

Emerging Markets Issuers May Face New Listing Requirements

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Canadian issuers with significant business operations in emerging markets are coming under increased scrutiny by market regulators here. In the last 12 months, the Ontario Securities Commission (OSC) and the two major Canadian stock exchanges have published three papers on the adequacy of regulations governing emerging-market issuers.

On March 20, 2012, the OSC published the results of a regulatory review of emerging market issuers: *Staff Notice 51-719 - Emerging Markets Issuer Review* (OSC Review). Following that, on November 9, 2012, the OSC published an issuer guide for companies operating in emerging markets: *Staff Notice 51-720 – Issuer Guide for Companies Operating in Emerging Markets* (Issuer Guide). Subsequently, on December 17, 2012, the TSX and the TSXV (collectively, the Exchanges) published a consultation paper on emerging market issuers: *Consultation Paper on Emerging Market Issuers* (Consultation Paper).

The term “emerging market issuer” generally means an issuer with a significant connection, or significant business operations, in a jurisdiction outside of Canada, the United States, Western Europe, Australia and New Zealand. As of April 30, 2011, there were 108 issuers from emerging markets listed on the TSX, the TSXV, and the CNSX. Of those, 44 per cent were operating in the mining industry, a bigger proportion than in any other industry.¹ (The remaining 56 per cent included oil and gas operators, forestry concerns, technology companies and diversified enterprises.)

As Canadian corporations have increased their presence in global markets in recent years, companies from emerging markets have been seeking to access Canadian capital markets in greater numbers. While this presents a growing opportunity for investors, regulators are concerned about risks that can be associated with such investments, and whether existing investor protection measures are adequate.

The OSC Review was conducted to assess the quality and adequacy of disclosure and corporate governance practices for existing emerging market issuers, as well as the adequacy

of the “gatekeeper” roles played by auditors, underwriters and exchanges. An analysis of 24 sample issuers was undertaken, following which general areas of concern were highlighted and recommendations made.

In response to the OSC Review, a decision was made to work within the existing regulatory framework, without creating or modifying regulations. The OSC published the Issuer Guide to clarify the existing continuous disclosure requirements for emerging market issuers. The Issuer Guide identifies eight areas to consider for companies operating in emerging markets, with disclosure tips to help companies and their boards assess risks and comply with securities laws.

The Exchanges, also recognizing potential risks associated with emerging market issuers, began their own review, which identified areas of concern that resembled those identified by the OSC, including:

MANAGEMENT AND CORPORATE GOVERNANCE

- Management based in emerging markets may be unfamiliar with, and inexperienced in, Canadian securities law requirements.
- Communication issues due to lack of language fluency.
- Management based in Canada may be unfamiliar with, and inexperienced in, the laws and requirements of the local business jurisdiction.

FINANCIAL REPORTING

- Canadian auditors may lack sufficient experience and expertise in the applicable jurisdiction.
- Differences in banking systems, business cultures, and rules may lead to inadequate internal controls over financial reporting matters.
- If based in the other jurisdiction, the CFO or audit committee may lack sufficient expertise and experience with applicable audit practices and procedures.

NON-TRADITIONAL CORPORATE/CAPITAL STRUCTURES

- Tax or foreign ownership restrictions in certain jurisdictions may encourage or necessitate more complex corporate or capital structures. This may lead to inadequate disclosure of the risks and limits on the ability of shareholders to have recourse against the assets of the issuer.

LEGAL MATTERS RELATING TO TITLE AND ABILITY TO CONDUCT OPERATIONS

- It may be difficult for issuers to demonstrate that they have title to principal operating assets.
- Many jurisdictions require specific permits or business licences, particularly if the business is considered foreign. This may affect the issuer’s ability to carry out its business operations.

The Consultation Paper was published by the Exchanges to i) present potential risks associated with the listing of emerging market issuers, ii) provide preliminary guidelines to issuers, and iii) solicit comments from market participants on possible new guidelines or requirements. The TSX and TSXV each have separate lists of questions for public comment. In addition, the TSXV published a proposed policy document for comment. The consultation period concluded

February 28. Comments are being reviewed and each exchange will determine whether it will implement new guidelines or requirements for listing emerging market issuers.

For issuers in the resources industry, the Consultation Paper notes that the TSX considers certain emerging market risk factors to be mitigated if the issuers have produced independent technical reports. The consultation process is asking whether other factors should be considered when determining if an issuer should be qualified as an emerging market issuer, or whether resource issuers with independent technical reports should be automatically exempted from the definition (and therefore from certain regulatory requirements) if other conditions are met.

The proposed policy document for the TSXV creates a class of issuers known as “excluded resource issuers”, which are subject to relaxed listing requirements as compared to issuers falling under the definition of emerging market issuer. As set out in the proposed policy document, an excluded resource issuer is a mining or oil and gas issuer for which a majority of the issuer’s senior officers, directors, control persons or associates of a control person of the issuer have not been resident in an emerging market jurisdiction for a majority of the 10 years preceding the issuer’s application for listing.

For now, emerging market issuers should be aware that they may soon be subject to new regulatory rules and so should consider a review of their operations in light of the risk factors listed above.

The disclosure tips contained in the Issuer Guide should also help identify areas that are becoming the focus of OSC investigations and TSX review.

The Issuer Guide can be found at

http://www.osc.gov.on.ca/en/SecuritiesLaw_sn_20121109_51-720_issuer-guide.htm.

¹ OSC Review, at 3-4.