

**OSC Staff Notice 51-706**

**October 20, 2010**



# **Corporate Finance Branch Report**

## **Fiscal 2010**

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## 1. Introduction

This report is a summary of the key activities and initiatives of the Corporate Finance Branch (the Branch or we) of the Ontario Securities Commission (the OSC or the Commission) for fiscal 2010 (April 1, 2009 to March 31, 2010).

### 1.1 Role of the Corporate Finance Branch

The Branch is responsible for regulating approximately 4,200 reporting issuers in Ontario, of which approximately 1,400 are based in Ontario. This includes public companies and other issuers of securities, other than investment funds (referred to in this report as issuers or reporting issuers).

The cornerstone of our regulation of issuers is disclosure. We require issuers to provide information to the marketplace about the securities they are selling, their business and the activities or knowledge of their insiders. Complete, accurate and timely information is critical to maintaining and strengthening investor confidence and efficient capital markets. Our review program for continuous disclosure (CD), prospectus and other filings is focused on upholding high standards of disclosure by issuers.

We also regulate issuers by:

- prohibiting certain activities such as insider trading and certain types of pre-marketing that we think can be harmful to investors and the markets
- applying measures to protect investors in take-over bids and significant conflict of interest transactions, and
- issuing guidance and mandating procedures to make voting rights more effective for investors.

You can find more information on the Branch in the About the OSC section of the OSC website (found at: [http://www.osc.gov.on.ca/en/About\\_cf\\_index.htm](http://www.osc.gov.on.ca/en/About_cf_index.htm)).

### 1.2 Purpose of this report

During fiscal 2010, we remained focused on providing protection to investors and fostering fair and efficient capital markets as the markets continued to undergo significant change. In doing so, we undertook several initiatives that were designed to:

- proactively address continuing market conditions
- improve disclosure provided to investors for the purpose of making investment decisions
- preserve and enhance investor rights
- respond to feedback from investors, issuers and other market participants regarding the securities regulatory framework for reporting issuers, and
- keep pace with global developments.

This report is intended to help issuers improve their understanding of securities law requirements. It may also be of interest to investors and investor advocacy groups. This report is intended to supplement the information in various Commission and Staff Notices on specific topics applicable to these issuers. It summarizes the Branch's key initiatives during fiscal 2010 relating to:

- disclosure to investors
- International Financial Reporting Standards (IFRS) reporting and communication
- shareholder empowerment and board governance, and
- exempt market financing and novel, complex products.

We also discuss developing issues and some aspects of the Branch's plans for fiscal 2011 (April 1, 2010 to March 31, 2011) that we believe will be of particular interest to issuers and their investors.

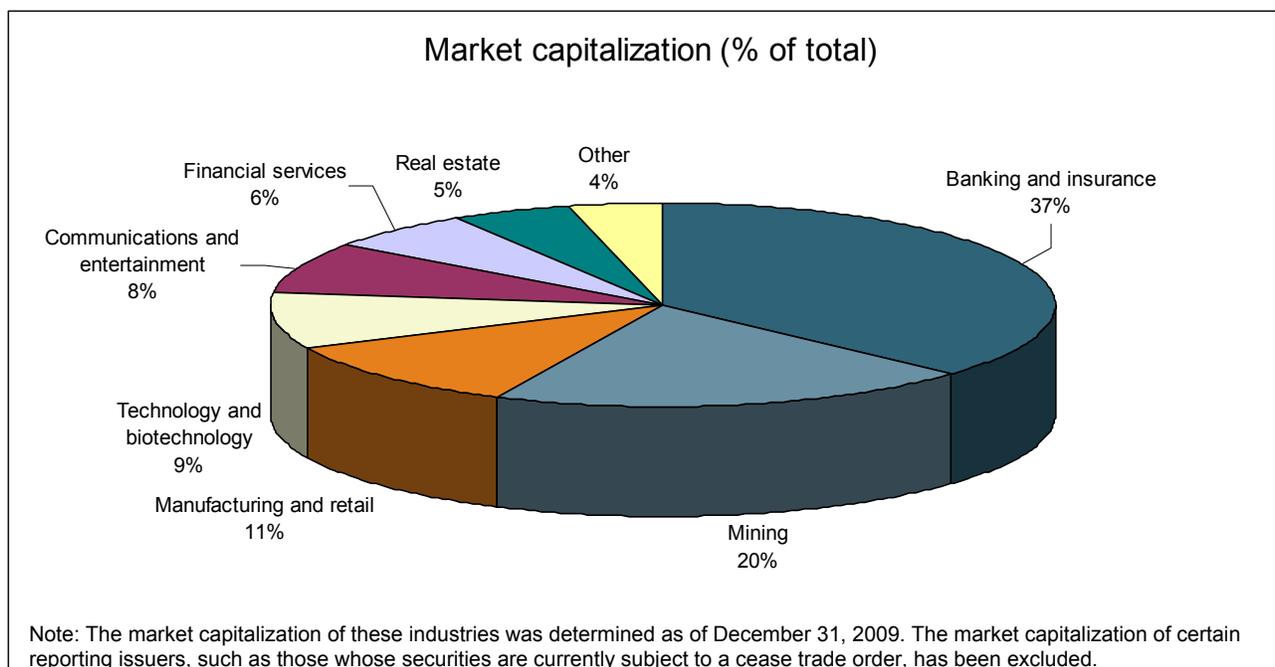
### 1.3 Ontario's capital markets

We are the principal regulator and generally have responsibility for all 1,429 reporting issuers with head offices in Ontario that represent approximately \$702 billion or 37% of Canada's \$1.9 trillion market capitalization (as of March 31, 2010).

The number of reporting issuers in Ontario for which the OSC is the principal regulator has remained relatively consistent over the past three years.

	Fiscal 2008	Fiscal 2009	Fiscal 2010
<b>Reporting issuers</b>	1,466	1,482	1,429

The issuers that we regulate span a variety of industries. The three largest industry groups in Ontario's capital markets by percentage of market capitalization are banking and insurance, mining, and manufacturing and retail. The three largest industry groups by number of reporting issuers are mining, technology and biotechnology, and financial services.



Given the diversity in Ontario's capital markets and the scope of the Branch's activities, we deal with a variety of regulatory issues. We focus many of our reviews along industry lines in order to enable us to gain a greater understanding of the specific issues and concerns of each industry. Doing so allows us to address accounting and general disclosure issues affecting these industries.

#### Highlights of our two largest industry specializations

- Banking and insurance issuers:** Ontario's banking and insurance industry, although small in number of issuers, represents 37% of Ontario's market capitalization. In assessing a bank or insurance issuer's business, it is imperative to understand the nature and extent of risks arising from financial instruments that an issuer is exposed to and how these risks are managed. Our reviews often focus on the adequacy of the disclosure of the risks and uncertainties, including how these risks impact the valuation of financial instruments and disclosure in the financial statements and management's discussion and analysis (MD&A).
- Mining issuers:** The OSC is the principal regulator of approximately 350 reporting issuers operating in the mining industry. These issuers have a combined market capitalization of more than \$135 billion, representing 20% of Ontario's market capitalization. The stage of development of a mining company largely determines its risk profile. Mining issuers can range from start-up companies that conduct a single grass-roots exploration program to multinational companies that develop and operate producing mines throughout the world. We factor a mining issuer's stage of development into how we design and conduct our review.

## 2. Disclosure to investors

In this section of the report, we explain how we focus our Branch operations on our disclosure review programs. Issuers need to provide complete, accurate and timely information to allow investors to make informed investment decisions to buy, sell or hold securities or to participate in a change of control. We are seeking and getting enhanced disclosure through our comments on CD, prospectus and rights offering reviews. We also get longer term enhancements to disclosure by reviewing and updating our rules, policies and notices.

