FAIR | Canadian Foundation *for* Advancement *of* Investor Rights

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**RE: CSA Notice and Request for Comment regarding Proposed Streamlined Prospectus Exemption for Rights Offerings (the "Notice")**

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FAIR Canada is pleased to offer comments to the Canadian Securities Administrators (the "CSA") regarding proposed amendments to the existing prospectus-exempt rights offering regime so as to allow reporting issuers (other than investment funds that are subject to National Instrument 81-102) to raise money by way of a rights offering on a prospectus exempt basis (the "Proposed Amendments").

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

1. **FAIR Canada Supports updating the rights offering prospectus exemption for reporting issuers.**

***Introduction***

1.1. FAIR Canada supports regulatory efforts to improve the ability of reporting issuers to raise capital in a cost efficient manner that, at the same time, provides adequate protection to investors. FAIR Canada supports efforts to examine why some prospectus exemptions, such as rights offerings, have been rarely used in the various jurisdictions in Canada whilst they are commonly used in other jurisdictions (such as the United Kingdom, Hong Kong, and Australia) in order to make

changes so such prospectus exemption are utilized more often..[1] The Notice indicates that CSA Staff have conducted research, collected data and held informal consultations with market participants to identify issues and consider changes. This has resulted in the Proposed Amendments. FAIR Canada welcomes such steps.

1.2. FAIR Canada would have liked to see publicized in the Notice the results of the research undertaken especially any benchmarking of the key features of the rights offering regimes in those jurisdictions that commonly use it (notably Australia, Hong Kong and the UK).[2] It would also be beneficial in the interests of transparency to provide some detail as to what categories of stakeholders were consulted – were institutional shareholders consulted in addition to issuers, for example? Finally, it would be valuable to publish in the Notice any available information on the amount of capital raised in other jurisdictions through the exemption, and the percentage of total capital raised in other jurisdictions using the exemption as compared to other prospectus exemptions, if available. Making this information public would further the understanding of all stakeholders of capital raising in other jurisdictions and improve the quality of comments received in respect of the Proposed Amendments.

1.3. FAIR Canada notes that rights offerings are usually conducted by companies to raise cash for specific or general purposes including: to repay debt; to satisfy capital adequacy requirements (as applicable); to fund acquisitions; or to create working capital.

1.4. From the perspective of the retail investor, rights offerings may generally be viewed favourably (versus a private placement, for example) to the extent that they:

(a) Offer existing shareholders shares in proportion to their existing holdings (the "right of pre-emption") and

(b) Allow the existing shareholders to sell the right to subscribe for shares (the "right of compensation for non-subscribing shares").

1.5. A rights offering should provide the retail investor with the following choices:

- Accept the offer and subscribe for the shares at the issue price (ie take up the rights);
- Sell the entitlement to their right of pre-emption (also known as a "nil-paid" entitlement) (ie sell their rights);
- Do nothing, in which case alternative subscribers will be sought at the end of the rights issue and any proceeds above the issue price, less expenses, will be passed to the shareholder (ie do nothing and receive the proceeds of a sale of the rights); or
- Do a combination of the above three options.

1.6. In theory, the value that non-accepting shareholders receive in a rights issue can be the same regardless of which course of action they choose to take – take up their rights, sell those rights or

[1] See our letter to the CSA dated January 20, 2014 on the proposed prospectus exemption for distributions to existing shareholders, available online at <http://faircanada.ca/wp-content/uploads/2011/01/FAIR-Canada-comments-re-Proposed-Exemption-for-Distributions-to-Existing-Security-Holders.pdf>.

[2] For example, changes were made to the process for undertaking a rights issue in the UK as a result of the Rights Issue Review Group's report in November 2008 which dealt with the efficiency and orderliness of the rights issue procedure.Available online at <http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/d/pbr08_rightsissue_3050.pdf>.

do nothing.[3] However, in practice, there may be little or no value in the nil-paid right as the market may be illiquid and they are often underpriced.[4] Nonetheless, shareholders prefer to have tradability of rights.[5]

1.7. FAIR Canada notes that corporate law, listing rules and securities law requirements must be reviewed in order to derive a rights offering framework that best improves shareholder value. The CSA Notice does not discuss the applicable corporate law or listing rules of the TSX or TSX-V or other exchanges and how they assist in creating an efficient and orderly rights offering regime that is in the interests of all market participants, including retail investors. This would have been helpful to include.

