PMAC

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

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July 12, 2013

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Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

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The Secretary
Ontario Securities Commission
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Dear Sirs and Mesdames:

Re: CSA Notice and Request for Comment on Proposed Amendments to the Early Warning Reporting Rules

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The Portfolio Management Association of Canada ("PMAC"), through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to submit the following comments regarding CSA Notice and Request for Comment Proposed Amendments to Multilateral Instrument 62-104 *Take-Over Bids and Issuer Bids* and National Policy 62-203 *Take-Over Bids and Issuer Bids* and National Instrument 62-103 *Early Warning System and Related Take-Over Bid and Insider Reporting Issues* ("NI 62-103") (together, the "**Proposed Amendments**").

As background, PMAC represents investment management firms registered to do business in Canada as portfolio managers. In addition to this primary registration, some firms are dually registered as investment fund managers and/or exempt market dealers or other registration categories but generally 70% of their income is derived from portfolio manager registration to be members of PMAC. PMAC was established in 1952 and currently represents over 170 investment management firms that manage total assets in excess of $800 billion (excluding mutual funds assets). Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by Members. For more information about PMAC and our mandate, please visit our website at www.portfoliomanagement.org.

General Comments

We are supportive of attaining greater transparency about significant holdings of issuers' securities. The objective of the Proposed Amendments is to provide greater transparency about significant holdings of issuers' securities by proposing, among other things, an early warning reporting threshold of 5%. While the Proposed Amendments intend to capture active shareholders, we are concerned that some of the proposed changes may in fact have a negative impact on passive shareholders. In many cases, the dissemination of this type of information may lead to greater market efficiency but we are concerned that there may also be significant unintended consequences if the early reporting threshold for eligible institutional investors (EIIs) is decreased from 10% to 5% in all issuers given the specific characteristics of the Canadian equity markets. While we understand that the CSA is not proposing comprehensive reforms to the alternative monthly reporting (AMR) framework in NI 62-103 applicable to EIIs, some of the Proposed Amendments will apply to EIIs reporting under the AMR regime. We would be interested in participating in any revisions the CSA may consider in regard to more comprehensive changes to the AMR regime as part of a future review.

We believe that in regard to proxy voting related issues, such as hidden ownership and empty voting, the CSA should review the effectiveness of the current proxy voting system as a separate matter to early warning issues. We understand that the Ontario Securities Commission ("OSC") has identified this as a priority for the next fiscal year and the OSC and members of the CSA are reviewing concerns about the effectiveness of the proxy voting system by which shareholder voting rights are exercised. The OSC and other members of the CSA plan to publish a concept paper in Summer 2013 to outline and seek feedback from stakeholders on issues related to the proxy voting system. As a result, since this concept paper is expected imminently, we suggest it may be more appropriate to see what findings result from this consultation instead of addressing proxy voting related issues through the Proposed Amendments.

We also believe the CSA should conduct further research and analysis on international standards before moving forward with any final changes, particularly because while several jurisdictions do maintain a 5% (or lower) reporting threshold, the market characteristics of these jurisdictions are quite different than those of the Canadian market and there may be significant reasons why equivalent reporting levels (absent any decreased reporting frequency) may be harmful in the Canadian context.

Summary of Recommendations

1. The proposed early warning threshold of 5% should not apply to EIIs reporting under the AMR system.
2. We do not support the proposal to make the AMR regime unavailable for EIIs who solicit or intend to solicit proxies from security holders of a reporting issuer on matters relating to the election of directors or matters involving the securities of the reporting issuer. We recommend that the CSA issue guidance around what could constitute "intent to solicit" and that merely normal course discussions on these matters would not necessarily trigger the disqualification in section 4.2 of NI 62-103.
3. We recommend that the CSA remove the requirement to disclose information relating to the acquiror's future plans and intentions.
4. Mutual funds should not be subject to a 5% reporting threshold.
5. Hidden ownership and empty voting activities should be regulated in a way that ensures accurate, effective and valuable disclosure is made available to issuers and the market and would be more appropriately addressed in the review of the proxy voting system.
6. We recommend that the CSA exclude small cap issuers from the Proposed Amendments and the 5% reporting threshold.