During fiscal 2010, the Branch continued its focus on holding issuers to high standards of disclosure. This involved:

- reviewing CD, prospectuses and rights offering circulars to assess issuer's compliance with disclosure obligations (discussed in section 2.1 *Review program for CD and offering documents*), and
- proposing changes or issuing additional guidance to facilitate enhanced disclosure to investors in a number of important areas (discussed in section 2.2 *Enhancing disclosure by reporting issuers and insiders*).

### 2.1 Review program for CD and offering documents

Our review programs for CD and offering documents are risk-based and outcome focused. They have two main objectives:

<p><b>Compliance</b></p> <p>→ to assess whether issuers are complying with their disclosure obligations.</p>	<p><b>Issuer education and outreach</b></p> <p>→ to help issuers better understand their disclosure obligations.</p>
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#### Risk-based approach

Generally, we use risk-based criteria to determine (1) the issuers whose disclosure we will select for review and (2) the level of review required. The criteria are designed to identify issuers whose disclosure is most likely to be materially improved or brought into compliance with Ontario securities law or accounting standards as a result of our review. Based on our previous experience, data analysis and awareness of best practices, we have found that certain criteria are useful in predicting where compliance problems may exist. The criteria used include both qualitative and quantitative factors, and are regularly reviewed and updated as market conditions change. This allows us to address particular areas of concern in a timely manner.

Notwithstanding our risk-based approach, some issuers are selected for review on a random basis.

## Types of reviews

In general, we will conduct either a “full” review or an “issue-oriented” review. A full review is broad in scope and generally encompasses a review of the full prospectus or a review of an issuer’s CD record for a period of at least 12 months. An issue-oriented review is an in-depth review focusing on one or more specific accounting, legal or regulatory issue(s) that we believe warrant regulatory scrutiny. Full and issue-oriented reviews allow us to:

- assess compliance with new requirements and accounting standards, and
- communicate our interpretation of securities law requirements and areas of concern.

In addition, issue-oriented reviews allow us to quickly address specific areas of risk.

## Outcomes for fiscal 2010

Through our reviews, we strive to foster a culture of compliance with our disclosure regime. Compliance is an important part of our regulatory oversight. Enhanced compliance can lead to more complete, accurate and timely disclosure for investors, which in turn enables them to make better informed investment decisions.

In fiscal 2010, a significant number of our compliance reviews resulted in either enhanced compliance by reporting issuers or commitments to improve compliance going forward.

Program	Percentage of files that resulted in an outcome	Dominant outcome
CD reviews	72% of reviews	Prospective disclosure enhancements (63% of outcomes)
Prospectus reviews	57% of reviews	Material disclosure enhancements (57% of outcomes)

The outcomes of our CD and prospectus review programs are discussed in more detail below.

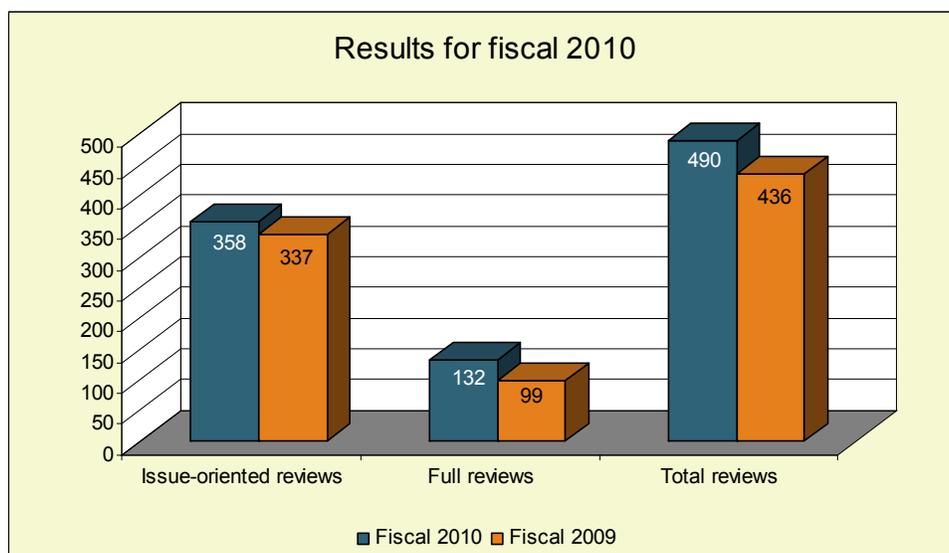
### A. CD reviews

A critical component of the Branch’s focus on compliance with disclosure requirements is our CD program. This program is designed to monitor and enhance compliance with accounting standards and disclosure requirements under securities law. Our reviews focus on critical disclosures that are important to investors and areas where material changes and enhancements are required. This program also contributes to the culture of compliance in our marketplace, as reporting issuers are aware that we review a significant number of issuers each year and that their disclosure may be reviewed at any point. Having high quality, transparent information allows investors to have confidence in the credibility of the information provided by reporting issuers.

## Results for fiscal 2010

The overall number and composition of CD reviews undertaken each year depends on market conditions and risks identified. Given continuing market conditions and the importance for investors of having a reliable CD

record to use when making their investment decisions, we increased our focus on CD reviews in fiscal 2010. Specifically, the number of full reviews conducted in fiscal 2010 increased by 33% from the previous year. The number of issue-oriented reviews also increased by 6% from the prior year.



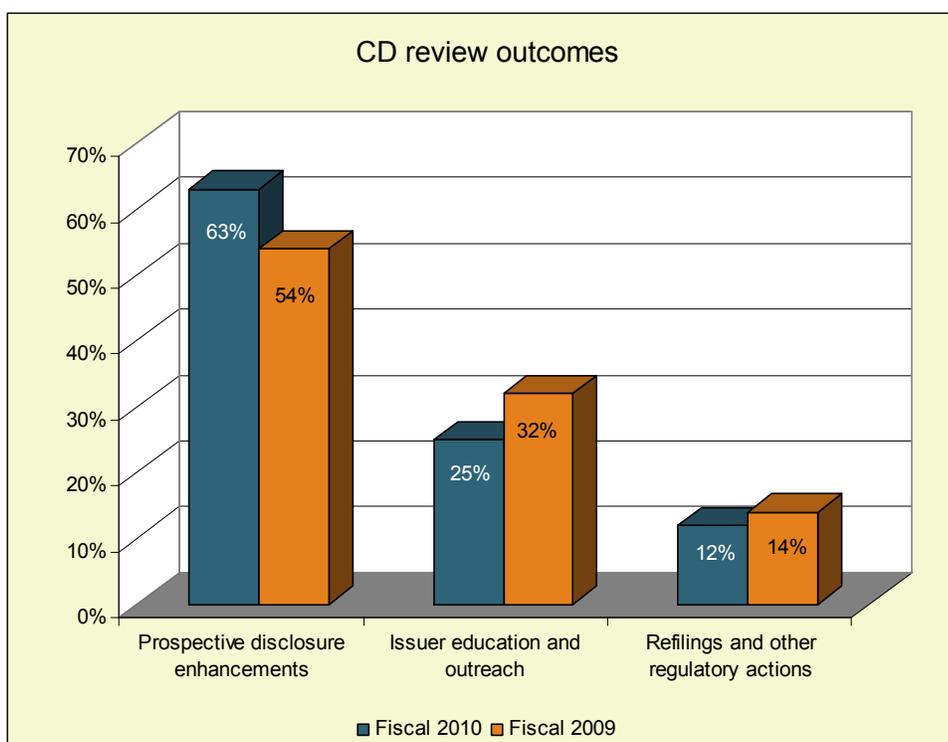
### Outcomes for fiscal 2010

We generally select for review issuers at higher risk of non-compliance. In fiscal 2010, 72% of our CD reviews resulted in an outcome, compared to 80% in fiscal 2009. While we have seen efforts from issuers to improve their disclosure, we believe that further enhancements to their disclosure are needed.