1.8. A recent paper entitled "Rights Offerings, Trading, and Regulation: A Global Perspective"[6] examined the rights offering around the world using a sample of 8,238 rights offers in 69 countries and provides insight as to which rules may increase shareholder value. For example, in Hong Kong and the UK a company's ability to decide whether rights will be tradable is structured and regulated – if the offerings are without tradable rights, they are called open offers and are subject to a separate set of regulations including a limit on the discount to the market price. In those jurisdictions, issuers do not have a free choice as to whether the rights are traded but rather it is subject to specific conditions if tradability is removed.

***Shortening the Time Frame***

1.9. According to the Notice, industry stakeholders said that the length of time to complete an offering results in a lack of certainty of financing and increased costs. The Notice also indicated that the average time to complete an offering was 85 days and the average length of time between filing of the draft circular and notice of acceptance by the regulator was 40 days.[7] The Proposed Amendments are designed to shorten the timeframe to complete an offering. The exercise period for the new exemption is to be a minimum of 21 days and a maximum of 90 day.

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[3] For example, a company with 100 million shares that trade at $1 each, makes a one-for-one rights issue at 70 cents per share. A shareholder who had an original holding of 1,000 shares who takes up the rights in full will have 2,000 shares worth $1,700; each share will now be worth 85 cents; and the shareholder who held 1,000 shares but who did not take up their rights would be left with shares worth a total of $850. That shareholder may be able to sell the rights at the theoretical ex-rights price of 85 cents less the issue price (70 cents) and receive $150 in cash. This together with the new value of the shares equals the shareholders original $1,000 in the company. See:"A Report to the Chancellor of the Exchequer: by Rights Issue Review Group" (Office of Public Sector Information, Norwich, 2008) at ss. 8.8 – 8.9. Online: <http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/d/pbr08_rightsissue_3050.pdf> (November 2008) at ss8.8,8.9. ]

[4] Massimo Massa, Theo Vermaelen & Moqi Xu, *Rights Offerings, Trading, and Regulation: A Global Perspective (*Insead Faculty & Research Working Paper, 2013) at 2. The authors found that of 8,238 rights issues announced during the period 1995-2008, the average right has zero returns on 55% of the trading days, as compared with 20% for the underlying stock.

[5] *Ibid*. at 2.

[6] *Ibid*.

[7] CSA Notice and Request for CommentProposed Amendments to National Instrument 45-106 Prospectus and Registration Exemptions, National Instrument 41-101 General Prospectus Requirements, National Instrument 44-101 Short Form Prospectus Distributions, and National Instrument 45-102 Resale Restrictions and Proposed Repeal of National Instrument 45-101 Rights Offerings (November 27, 2014), at 2. Online: <http://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20141127_45-106_pro-amend.htm>

1.10. The length of time to complete a rights offer has been the subject of examination and regulatory reform in other jurisdictions. The UK made changes to its regime to shorten the length of time. The minimum rights issue offer period was reduced from 21 days to 10 business days (or 14 clear days when statutory pre-emption rights apply).[8] Listed issuers are able to hold general meetings on 14 clear days' notice if certain conditions are complied with.[9]

1.11. The UK Report that preceded changes to the rights offering in that jurisdiction notes that reducing the length of time would reduce the period when a company (and its reputation) is at risk and its share price open to potential abuse (some companies experienced changes in their financial position and prospects during the process and claims were made of short selling). The Report notes that "*Efficient capital raising techniques are essential to enable companies to raise capital at least cost. Orderly capital raising not only helps reduce the cost of raising capital but also preserves the integrity of the market and the issuer's reputation. Improvements will therefore benefit the market, companies and shareholders.*"[10]

1.12. FAIR Canada notes that the UK was able to significantly reduce the length of time without having to do away with a rights offering prospectus altogether – rather it reduced disclosure requirements as compared to a full prospectus in order to lower the cost and administrative burden by omitting from a rights issue prospectus the information that is already available to the market through its ongoing disclosure obligations.[11]