Set out below are our comments on specific issues identified in the Proposed Amendments.

Impact of Proposed Amendments on EIIs

The proposed early warning threshold of 5% should not apply to EIIs reporting under the AMR system provided in Part 4 of NI 62-103. We do not believe that this proposed change to the current reporting threshold (10%) should apply to EIIs who report under the AMR regime as there may be significant unintended consequences if the early reporting threshold for EIIs is decreased from 10% to 5% in all issuers given the specific characteristics of the Canadian equity markets. EIIs should be permitted to maintain the current reporting threshold for a number of reasons, including:

- the policy rationale for creating this exemption and having relaxed timing requirements for reporting in the first place (these institutional investors have passive intent with respect to their ownership or control of securities of reporting issuers) has not changed and requiring additional disclosures from EIIs will not help address issue of hidden ownership and empty voting
- the disclosure of the identity and holdings of an EII may impact its ability to effectively trade a security on behalf of clients
- creates an unnecessary cost, administrative and onerous compliance burden on EIIs (i.e. the proposed requirement to report within 2 business days of exceeding the threshold, rather than 10 days after month-end would be unduly onerous)
- unnecessary flooding of the market with reports from passive investors which may cause confusion in the market
- negative impact on smaller capitalized companies as some EIIs may be deterred from making investments in these companies that could foreseeably trip the 5% reporting threshold. There are many instances in which disclosure of holdings of greater than 5% would be required in smaller capitalization companies, and this may be detrimental to having a fair and efficient market in these securities.

We recommend that no changes be made to the AMR regime. However, if changes are made, consideration should be given to the U.S. Form 13G model, which allows for annual disclosure (i.e. 30/45/60 days after year-end) rather than on a monthly basis.

Changes to AMR Framework in NI 62-103

We have concerns regarding the proposal to make the AMR regime unavailable for EIIs "*who solicit, or intend to solicit, proxies from security holders of a reporting issuer on matters relating to the election of directors of the reporting issuer or a reorganization, amalgamation, merger, arrangement or similar corporate action involving the securities of the reporting issuer*". In our view, this wording is too broad and could capture otherwise discrete discussions and or communications amongst security holders regarding these matters that in no way creates an intent to solicit proxies and consequently, impedes shareholder democracy and engagement. We recommend that the CSA issue guidance around what could constitute "intent to solicit" and that merely normal course discussions on these matters would not necessarily trigger the disqualification in section 4.2 of NI 62-103. We believe reference should be made to the definition of "solicit" in NI 51-102 and in particular, the exception included in subsection (k) of that definition.[1] This subsection excludes from the definition of "solicit" any communications by securityholders (subject to exclusions for certain securityholders) concerning the business affairs of the issuer, including its management or proposals contained in a management information circular.

In addition, we believe the CSA should consider including a definition of "passive intent" so that it is clear the Proposed Amendments would not apply nor impact shareholders who are not

[1] See subsection 1.1(1)(k) of National Instrument 51-102 *Continuous Disclosure Obligations*.

actively seeking to build significant blocks of securities that may influence control of a reporting issuer. Similarly, such definition should make it clear that, for example, funds that are investing in securities for investment purposes are deemed to have passive intent.

Enhanced Disclosure

The Proposed Amendments include comprehensive changes to the current disclosure obligations under the early warning system. These changes contemplate significant additional information such as the purpose of the acquisition of securities, future plans and intentions, as well as derivative holdings. It is not clear to us that this additional information may have value and we do not believe that these increased disclosure obligations will necessarily assist the market. In particular, we do not support a requirement for shareholders to disclose their future plans and intentions. First, this information in many cases will be sensitive and proprietary. What will likely result is boilerplate language that will do little to assist the market. Second, requiring investors to anticipate and disclose future intentions and plans opens the door to challenges by issuers and regulators as it may force investors to speculate about the future unnecessarily.

Similarly, we do not believe there is a need for increased disclosure regarding the investment intent of EIIs under the AMR regime. In our view, there is no justifiable need to go beyond basic information such as the identity of the acquiror, the interest in securities of the issuer and the nature of such interest. EIIs should not be required to provide additional information that reveals their investment strategies. There is simply no policy rationale for this.