We classify the outcomes of CD reviews into three categories:

- prospective disclosure enhancements
- issuer education and outreach, and
- refilings and other regulatory actions.

A CD review can have more than one category of outcome. For example, an issuer may be required to refile certain CD documents as well as make changes on a prospective basis. The chart below shows the range of review outcomes for fiscal 2010 compared to fiscal 2009.



Generally, the outcomes have remained consistent with prior years as prospective changes continue to be the most dominant outcome.

#### Summary of CD review outcomes

- Prospective disclosure enhancements:** In fiscal 2010, the majority of the outcomes involved informing the issuer that certain enhancements were required in its next CD filing as a result of deficiencies identified. For example, issuers agreed to make prospective enhancements to executive compensation, forward-looking information and asset impairment, as well as disclosure related to the certification requirements set out in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* (NI 52-109).
- Issuer education and outreach about specific disclosure risks:** A newer area of focus has been issuer education and outreach. We selected issuers based on a particular risk profile and proactively alerted them to certain disclosure enhancements that should be considered in their next CD filing. In fiscal 2010, issuer education and outreach were mainly focused around IFRS.
- Refilings and other regulatory actions:** Another area of outcomes involved the identification of significant deficiencies that led to a refiling of a CD document, such as MD&A and certificates filed under NI 52-109, or another regulatory action, such as adding the issuer to the default list, issuing a cease trade order or referring the issuer to the OSC's Enforcement Branch.

Refer to CSA Staff Notice 51-332 Continuous Disclosure Review Program Activities for the fiscal year ended March 31, 2010 (dated July 9, 2010) for a discussion of the common deficiencies identified in CD reviews.

### Issue-oriented CD reviews conducted in fiscal 2010

Of the 490 CD reviews completed in fiscal 2010, 73% of the reviews were issue-oriented reviews. Issue-oriented reviews are an effective way to:

- assess issuers' understanding of new accounting standards, such as IFRS, or regulatory requirements such as certification, forward-looking information and executive compensation, and
- focus on particular areas of risk, such as continuing market conditions.

During fiscal 2010, we conducted six issue-oriented reviews, five of which are summarized below. The sixth, relating to IFRS transition disclosure, is discussed in section 3.2 *Compliance review of IFRS transition disclosure* below.

Review	Purpose of review	Outcomes
<b>Certification requirements under NI 52-109</b>	To identify specific areas of non-compliance with the requirements of the new NI 52-109 that came into effect on December 15, 2008.	<p>We identified some level of non-compliance with the requirements of NI 52-109 by 62% of the issuers reviewed. For 30% of the issuers reviewed, the filings were so deficient that the issuers were required to refile their annual MD&amp;A and/or certificates to comply with the requirements under NI 52-109. Prospective changes were required for 32% of the issuers reviewed to correct some aspect of their compliance with the provisions of NI 52-109 going forward.</p> <p><u>CSA Staff Notice 52-325 Certification Compliance Review</u> (dated September 11, 2009) provides guidance to reporting issuers and their certifying officers to facilitate compliance going forward.</p> <p>We plan to continue to work with issuers in this area by conducting a follow-up compliance review in fiscal 2011. See Areas of focus for fiscal 2011 below for further information.</p>

Review	Purpose of review	Outcomes
<b>Executive compensation disclosure</b>	To assess compliance with the new Form 51-102F6 <i>Statement of Executive Compensation</i> that came into effect on December 31, 2008.	<p>Most of the issuers reviewed were asked to make prospective enhancements to their executive compensation disclosure including:</p> <ul style="list-style-type: none"> <li>• disclosing performance goals or similar conditions along with the benchmark group used for specific levels of compensation</li> <li>• providing more information regarding the grant date fair value of share-based and option-based awards, and</li> <li>• quantifying the estimated benefits payable as a result of a termination or change of control.</li> </ul> <p>Issuers should review both the requirements in the form and the guidance in <a href="#"><u>CSA Staff Notice 51-331 Report on Staff's Review of Executive Compensation Disclosure</u></a> (dated November 20, 2009) to assist them in the preparation of their executive compensation disclosure going forward.</p>
<b>Forward-looking information (FLI)</b>	To assess compliance with the FLI requirements under Parts 4A and 4B of National Instrument 51-102 <i>Continuous Disclosure Obligations</i> (NI 51-102) that came into effect on December 31, 2007.	<p>We identified areas where FLI disclosure was either non-compliant, or where it could be made more readable and user-friendly. These include the disclosure regarding:</p> <ul style="list-style-type: none"> <li>• the identification of FLI</li> <li>• material risk factors and material factors and assumptions</li> <li>• the purpose of FLI</li> <li>• goals and targets, and</li> <li>• the impact of the transition to IFRS.</li> </ul> <p><a href="#"><u>CSA Staff Notice 51-330 Guidance Regarding the Application of Forward-Looking Information Requirements under NI 51-102 Continuous Disclosure Obligations</u></a> (dated November 20, 2009) contains guidance for issuers on these areas.</p>

Review	Purpose of review	Outcomes
<b>Continuing market conditions - Asset impairment</b>	<p>To review how reporting issuers in industries with a higher risk of having an impairment of assets have dealt with the impairment of:</p> <ul style="list-style-type: none"> <li>• goodwill</li> <li>• intangible assets</li> <li>• long-lived assets</li> <li>• investments, and</li> <li>• future tax assets.</li> </ul>	<p>While our review did not find the accounting for the impairment to be a significant concern, we found disclosure to be generally deficient in management's discussion &amp; analysis (MD&amp;A) regarding the rationale and circumstances behind impairment charges and the methodology used in the impairment analysis.</p> <p>We required issuers to enhance their MD&amp;A disclosure, especially with respect to their critical accounting estimates, to provide a greater link between the financial statements and the related MD&amp;A disclosure.</p>
<b>Continuing market conditions - Going concern</b>	<p>To review reporting issuers' disclosure of their going concern uncertainty as required by section 1400 of the CICA Handbook and the disclosure requirements regarding financial condition, liquidity needs and risks in Form 51-102F1 <i>Management's Discussion &amp; Analysis</i>.</p>	<p>We found that the issuers generally did not provide complete disclosure of this risk in the financial statements and MD&amp;A. We required some issuers to provide prospective disclosure enhancements in the notes to their financial statements and their MD&amp;A disclosure. In particular, the discussion of liquidity and capital resources did not provide an adequate analysis of the issuers' cash needs and was not linked to the going concern note in their financial statements.</p>

### Areas of focus for fiscal 2011

While the number and type of reviews may change depending on current economic conditions and market developments, the following issue-oriented reviews are currently planned for fiscal 2011:

#### Proposed issue-oriented reviews

- **Risk disclosure:** Disclosure of risk and risk management practices enables investors and other stakeholders to understand and evaluate risks and their potential impact on a reporting issuer's future prospects. We will conduct a review of this disclosure in MD&A, annual information forms, prospectuses and other documents filed in 2010. The objectives of the review will be to: (1) assess compliance with existing risk disclosure requirements which are mainly set out in NI 51-102, National Instrument 41-101 *General Prospectus Requirements* and National Instrument 44-101 *Short Form Prospectus Distributions*, (2) use the results of the review to educate reporting issuers about the requirements and promote best practices for risk disclosure, and (3) identify any requirements that need clarification or further explanation to assist issuers in fulfilling their risk disclosure requirements.
- **Corporate governance:** Some investors and other stakeholders have raised concerns about the corporate governance disclosure currently being provided by some reporting issuers. As a result, we are conducting a follow-up corporate governance disclosure review to assess compliance with the existing disclosure requirements set out in National Instrument 58-101 *Disclosure of Corporate Governance Practices* (NI 58-101). The review involves assessing the adequacy of corporate governance disclosure in information circulars (or annual information forms or annual MD&A, if applicable) filed by reporting issuers in spring 2010. It is intended to build on the CSA's 2007 review, described in CSA Staff Notice 58-303 *Corporate Governance Disclosure Compliance Review*. Following the review, we expect to issue a staff notice in 2010 that will summarize the results of the review and provide additional guidance for reporting issuers.
- **Follow-up review of NI 52-109 certification:** Certification of disclosure controls and procedures is meant to confirm that the information required to be included in the periodic reports filed with the OSC is not misleading and fairly presents the financial condition of an issuer. When we first looked at certification compliance in fiscal 2009, we found a high non-compliance rate (approximately 62%) with the requirements of NI 52-109 (see the discussion of the 2009 issue-oriented review on page 10). As a result, we are conducting a follow-up review. Our follow-up review focuses on two aspects: (1) assessing form compliance, including following up on issuers previously reviewed for which deficiencies were identified, and (2) reviewing issuers that refiled their financial statements in fiscal 2009. We expect to issue a staff notice in the fall of 2010 that will summarize the results of the review.

- **Material contracts:** The material contract filing requirements are an important aspect of our CD regime because they enable investors and potential investors to understand the terms and conditions of contracts that are of key significance to a particular issuer's business and/or operations. We plan to review compliance with material contract filing requirements under NI 51-102. The review will focus on whether issuers are: (1) filing all of their material contracts, (2) interpreting the exemption for contracts entered into in the "ordinary course of business" correctly, and (3) complying with provisions allowing for the omission and redaction of information from material contracts.

In addition, we plan to conduct a follow-up review of IFRS transition disclosure in fiscal 2011. Refer to section 3.2 *Compliance review of IFRS transition disclosure* for more information about the review.

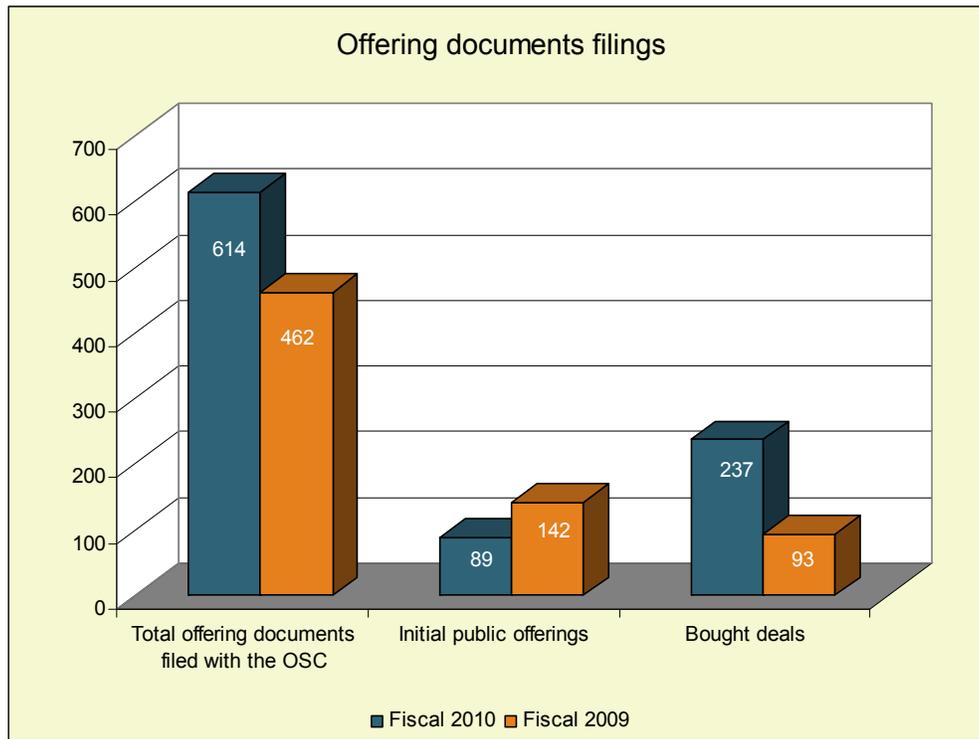
## **B. Prospectus reviews**

Another key component of the Branch's disclosure compliance program focused on disclosure is our review of offering documents. When issuers seek to raise capital, they are required to meet a number of disclosure requirements considered important to assist investors in making informed investment decisions. We discuss below some of the results of our reviews of public offering documents in fiscal 2010.

### **Filings made in fiscal 2010**

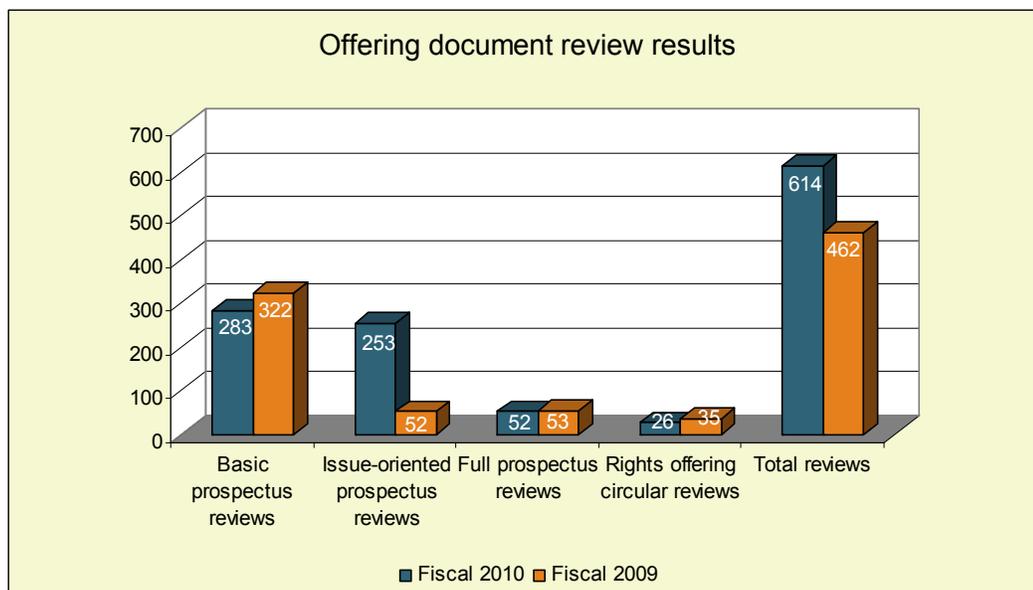
There was a 33% increase in the total number of offering documents (excluding investment fund offerings) reviewed by us in fiscal 2010 from the previous year. We believe this is largely a reflection of the general recovery of the Canadian and global economies, and the perception that raising capital in the public markets was more attractive than in fiscal 2009. The composition of the filings changed in fiscal 2010. In particular, we saw a 37% decrease in the number of initial public offerings (IPO) in fiscal 2010 and a 155% increase in the number of bought deals in fiscal 2010.

Issuers in a range of industries sought public financing. Fifty per cent of the offerings were made by issuers in the mining and oil & gas industries. Issuers in the real estate industry were also active in the public markets in fiscal 2010.