## 2. Key Components of the Revised Rights Offering Exemption

2.1. Below, we summarize the key components of the proposed exemption:

- Availability - Available to reporting issuers, both listed and unlisted issuers (formerly it was also available to non-reporting issuers) but not investment funds that are subject to NI 81-102.
- Dilution Limit - No more than 100% of the reporting issuers' securities may be issued under the exemption in any 12 month period (formerly the dilution limit was 25%).
- Notice - A new form of notice will be filed and sent to shareholders that will inform shareholders as to how to access the rights offering circular electronically. The circular would not be required to be mailed to security holders.
- Circular - Concurrently, with the filing of the Notice, issuers will prepare and file a rights offering circular but will not have to send it to shareholders.

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[8] Taylor Wessing, "Secondary Issues"(2013) at 6. Online: <http://www.taylorwessing.com/uploads/tx_siruplawyermanagement/Secondary_Issues.pdf>.

[9] *Ibid. at 6.*

[10] *Supra* note 3 at 3.

[11] Reduced disclosure requirements apply to companies that are on the Official List of the UK Listing Authority and to companies quoted on the Alternative Investment Market (where no public offer prospectus exemption is available) The reduced disclosure requirements apply to rights issues which comply with the statutory pre-emption provisions in the in the Companies Act 2006 and also to issues where the statutory pre-emption rights have been disapplied and replaced by "near identical rights" meeting certain conditions (including that the rights are transferrable or, if not, the shares arising from such rights are sold for the benefit of those shareholders who did not take up their entitlements). See TaylorWessing *Supra note 8* at 6.

- Review by Regulators – A notice and offering circular will be filed by issuers but staff will not review either prior to use nor issue a notice of acceptance. For a period of two years from the adoption of the Proposed Amendments, CSA staff in certain jurisdictions will conduct reviews of circulars (likely on a post-distribution basis).
- Shareholder Protections:
  - Offer to be made to all security holders – the issuer must make the subscription privilege available on a pro rata basis to each security holder of the class of securities to be distributed on exercise of the rights (the present exemption does not clearly require to offer rights to all security holders).
  - Statutory civil liability for secondary market disclosure would apply to the acquisition of securities in a rights offering.
- Allow for Trading of Rights – It will allow for the trading of rights (as does the current exemption)
- Pricing - Listed issuers must price the right lower than the market price at the time of filing of the Notice (which follows market practice). For unlisted issuers the price must be lower than the fair value at the time of filing of the notice. However, the provision would not apply if insiders of the issuer are restricted from increasing their proportionate interest in the issuer through the offering or through a stand-by commitment.
- Stand-by commitments - Are permitted, subject to certain requirements.
- News Release - The issuer must file a closing news release which includes prescribed information about the rights offering, including aggregate gross proceeds, amount of securities distributed under each of the basic subscription privilege, the additional subscription privilege and the stand-by commitment.

## 3. FAIR Canada Comments on the Proposed Amendments leading to the Revised Rights Offering Exemption

3.1. FAIR Canada makes the following recommendations regarding the Proposed Amendments, in order to have an efficient process which enhances market integrity and provides adequate investor protection:

***Delivery of Notice and Circular***

3.2. *FAIR Canada strongly recommends that the Notice, if provided electronically, be required to have a specific link to the Offering Circular (as is required for delivery for the Fund Facts document).* FAIR Canada is concerned that retail investors will find it difficult to access the Offering Circular if it is simply made available on SEDAR. Many retail investors are unlikely to be familiar with SEDAR, which can be difficult to navigate. It is also clear that fewer retail investors will review the Offering Circular if it is not delivered to them but rather only made available (given what we have learned from behaviour economics). If the issuer is unable to deliver to certain shareholders electronically, the Notice should be sent with clear instructions on how to access the Offering Circular electronically and also a telephone number should be provided for those who wish to obtain a hard copy of it (at no expense to the shareholder).