Impact of Proposed Amendments on Funds

In considering the impact of the Proposed Amendments to mutual funds, we do not think mutual funds should be subject to a 5% reporting threshold as there are no evident benefits to our capital markets in requiring mutual funds to comply with early warning requirements at the proposed threshold of 5%. Furthermore, this would not be consistent with the investment restrictions set out in NI 81-102 which prevents mutual funds from holding more than 10% of the votes attaching to the outstanding voting and equity securities of a reporting issuer, and from purchasing a security for the purpose of exercising control over or management of the issuer. Moreover, NI 81-102 mutual funds generally do not purchase a security for the purpose of exercising control over or management of the issuer of the security. It should also be noted that in the case of index mutual funds, the CSA has already determined that funds with passive intent are permitted to hold more than 10% of the securities of an issuer, as per subsection 2.1(5) of NI 81-102. Therefore, we do not see any benefits to requiring mutual funds to report at 5% and recommend that such mutual funds be exempted from a 5% reporting threshold.

Hidden Ownership and Empty Voting

We acknowledge the potential risks of the use of derivatives to avoid early warning requirements and we understand that hidden ownership and empty voting activities have caused the regulators to take a closer look at these activities and to address the possibility of reporting abuses. However, while we agree that these types of activities (and both an investor's economic and voting interest in the case of securities lending) should be disclosed and regulated, we believe more targeted regulation is appropriate to meet the CSA's policy objectives. In order to ensure proper transparency of securities ownership in light of the increased use of derivatives by investors, we believe that more clarity is required around the proposed definitions (i.e. equity equivalent derivative and specified securities lending arrangements) and, in general, on securities lending arrangements that would be caught under the early warning reporting regime. For example, portfolio managers will typically review the firm's securities holdings when running reports but will not necessarily review which securities are on loan and to whom the voting rights reside with. This might present systemic barriers to accurate reporting. Absent any clear rules and/or guidance around the CSA's express intent on who reports what, there may be double reporting by borrowers and lenders. In addition, many derivative instruments do not provide any additional proxy voting rights and therefore including these in the reporting threshold determination may have a distorting effect on reporting.

In our view, there may be other more appropriate ways to regulate abuses of hidden ownership and empty voting. For instance, in the case of securities lending arrangements, implementing controls around activities that would otherwise permit the borrower to borrow securities before the record date simply for proxy voting purposes and implementing more fulsome disclosure requirements on borrowers to disclose their holdings, including total holdings and holdings for which they have voting rights but not the economic interest would be more effective. It is our understanding that the terms contained in securities lending arrangements are typically standard in nature and do not provide information that would be beneficial to the issuer in helping to determine who has a large position in the voting rights of a security. We believe that requiring lenders to provide additional and onerous disclosure about the terms of the securities lending arrangement does not provide valuable information to the market or issuer nor does it adequately address the concerns around hidden ownership and empty voting. Consequently, by requiring the lender to disclose more detailed information does not guarantee that effective and valuable disclosure would be available or that the policy objectives would be met.

In regards to derivatives, the Proposed Amendments and discussion therein includes some examples of financial instruments that would trigger a disqualification from the AMR regime. We note that while some examples are provided, we understand that these are not the full spectrum of equities that would fall under this definition. We strongly believe the marketplace needs to have a better understanding of what exactly is contemplated here. Additionally, as with securities lending, if the intent is to increase transparency and address issues such as hidden ownership or empty voting, consideration should be given as to what disclosure would best meet these objectives. For example, derivatives which do not carry an obligation to acquire the underlying equity securities or which do not have voting rights attached should be excluded.

Finally, related to clearer definitions albeit not directly on the topics of hidden ownership and empty voting, we note that the early warning system is currently triggered after the acquisition of 10 per cent or more of the beneficial ownership, control and/or direction over, the *voting or equity securities of any class of an issuer or convertible into a class [emphasis added]*. Given the evolution of share class structures for issuers, the use of "equity securities" as a trigger can operate indiscriminately for preferred shares. As a result, we recommend the CSA issue guidance around reporting on preferred share holdings, particularly for preferred shares of "split share" corporations.