### Results for fiscal 2010

The chart below shows the composition of the type of offering document reviews we conducted in fiscal 2010 compared to fiscal 2009.



As with CD reviews, the overall number and composition of offering document reviews undertaken each year depends on market conditions and risks identified. The number of full prospectus reviews conducted in fiscal 2010 is consistent with the previous year. The significant increase in issue-oriented prospectus reviews in fiscal 2010 is a result of changes made to our risk-based selection criteria to respond to continuing market conditions and recent regulatory developments.

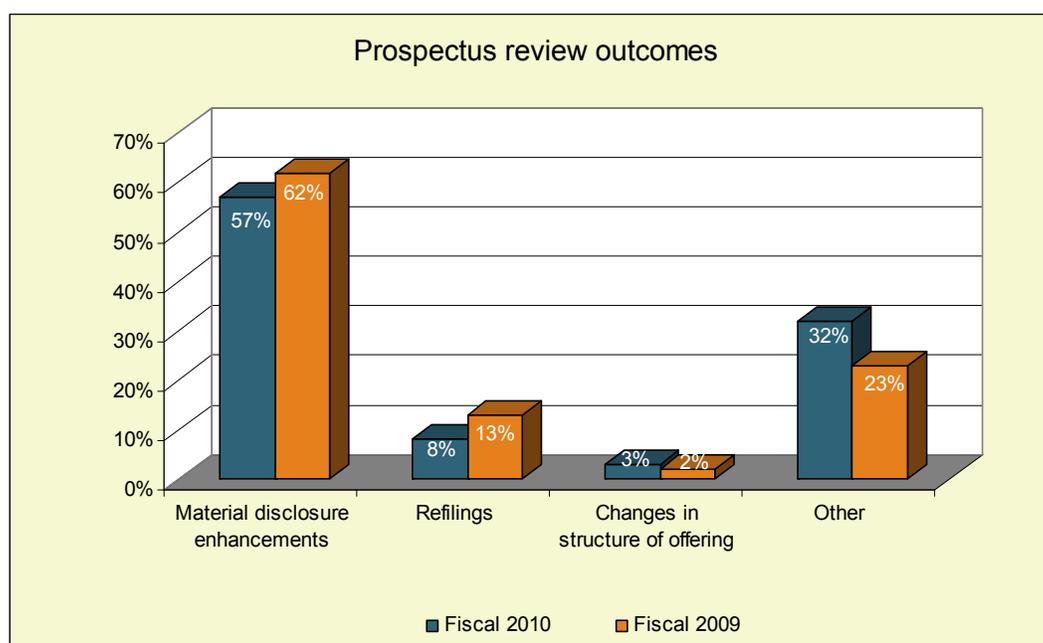
### Outcomes for fiscal 2010

In addition to selecting all IPO prospectuses, we generally select issuers at higher risk of non-compliance for review. In fiscal 2010, 57% of the offering documents selected for review resulted in an outcome, compared to 75% in fiscal 2009. Due to regulatory changes in fiscal 2010, we started tracking outcomes from prospectus reviews where the OSC was not the principal regulator. Outcomes on these reviews were lower than for prospectuses filed with the OSC as principal regulator, as the OSC does not record an outcome for issues raised and resolved by the issuer's principal regulator.

We classify the outcomes of our full and issue-oriented prospectus reviews into four categories:

- material disclosure enhancements
- refilings
- changes in offering structure, and
- other outcomes.

The chart below shows the range of review outcomes for fiscal 2010 compared to fiscal 2009.



Consistent with prior years, material disclosure enhancements remained the most dominant outcome.

#### Summary of prospectus review outcomes

- **Material disclosure enhancements:** In fiscal 2010, more than half of our outcomes were material disclosure enhancements made by issuers. The key areas requiring enhancements were disclosure of qualified persons, technical mining information, use of proceeds, risk factors and executive compensation.
- **Refilings:** Less commonly, our reviews resulted in the refiling of a significantly deficient document or the filing of a required document that was not previously filed. Many of the deficiencies that led to a refiling in fiscal 2010 related to a failure to file technical reports and related consents.

- **Changes in structure of offering:** A few of the outcomes involved a change in the offering structure as a result of our review. The most common change was an increase in the minimum offering size to ensure that the issuer had sufficient funds to sustain its operations for a reasonable period of time and/or achieve the disclosed purposes of the offering.
- **Other:** This category includes outcomes that do not result in a change to a prospectus but are significant to our mandate in other ways. For example, it includes reviews where we have had substantive discussions with the issuer, exemptive relief was granted or procedural enhancements were implemented by the issuer. A significant number of these outcomes were undertakings filed by issuers under which they agreed to pre-clear the disclosure in prospectus supplements related to the issuance of convertible, exchangeable or complex securities.

## 2.2 Enhancing disclosure by reporting issuers and insiders

### A. Disclosure by reporting issuers

In fiscal 2010, we continued to focus on investor protection by taking steps to improve the disclosure provided to investors by reporting issuers. In particular, we achieved milestones on two disclosure-related initiatives: the publication of the OSC's report on corporate sustainability reporting and the publication for comment of a new set of mining disclosure requirements. These initiatives are discussed below.

#### Corporate sustainability reporting

On April 9, 2009, the Ontario Legislature approved a non-binding resolution calling on the OSC to undertake a broad consultation to consider best practices in corporate social responsibility and environmental, social and governance disclosure. In response, the OSC published on December 18, 2009:

- [OSC Corporate Sustainability Initiative Report to the Minister of Finance](#), and
- [OSC Notice 51-717 Corporate Governance and Environmental Disclosure](#).

These documents summarize our plan to enhance compliance by reporting issuers with existing corporate governance and environmental disclosure requirements. Our plan involves:

- **Corporate governance disclosure compliance review:** During 2010, we are conducting a follow-up corporate governance disclosure review to assess compliance with the existing disclosure requirements. Refer to Areas of focus for fiscal 2011 in section 2.1 *Review program for CD and offering documents* for further information.
- **Environmental reporting guidance:** During 2010, we are developing additional staff guidance on disclosure of environmental matters. The staff guidance seeks to build on OSC Staff Notice 51-716 *Environmental Reporting* (dated February 27, 2008). In developing the staff guidance, we are consulting with stakeholders and experts in this area. We are also considering international developments, such as the SEC's interpretative release, *Commission Guidance Regarding Disclosure Related to Climate Change*, which became effective on February 8, 2010. We intend to publish the guidance in fall 2010 so that reporting issuers have sufficient time to consider the guidance when preparing their 2010 annual CD documents.

Both of these initiatives reflect the feedback received during our consultations in 2009. We consulted with various stakeholders, the OSC's advisory committees and the Prospectors & Developers Association of Canada. We also held a roundtable discussion on September 18, 2009, which was attended by representatives of investors, issuers and professional bodies, analysts, legal and accounting advisors and academics.

#### **Updating of mining disclosure requirements**

On April 23, 2010, the Canadian Securities Administrators (CSA) published for a 90-day public comment period a proposal to amend National Instrument 43-101 *Standards of Disclosure for Mineral Projects* (NI 43-101). The comment period closed on July 23, 2010 and the CSA received 50 written submissions.

NI 43-101 is generally regarded as a world standard for mining disclosure and it is important to Ontario's capital markets given the size of our mining industry. This is the first major proposal for amendments since NI 43-101 came into effect in 2001 and reflects nine years of regulatory experience with the instrument and broad industry consultation through focus groups and advisory committees.

The purposes of the proposed changes are to enhance the efficiency and effectiveness of the regulation of mining disclosure, reduce compliance costs for reporting issuers, and maintain internationally-leading standards for mining disclosure consistent with our mandate of investor protection.