***Review by Regulators***

3.3. FAIR Canada strongly recommends that the CSA not completely abandon the regulatory review of the Offering Circular. Regulators in leading jurisdictions still require a prospectus, albeit a shorter one, that is subject to regulatory scrutiny before issuance. FAIR Canada believes that reporting issuers will be much more likely to have compliant Offering Circulars and compliant processes if there is regulatory review and oversight. CSA Staff Notice 51-341 Continuous Review Program for the Fiscal Year ended March 31, 2014 found 76% of the reporting issuers subject to a full review or an issue-oriented review of their continuous disclosure documents were deficient and required improvements to their continuous disclosure or were referred to enforcement, cease traded or placed on the default list.[12] In the face of this data, it makes little sense for the regulator to step away from its oversight function. Review of the Notice and Offering Circular should be carried out. In order to achieve a reduced time frame, FAIR Canada recommends that securities regulators improve their internal processes to reduce the time it takes to conduct a regulatory review of the Offering Circular. In the alternative, FAIR Canada suggests that a process whereby issuers would have to file the Notice and Offering Circular with the relevant securities regulator and a certain percentage of those filed would be selected for regulatory review based on a risk-based selection process. Alternatively, FAIR Canada suggests that the expedited process should be available only to listed issuers and continue to require regulatory review of the Offering Circular for unlisted issuers.

3.4. FAIR Canada disagrees that the user friendly format of the Offering Circular and the addition of civil liability for secondary market disclosure mitigates the reduced level of investor protection which results from no regulatory review of the Notice and Offering Circular. It is far preferable to have a regulatory regime that ensures compliance and adequate investor protection *ex ante* than it is to achieve it *ex poste*, after harm has occurred. FAIR Canada supports the proposal to have the statutory civil liability for secondary market disclosure provisions apply to the acquisition of securities in a rights offering including through misrepresentation in an issuer's Offering Circular. This furthers the policy objective of access to justice when investors are harmed. Given that investors will rely on the continuous disclosure record of the issuer when deciding what action to take with respect to the Offering Circular, it also makes sense to extend the statutory liability for secondary market disclosure to the Offering Circular itself. However, it does not obviate the need for regulatory review. While secondary market liability provisions will go some way to ensure compliance, it is not sufficient (including the fact that not all instances will result in an economically viable action, and the misrepresentation may not come to light until after the statutory limitation period).

***Compensation to Shareholders***

3.5. FAIR Canada recommends that the CSA consider following the Hong Kong and UK rights offering process which requires issuers to reimburse non-exercising shareholders from the proceeds due to purchased new shares. Shares arising from the rights are sold for the benefit of those shareholders who did not take up their entitlements, after the subscription period, so that any

[12] (2014) 37 OSCB at 6663. Online: <http://www.osc.gov.on.ca/documents/en/Securities-OSCB/oscb_20140717_3729.pdf>

premium realized over and above the offer price and placing expenses is paid to those non-exercising shareholders.

***Shareholder Approval***

3.6. FAIR Canada recommends that shareholder approval should be required in the event that the amount of dilution goes beyond a certain threshold. A dilutive share issuance that materially affects the control of an issuer should require shareholder approval by a 2/3rd majority. Significant changes in an issuer should be subject to shareholder approval.

***Re-election of Board***

3.7. FAIR Canada also recommends that the CSA should consider requiring the full board to stand for re-election at the next annual general meeting (should they not already be required to do so) if the monetary proceeds of the rights offering exceed a certain level of the issuer's pre-issue market capitalization or if the amount of dilution exceeds a certain level (for example, 1/3). This would enhance good governance.

***Authority to Issue Shares***

3.8. FAIR Canada recommends the CSA consider requiring the issuer to confirm in the Notice that it has sufficient authorized shares to fulfill the subscription rights or, require that it obtain shareholder approval to amend its articles prior to commencement of the rights offering.

***Tradability of Rights***

3.9. Recent research has found that investors desire rights tradability and react better to rights offerings with tradable rights.[13] There is a greater potential for shareholder abuse if rights are not tradable. FAIR Canada suggests that the CSA should examine the existing research to determine what type of regime most enhances shareholder value. In particular, questions to be examined include:

- Is shareholder value enhanced in those countries that allow for choice by issuers in tradability of rights versus mandating tradability?
- Is shareholder value enhanced by setting out conditions for trading restrictions? (in the UK and Hong Kong, offerings without tradable rights are called "open offers" and are subject to a separate set of regulations including discount limits (10% in the UK)).
- Do issuers perform better after offerings with tradable rights versus those with non-tradable rights?
- What are the reasons issuers make rights non-tradable?