Impact of Proposed Amendments on Small Cap Issuers

We acknowledge that for many large companies that are inter-listed in the U.S. market, Canadian managers are already required to file Form 13G when the 5% threshold is reached. However, for large managers of Canadian equity products (greater than $2 Billion in AUM), there are many instances in which disclosure of holdings of greater than 5% would be required in smaller capitalization companies, and this may be detrimental to having a fair and efficient market in these securities.

The U.S. market is significantly larger than the Canadian market and it is much easier for an investment manager to gain access to a particular sector or industry by purchasing the securities of several issuers and staying below the 5% threshold in each name. It is a fact that the breadth of the Canadian market is much narrower than the U.S. market, and investment managers do not have the luxury of several choices in many sectors or industries, meaning that investment managers often exceed the 5% threshold. Institutional investors in Canada will acquire positions of certain issuers that will very often be near to or exceed the 5% range (for example, positions ranging from $1-10 million range) so that the investment has a meaningful impact on the performance of their portfolios. As a result, a $5 million position in a $100 million capitalized company would trip the reporting requirement. Interestingly, as of May 31, 2013, 31 out of 47 new TSX listings have a market capitalization of less than $100 million.[2] Correspondingly, 71 out of 72 new TSX-V listings over the same period have a market capitalization of under $100 million. These statistics illustrate the impact that a 5% reporting threshold may have in the Canadian context.

The Canadian market has evolved over the last several years leaving liquidity and market capitalizations outside the S&P/TSX 60 Index somewhat limiting. Our Members know that their ability to effectively trade a security on behalf of clients can at time be impaired if the marketplace is aware that an investment management firm is a large shareholder in a security. To require disclosure at holdings of 5% in the securities of such smaller capitalization companies would impair the ability of our members to transact on behalf of clients which, in turn, hurts Canadian institutional and retail investors for no apparent benefit.

In our view, if our Members were required to disclose holdings at 5% in the smaller capitalization companies, one result will be the positions of our Members (and Canadian investors on whose behalf we invest) being gamed by market participants, resulting in less desire to own the securities of such smaller capitalization companies. This, in turn, would reduce the ability of such companies to have efficient access to capital which will be an impediment to the Canadian securities markets and the Canadian economy generally. In addition, disclosing holdings at a 5% threshold for some of our Members would pose an enormous reporting burden (particularly, on smaller registrants) and resources/cost drain without the corresponding benefit to the market.

It is apparent that more frequent reporting for passive institutional investors would not assist the CSA's objective of responding to shareholder activism or warning of takeovers, and would significantly impact investment managers by increasing the cost of acquiring and accumulating positions, as well as the impact of this transparency in the market. Notwithstanding, should the CSA reduce the reporting threshold under the AMR regime to 5%, it should consider a less frequent disclosure regime as is the case in the U.S. (i.e. 13G filings are only required to be filed on an annual basis, within 45 days of the end of the calendar year when holdings exceed 5% or within 10 days at the end of the month if holdings go over 10%). This would mitigate the costs and burden associated with a lower reporting threshold. We believe a review and analysis of 13G (and 13F filings) as required in the U.S. would be useful to determine the appropriateness if applied in a Canadian context. Flooding the market with trade reports of relatively immaterial passive investment positions will not in many cases necessarily provide greater transparency.

On the basis of the foregoing, we recommend that the CSA exclude small cap issuers from the Proposed Amendments and the 5% reporting threshold.

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[2] See statistics provided by Market Intelligence Group (MiG) on TSX & TSXV YTD New Listings available at: http://www.tmx.com/en/mig/index.html.

Conclusion

In summary, we support increased transparency about significant holdings of issuers' securities and we understand that the Proposed Amendments intend to capture active shareholders. However, we are concerned that some of the proposed changes may in fact have a negative impact on EIIs and smaller cap issuers. We recommend that the CSA address these concerns by maintaining the reporting level for EIIs at the current threshold of 10% and exclude mutual funds as well as small cap issuers from the 5% reporting threshold contemplated by the Proposed Amendments.

If you have any questions regarding the comments set out above and/or any of our recommendations, please do not hesitate to contact Katie Walmsley at (416) 504-7018 or Julie Cordeiro at (416) 504-1118.

Yours truly,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

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