The proposed changes include:

- updating the expert certificate and consent requirements to provide greater consistency and efficiency, and
- modifying the technical report disclosure requirements to enable the reports to better reflect the stage of development of a mineral property, and as a result, provide more useful information to investors.

In addition, the CSA has requested specific feedback on whether to keep, modify or eliminate the existing requirement to file a technical report with a short form prospectus. The feedback will likely confirm whether the time and costs of producing a technical report for a short form prospectus is a significant issue for the mining industry, and whether investors think they will be disadvantaged if new technical disclosure in a short form prospectus is not supported by a current technical report.

Issuers in the mining industry should monitor these changes to ensure their mining technical disclosure in their CD documents, including technical reports, and on their websites complies with all current disclosure requirements.

## **B. Disclosure by insiders**

During fiscal 2010, we finalized National Instrument 55-104 Insider Reporting Requirements and Exemptions (NI 55-104), which came into force on April 30, 2010.

The new instrument modernizes, harmonizes and streamlines insider reporting in Canada, and will benefit investors by:

- focusing the insider reporting requirement on a core group of insiders with the greatest access to material undisclosed information and the greatest influence over the issuer
- improving the consistency of the reporting requirements for stock-based compensation arrangements, and
- after a transition period, accelerating the filing deadline for reports of trading activity, which will make this important information available to the market sooner.

Reporting issuers and their advisors should familiarize themselves with the new insider reporting requirements to assist their reporting insiders in complying with their reporting obligation. In addition, reporting issuers should adopt appropriate policies and procedures relating to blackout periods, timely disclosure of material information, and monitoring and restricting of insider trading and tipping activities.

For further guidance on the new insider reporting regime, refer to:

- CSA Staff Notice 55-315 Frequently Asked Questions (FAQs) about National Instrument 55-104 Insider Reporting Requirements and Exemptions dated April 28, 2010
- CSA Staff Notice 55-312 Insider Reporting Guidelines for Certain Derivative Transactions (Equity Monetization) (REVISED) dated June 11, 2010, and
- CSA Staff Notice 55-316 Questions and Answers on Insider Reporting and the System for Electronic Disclosure by Insiders (SEDI) dated June 11, 2010.

### 3. IFRS reporting and communication

Following a period of public consultation, the Canadian Accounting Standards Board adopted a strategic plan to move financial reporting for Canadian publicly accountable enterprises to IFRS as issued by the International Accounting Standards Board. For financial years beginning on or after January 1, 2011, Canadian GAAP for publicly accountable enterprises will be IFRS as incorporated into the CICA Handbook.

The OSC supports Canada's move to IFRS, a globally accepted, high quality set of accounting principles. With issuers increasingly making decisions in a global context, the move to IFRS places Canada with more than 100 other countries, including the United Kingdom, other European Union nations and Australia, that have already adopted IFRS. Our objective is to facilitate a smooth transition from current Canadian GAAP to IFRS for reporting issuers. During fiscal 2010, we continued to educate reporting issuers and their advisors on IFRS changes and transitional issues as they prepare their first set of IFRS-compliant financial statements.

#### 3.1 Regulatory impacts of IFRS

On October 1, 2010, we published amendments to the CD, prospectus and certification rules that address the changes required to reflect the adoption of IFRS. Subject to receiving Ministerial approval, the amendments will come into force for issuers with financial years beginning on or after January 1, 2011.

The amendments include a list of changes to accounting terms and phrases, and transition changes that should assist issuers with the conversion to IFRS. The amendments will:

- replace existing Canadian GAAP terms and phrases with IFRS terms and phrases
- change disclosure requirements in instances where IFRS contemplates different financial statements than existing Canadian GAAP
- require the opening IFRS statement of financial position to be presented in an issuer's first IFRS interim financial report and first IFRS financial statements
- provide a 30-day extension to the filing deadline for the first IFRS interim financial report, and
- clarify, amend or delete existing provisions where the provision is no longer accurate or appropriate.

The amendments are intended to provide an efficient transition mechanism for issuers to reflect the changeover to IFRS and produce high quality financial reporting for the benefit of investors and other stakeholders.

### 3.2 Compliance review of IFRS transition disclosure

It is likely that the conversion to IFRS will require a significant commitment of resources by reporting issuers and sufficient advance planning. IFRS transition disclosure is important to assist investors in assessing the readiness of a reporting issuer's transition to IFRS and the impact the adoption of IFRS may have on the issuer. Issuers that provide sufficient information about their conversion process and its effects prior to the IFRS changeover will reduce the level of investor uncertainty about their IFRS readiness. This disclosure should lead to a more stable and less disruptive transition to IFRS, which will be beneficial to both issuers and their investors.

During fiscal 2010, the Branch continued to work towards facilitating a smooth conversion to IFRS for reporting issuers and their investors. As part of this goal, we conducted targeted reviews of IFRS transition disclosures made by issuers in their 2008 and 2009 annual MD&A. Our review of the 2008 annual MD&A disclosures found that the issuers reviewed were not adequately disclosing information related to their IFRS transition efforts. A detailed discussion of the findings of this review can be found in OSC Staff Notice 52-718 IFRS Transition Disclosure Review dated February 5, 2010. We recently completed our review of 2009 annual MD&A. Overall, we found an improvement in the amount and quality of IFRS transition disclosure provided by issuers in their 2009 annual MD&A compared to the prior year. This improvement should be expected since we are closer to the changeover date of January 1, 2011 and issuers generally are farther along in implementing their changeover plans and assessing the impact of accounting policy differences. We issued CSA Staff Notice 52-326 IFRS Transition Disclosure Review on July 23, 2010 which details the findings of the review and provides additional guidance for issuers preparing future MD&A.

Issuers that provide sufficient information about their conversion process and its effects prior to the changeover date will reduce the level of investor uncertainty about IFRS readiness and inform investors and other stakeholders about the potential for volatility in future reported results. This disclosure should lead to a more stable and less disruptive transition to IFRS, which will be beneficial to both issuers and their investors.

Given the short time remaining before the changeover to IFRS, it is critical that issuers provide investors with sufficient information about their conversion process and the potential impact of IFRS on the expected financial results. We will continue to review IFRS transition disclosure provided by reporting issuers as part of our CD review program.

## 4. Shareholder empowerment and board governance

During fiscal 2010, merger and acquisition (M&A) activity increased as issuers shifted their focus towards growth opportunities. This recent rise in M&A activity has also resulted in more contested transactions. The Branch continued to concentrate on the enhancement and protection of shareholder rights in the context of M&A transactions and the ability of shareholders to participate in director elections and other matters that are the subject of shareholder meetings. The measures we took include:

- intervening in mergers, acquisitions and significant related party transactions
- providing guidance to market participants about the take-over bid process
- improving shareholder access to proxy related materials, and
- addressing board governance.

### 4.1 Overview of mergers and acquisition matters

We have a specialized transactional and policy team that regulates take-over bids, issuer bids, business combinations, related party transactions and early warning reporting. This regulation focuses on shareholder rights in change of control and conflict of interest transactions.

This past year, our regulatory efforts included:

- addressing non-compliance with disclosure requirements applicable to M&A transactions
- participating in Commission M&A hearings
- publishing CSA Staff Notice 62-305 *Varying the Terms of Take-Over Bids*, and
- coordinating with our CSA colleagues on major transactional and policy matters.