## 4. FAIR Canada Responds to Certain Questions Posed in the Request for Comments

***Question 1 – Exercise Period for a Rights Offering***

***(a) Do you agree that the exercise period should be a minimum of 21 days and a maximum of 90 days?***

[13] *Ibid.* at 23.

The UK Report cited in section 1.11 above indicates that a long exercise period can be problematic for issuers and can lead to behaviours that impact the integrity of the market. The CSA should consider whether it can further reduce the minimum rights issue offer period from 21 days and should benchmark to other jurisdictions (including other aspects of their rights offering regime) as part of its determination. The UK also has a process whereby issuers can choose through a shareholder meeting to disapply the statutory pre-emption rights so that they do not have to offer the rights to certain oversees shareholders but the rights otherwise attributable to those shareholders are sold for their benefit. This shortens the exercise period and should be examined as an option. The timetable for a rights offering will also have to take into account corporate law requirements for a meeting for shareholder approval, and listing requirements of the applicable exchange so they need to be reviewed to see if they are still appropriate.

***2. We propose that the Notice must be filed and sent before the exercise period begins and that the Circular must be filed concurrently with the Notice. Do you foresee any challenges with this timing requirement?***

No. The exercise period (or offer period) may have to occur after the Notice is filed and sent and the Circular filed, and a shareholder meeting has also been held. The record date and the offer period may start subsequent to the announcement of the offering so that shareholders can sell or buy their holdings if they prefer not to participate.[14]

***3. Some market participants have suggested that we consider requiring the issuer to only file and not send the Notice and the Circular. While we do not think that the issuer should have to send the Circular itself, it is our view that the issuer should send the Notice to ensure that each security holder is aware of the offering. We also understand that the issue would have to send rights certificates to security holders in any event.***

***(a) Do you foresee any challenges with requiring the issuer to send a paper copy of the Notice?***

No. The issuer should be able to provide delivery of the Notice by electronic means if the shareholder has accepted such method of delivery. If they have not then the Notice should be sent by mail.

***(b) Do you foresee any challenges with the Circular only being available electronically.***

Yes, please see our comments at Section 3.2 above.

***5. The required disclosure in the proposed Circular focuses on information about the offering, the use of funds available and the financial condition of the issuer. We do not propose to require information about the business in the Circular.***

***(a) Have we included the right information for issuers to address in their disclosure?***

***(b) Is there any other information that would be important to investors making an investment decision in the rights offering?***

[14] The average record date for rights issues globally is five days after announcement of the rights issue. Supra, note 4 at 6.

FAIR Canada suggests that the lead underwriters or stand-by guarantors should be identified and any fees paid in respect of the stand-by fee and any/or any underwriting fee in the aggregate should be disclosed. The circumstances in which the underwriting or stand-by guarantee can be withdrawn also should be disclosed.

The interests of persons involved in the offer and any conflicts of interest should be identified and avoided, and/or appropriately managed.

6. ***The Current Exemption permits the trading of rights and we propose to allow for the trading of rights under the Proposed Exemption. We have received mixed feedback from market participants on the costs and benefits of allowing rights to trade freely. ...***

   ***(a) Should we continue to allow rights to be traded? If so, why?***

   Please see section 3.10 above. We encourage the CSA to carefully examine this issue, including any empirical evidence such as the research done by Insead, and consider how the individual countries' regulations impact on what are the costs and benefits to restricting tradability and what regime most improves shareholder value. In addition, the CSA needs to examine the impact of tradability or non-tradability (and other rules) on the ability of shareholders who are foreign to take up the rights; or Canadian shareholders ability to participate or be compensated in respect of a rights offering of a foreign issuer.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Neil Gross at 416-214-3408 (neil.gross@faircanada.ca) or Marian Passmore at 416-214-3441 (marian.passmore@faircanada.ca).

Sincerely,

Canadian Foundation for Advancement of Investor Rights