exemption. However, under a ‘*reasonable precautions approach*’, an issuer could take comfort that the sale of illiquid securities by a non-reporting Ontario-based issuer to a BC investor would unlikely to flow-back to Ontario. In such circumstances, Ontario law would not apply and the Ontario-based issuer would satisfy the BC version of the OM Exemption in order to avail itself of the exemption. These two different approaches need to be reconciled in the private markets.

Accordingly, if the OSC seeks to provide an explicit exemption for distributions outside of Canada, we believe it should do the same now in connection with local Canadian jurisdictions and remove this uncertainty in interpreting the law.

We respectfully submit that if another jurisdiction in Canada has specifically taken a different approach in connection with a prospectus exemption that could be a distribution in Ontario, then the OSC should defer to that other jurisdiction’s views as a matter of comity of law. The extra-territorial application of Ontario securities laws to another Canadian jurisdiction results in regulatory uncertainty. This is unnecessary when certainty can now be provided consistent with the approach taken in the Proposed Rule by extending it to distributions outside of Ontario and within Canada. If the OSC is concerned about any potential malfeasance by an Ontario-based issuer distributing securities outside of Ontario, it always has its public interest jurisdiction under s. 127 of the Ontario *Securities Act*.

We note that issuers, law firms and exempt market dealers are taking different approaches. For example, if an Ontario-based issuer and its counsel take a ‘*reasonable precautions approach*’, then the subscription agreement will not impose certain Ontario requirements on BC investors. In contrast, a subscription agreement will be prepared differently by an Ontario-based issuer and its counsel if they take the view that the Ontario-based issuer has a ‘*real and substantial connection*’ to Ontario and must apply the Ontario version of the OM Exemption to BC investors. This situation is exacerbated at the dealer level where compliance staff subjected to different interpretative approaches have to adapt their policies and procedures for completing subscriptions depending on the issuer’s approach to such matters, assuming it has not take its own approach and imposes the same on all issuers on its product shelf.

We strongly believe the marketplace requires certainty involving such matters and we hope the OSC would use the Proposed Rule as an opportunity to provide clarity that is important for the stability of our Canadian capital markets.

### **Consider a “most substantial” connection approach**

The substantial connection test is a reasonable and logical basis on which to address trades involving multiple jurisdictions. We submit that not all connecting factors are equal when it comes to assessing the jurisdiction with which a trade is most substantially connected. In the case of prospectus exemptions, the profile of the purchaser is, in many cases, an integral part of the exemption itself; meaning the securities regulatory authority considers the purchaser’s profile to be of such importance that it enshrines the profile in the terms of the exemption itself. On this basis, we submit that the jurisdiction of residence of the purchaser is the most substantial connecting factor in assessing which prospectus exemption applies to a trade.

Take the case of the OM Exemption as it applies in Ontario and British Columbia. It seems odd that the OSC would adopt a position that imposes the terms of the Ontario OM Exemption on a trade out of Ontario (*i.e.*, by an issuer in Ontario) to a purchaser resident in British Columbia. In our view, the trade is most substantially connected to British Columbia and, we submit, the rules applicable in British Columbia should apply.

We submit that this approach will result in the highest degree of predictability of outcome as well as the fairest application of investor protection.

**This is not regulatory “arbitrage”**

We understand the regulators are concerned about any approach that can be cast as regulatory “arbitrage” (*i.e.*, framing a transaction under the laws of a jurisdiction on the basis that those laws are most favourable to the transaction). Here, the difference is based on the jurisdiction of residence of the purchaser. This is not a factor controlled or created by the issuer or the dealer, so it cannot be a tool used to gain access to a more favourable prospectus exemption. Jurisdiction of residence is a fact.

**The Proposed Rule provides a bright-line prospectus exemptions yet provides continued uncertainty with the requirement to take ‘reasonable cautionary measures’**

We understand the intention of the Proposed Rule is to provide certainty with bright-line prospectus exemptions, however, the draft Companion Policy states that the OSC *expects* issuers, underwriters and other participants in the offering to implement reasonable precautions and restrictions to ensure that the securities do not flow-back to Ontario. We feel the continuation of the ‘*reasonable precautions*’ approach continues the uncertainty despite the OSC’s efforts in clarifying such matters.

If the OSC further articulated that the ‘*reasonable precautions*’ requirement is necessary and not inconsistent with the bright-line prospectus exemptions, then we respectfully submit that the OSC should provide examples of such measures to reflect more current practices in addition to those noted in the Interpretation Note.

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We thank you for considering our submissions and we would be pleased to respond to any questions or meet with you to discuss our comments.

Yours truly,

**COMMENT COMMITTEE MEMBERS**

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