#### Compliance

We routinely address non-compliance with take-over bid and early warning requirements. We identify non-compliance through independent staff review, third party complaints and self-reporting. Non-compliance outcomes include:

- public disclosure of non-compliance
- applications for compliance or public interest orders made to the Commission
- remedial measures, such as requiring the orderly sale of shares acquired without an exemption to the take-over bid provisions, and
- preventative action to minimize the risk of future non-compliance.

## Significant hearings

The Commission held two public interest hearings concerning related party transactions regulated by Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions* (MI 61-101). Both transactions involved a controlling shareholder.

### *Magna International Inc.*

On June 23 and 24, 2010, the Commission held a hearing concerning the proposed reorganization of Magna International Inc. (Magna) to collapse Magna's dual class structure (the Arrangement). In a statement of allegations, Staff asked the Commission to cease trade Magna's class B shares because:

- Magna's board of directors failed to provide a recommendation to shareholders and the management information circular (the Circular) in respect of the Arrangement did not contain sufficient information to allow shareholders to form a reasoned judgment, and
- the approval and review process followed by Magna's board was inadequate.

In its decision, the Commission concluded that while the Arrangement was not abusive of Magna's subordinate voting shareholders or the capital markets generally, the Circular contained serious and substantive deficiencies which precluded the subordinate voting shareholders from being able to make an informed voting decision in respect of the Arrangement.

The Commission took a contextual approach in reaching this conclusion. The Commission stated that the disclosure standard for a management information circular must be applied in the circumstances of the transaction. In the case of the Arrangement, the following circumstances were found to be relevant:

- The Arrangement was a material related party transaction between Magna and its controlling shareholder
- Neither the board nor special committee made any recommendation to the subordinate voting shareholders as to how to vote on the Arrangement
- Neither the board nor special committee gave their view as to the fairness of the Arrangement
- No fairness opinion was obtained with respect to the Arrangement, and
- The Arrangement was complex and some portions of the consideration to be paid were difficult to evaluate.

Given these circumstances, the Commission concluded that the Circular must provide the subordinate voting shareholders with substantially the same information and analysis received by the special committee.

The Commission ordered the Arrangement be cease traded until Magna provided extensive supplemental disclosure in the Circular.

The Commission stated that it had concerns about the process followed by the Magna board, the special committee and management in reviewing and submitting the Arrangement to the subordinate voting shareholders. The Commission stated its intention to discuss those concerns in its full reasons for the decision.

### *MI Developments Inc.*

Staff was involved in a Commission hearing on whether MI Developments Inc. (MID) failed to comply with MI 61-101 in connection with certain related party transactions. On December 23, 2009, the Commission released its reasons. These are some of the significant aspects of the decision:

- Only staff has a right to bring an application under section 127 of the *Securities Act* (Ontario) (the Act).
- The Commission has discretion to permit a person other than staff to make an application under section 127 of the Act. The Commission cited the following reasons to support its decision to permit the applicants to bring their applications under section 127 of the Act in this case:
  - the applications involved past and possible future related party transactions, governed by MI 61-101
  - the applications involved breaches of MI 61-101, but were not purely enforcement in nature
  - the relief sought was future looking and was intended to prevent future related party transactions
  - the Commission had the authority to impose an appropriate remedy, and
  - the applicants, as substantial shareholders of MID, were directly affected by the past conduct of MID and would have been directly affected by future related party transactions.
- The Commission confirmed that issuers can arrange their affairs through *bona fide* transactions to qualify for exemptions from our conflict of interest regime, MI 61-101. However, the Commission emphasized that it would look to the substance and effect of the transaction to determine whether the issuer should be able to rely upon the exemption.

### **Policy initiatives**

#### *Varying the terms of a bid*

We published [CSA Staff Notice 62-305 Varying the Terms of Take-Over Bids](#) on December 18, 2009 to address concerns over how the market was interpreting certain rules relating to formal take-over bids. Specifically, the notice sets out the views of CSA staff on the ability of an offeror to vary the terms of a formal bid in a manner that makes the bid less favourable to target security holders. The notice highlights that an offeror's conditions to a formal take-over bid should be *bona fide*, and should be interpreted in good faith since the bid creates an expectation among security holders that the bid will be completed at the price specified if the conditions are satisfied.

#### *Shareholder rights plans*

We, together with our CSA colleagues, are following recent developments in shareholder rights plan case law both in Ontario and across Canada. National Policy 62-202 *Take-Over Bids – Defensive Tactics* currently sets out the CSA's views on defensive tactics. In May 2009, the Commission dismissed an application by Pala

Investments Holding Limited to cease trade the shareholder rights plan of Neo Material Technologies Inc. The plan was adopted by the target board and approved by the shareholders during the course of a hostile partial bid. Staff are reviewing the impact of this, and other recent CSA decisions, to determine whether there is a need for further guidance on shareholder rights plans.

#### 4.2 Communication with beneficial owners of securities

As part of our focus on shareholder rights, we want to improve the process through which beneficial owners of reporting issuer securities, as opposed to registered securityholders, receive proxy related materials and how their voting instructions are solicited. Our goal is to make it simpler for beneficial owners to understand what they are being asked to vote on and to cast their vote.

During fiscal 2010, the CSA finalized proposed amendments to National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer* (NI 54-101).

The proposed amendments are intended to simplify and clarify aspects of the voting process for beneficial owners. They include:

- introduction of a voluntary “notice-and-access” method of informing registered holders and beneficial owners of reporting issuer securities that the proxy-related materials have been posted on a website that is not SEDAR, and explaining how to access them
- simplification of the process by which beneficial owners who hold securities through an intermediary are appointed as proxy holders
- enhanced disclosure by reporting issuers of the beneficial owner voting process, and
- restrictions designed to minimize the potential for misuse of certain beneficial owner information.

In developing the proposed amendments, CSA staff consulted with issuers, intermediaries, beneficial owners, a proxy advisory firm, proxy solicitors and service providers, as well as with the OSC’s advisory committees. The proposed amendments reflect the feedback received during those consultations.

The proposed amendments were published for a 144-day comment period on April 9, 2010. The comment period ended on August 31, 2010 and the CSA received 25 written submissions.

Our policymaking in the area of beneficial owner communications reflects our commitment to the principles animating NI 54-101:

- all securityholders of a reporting issuer, whether registered holders or beneficial owners, should have the opportunity to be treated alike as far as is practicable
- efficiency should be encouraged, and
- the obligation of each party in the securityholder communication process should be equitable and clearly defined.

### 4.3 Board governance

In addition to initiatives regarding shareholder rights, we continued our focus on disclosure surrounding the practices of those charged with “representing” shareholder interests, such as the board of directors. As part of our corporate sustainability reporting initiative, we reviewed the existing disclosure requirements regarding corporate governance matters during fiscal 2010. We heard feedback from stakeholders consulted that the existing disclosure requirements are adequate. However, they noted that compliance by reporting issuers with these requirements could be enhanced.

On December 18, 2009, the OSC announced its plan to conduct a review of compliance with the requirements of NI 58-101. Refer to Areas of focus for fiscal 2011 in section 2.1 *Review program for CD and offering documents* for a discussion of this review.

Consistent with our decision to focus on compliance with the existing requirements, CSA staff published [CSA Staff Notice 58-305 Status Report on the Proposed Changes to the Corporate Governance Regime](#) on November 13, 2009. The notice confirmed that the CSA did not intend to implement proposed changes to the corporate governance regime, including the related disclosure requirements, published for comment on December 19, 2008. The CSA’s decision was in response to comments received on the proposed changes. A majority of commenters expressed the view that it was not the appropriate time to introduce significant changes to the corporate governance regime in Canada, and in particular, they expressed concerns about moving towards a principles-based corporate governance regime. They also noted that issuers were currently focused on business sustainability issues in a challenging economic climate and on the transition to IFRS.

## 5. Exempt market financing and novel, complex products

Canadian investors increasingly are being offered, on an exempt basis as well as through prospectuses, a variety of novel and complex financial products. In fiscal 2010, we continued to work on initiatives intended to permit financial innovation without compromising investor protection. This work will continue into fiscal 2011.

### 5.1 Regulation of credit rating organizations

Credit rating organizations (CROs) play an important role in the financial markets. CRO ratings are referred to in a number of rules made under securities legislation. The importance of credit ratings, and their role in the recent global financial crisis and 2007 Canadian asset-backed commercial paper (ABCP) market turmoil, has resulted in a consensus in Canada and internationally that CROs must be subject to appropriate regulation.

During fiscal 2010, we continued to develop a framework for regulating CROs that will be complementary to international regulatory regimes. The CSA published proposed National Instrument 25-101 Designated Rating Organizations for a 90-day public comment period on July 16, 2010. The comment period closes on October 25, 2010. We encourage interested stakeholders to provide written submissions on the proposal.

Under the proposed instrument, a credit rating organization will be able to apply for designation as a “designated rating organization” by filing an application containing prescribed information. The central requirement of the proposed instrument is that, once designated, a rating organization must establish, maintain and ensure compliance with a code of conduct that is substantially the same as the Code of Conduct Fundamentals for Credit Rating Agencies published by the International Organization of Securities Commissions (IOSCO). A designated rating organization would also be required to establish policies and procedures to manage conflicts of interest, prevent inappropriate use of information, appoint a compliance officer and make an annual filing. While the CSA intends to appropriately regulate CROs, they are not proposing to direct or regulate the content of credit ratings or the methodologies used to determine credit ratings.

### 5.2 Offerings of novel and complex products

We continue to monitor how novel, complex products are sold in both the exempt markets as well as through prospectuses, and to develop appropriate regulatory responses.

#### Internet offerings of over-the-counter derivatives

The internet has increased the opportunities for Ontario residents to invest in securities, including over-the-counter derivatives such as contracts for difference (CFDs) and foreign exchange contracts. We became concerned that certain internet offerings were being made by unregistered, offshore entities to retail investors in Ontario. To address these investor protection concerns, we issued OSC Staff Notice 91-702 Offerings of

*Contracts for Difference and Foreign Exchange Contracts to Investors in Ontario* on October 30, 2009. The notice gives general guidance to market participants on CFDs, as well as foreign exchange contracts and similar over-the-counter derivatives.

Market participants must comply with the registration and prospectus requirements of Ontario securities law, or obtain exemptive relief, when offering these products to Ontario investors. This means investors will receive prospectus-level disclosure and registrants selling these products will need to fulfill their know-your-client and suitability obligations, unless exemptive relief has been granted.

### **Securitized products**

Securitized products are securities whose payments are supported by an underlying pool of cash-generating financial assets collected in a bankruptcy-remote special purpose vehicle. ABCP and collateralized debt obligations (CDOs) are types of securitized products. Examples of financial assets that are commonly securitized in this way include residential and commercial mortgages, credit card receivables, and automobile and agricultural equipment leases.

ABCP is generally issued in the exempt market. The majority of term asset-backed securities and other types of securitized products are prospectus qualified (often through a short form or shelf prospectus).

There is an international consensus that securitized products have unique features that require specific regulation. The 2007 Canadian ABCP crisis demonstrated the need to examine the regulation of securitized products, both on the disclosure side and the distribution side.

The CSA has been developing regulatory proposals to address these concerns in a manner that:

- balances investor protection with efficient capital markets, and
- facilitates transparency and a robust market infrastructure so that the securitization market can continue to function even in times of financial stress.

In developing proposals regarding securitization, we have considered international regulatory and industry developments, and are reviewing them against current Canadian requirements applicable to the distribution of securitized products. For example, we are reviewing the final recommendations of IOSCO's report, *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, and the SEC's notice of proposed rule-making relating to asset-backed securities and other structured finance products.

We expect to publish amendments to our rules relating to the sale of ABCP and other securitized products in the exempt market as well as through prospectuses later in 2010. Refer to CSA Staff Notice 45-307 Regulatory Developments Regarding Securitization (dated June 18, 2010) for further information.

These proposals are significant given the size of the Canadian securitization market. According to DBRS, as of March 31, 2010, the size of the Canadian securitization market was \$104 billion. The securitization market is significant to Ontario capital markets and the OSC is the principal regulator for the majority of asset-backed securities issuers.

### 5.3 Updating of exempt market regime

We continuously update our prospectus exemptions regime in response to market developments and related regulatory initiatives. On September 28, 2009, amended and restated versions of National Instrument 45-106 Prospectus and Registration Exemptions and OSC Rule 45-501 Ontario Prospectus and Registration Exemptions, and amendments to the related resale instrument, National Instrument 45-102 Resale of Securities came into effect. These amendments facilitate the implementation of our new registration regime, which was introduced at the same time through National Instrument 31-103 Registration Requirements and Exemptions, and amendments to the Act.

Our focus in fiscal 2011 will be on reviewing how products are sold to retail investors on a prospectus exempt basis. In particular, we are reviewing the accredited investor and \$150,000 minimum amount investment prospectus exemptions to assess whether they continue to be appropriate, or whether amendments are needed.

## 6. Questions and additional resources

### 6.1 Questions about this report

If you have any questions about this report, please contact:

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### 6.2 General questions

If you have any general questions about the Branch or any of its activities, please contact the OSC Inquiries and Contact Centre or Branch staff.

The OSC Inquiries and Contact Centre can be contacted by:

Phone: 416-593-8314 (Toronto area)/ 1-877-785-1555 (toll-free)/ 1-866-827-1295 (TTY)

E-mail: inquiries@osc.gov.on.ca

Fax: 416-593-8122

Appendix A contains the contact information for the professional and clerical staff in the Branch.

### 6.3 Additional resources

A part of our Branch's mandate is to foster a culture of compliance through outreach and other initiatives. Although we cannot provide legal, financial accounting or other advice, we try to assist issuers in meeting their regulatory requirements in a number of ways.

#### Corporate Finance section of OSC website

During fiscal 2010, we updated the Corporate Finance section of the OSC website. This section of the website provides a basic outline for issuers on how to comply with Ontario securities law and file certain documents with the OSC. It describes the steps an issuer needs to take to:

- distribute and market securities
- disclose information on a timely and accurate basis, and
- apply for regulatory exemptions.

In particular, there is a page that contains links to information for smaller issuers (both reporting issuers and other issuers) that want to learn more about Ontario securities law.

The Information for Companies section of the OSC website can be found at:

[http://www.osc.gov.on.ca/en/Companies\\_index.htm](http://www.osc.gov.on.ca/en/Companies_index.htm).

### **Other outreach initiatives**

We continued our efforts during fiscal 2010 to be transparent regarding the Branch's initiatives and practices and procedures in as timely a manner as possible. Our intent in doing so is to better enable issuers and their advisors to avoid potential regulatory issues before they undertake any transactions or make any regulatory filings. The primary tools that we use are staff notices (such as the notices referred to in this report) and public speaking engagements. We will continue to communicate regularly with our stakeholders about developing issues.

## Appendix – Corporate Finance Branch contact information

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COMMISSION

OSC Staff Notice 51-706



As the regulatory body responsible for overseeing the capital markets in Ontario, the Ontario Securities Commission administers and enforces the provincial Securities Act, the provincial Commodity Futures Act and administers certain provisions of the provincial Business Corporations Act. The OSC is a self-funded Crown corporation accountable to the Ontario Legislature through the Minister of Finance.