

SECURITIES & PUBLIC MARKETS BULLETIN

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THE PASSPORT SYSTEM: ONE STEP BACK, TWO STEPS FORWARD?...OR THE OTHER WAY AROUND?

On August 31, the Canadian Securities Administrators (the “CSA”) published for comment proposed National Policy 11-202 *Process for Prospectus Reviews in Multiple Jurisdictions* (“NP 11-202”) and proposed National Policy 11-203 *Process for Exemptive Relief Applications in Multiple Jurisdictions* (“NP 11-203”).

NP 11-202 and NP 11-203 supplement Proposed National Instrument 11-102 *Passport System* (“NI 11-102” or the “Passport System”) published in the spring and are intended to resolve a number of questions that arise out of the fact that the Ontario Securities Commission has indicated that it does not intend to implement the Passport System.

BACKGROUND

One Step Back

The CSA originally published NI 11-102 for comment on March 28, 2007. The term “National Instrument” is used to indicate that a rule has been accepted by all 13 members of the CSA, so it was surprising that on the same day this “National Instrument” was published, the Ontario Securities Commission (the “OSC”) published a notice (the “Notice”) indicating that it did not intend to adopt it¹.

The OSC indicated that “although the [proposed Passport System] may add incremental administrative improvements and efficiencies to our current regulatory processes, it does not resolve the need to modernize Canada’s securities regulatory structure”. The OSC’s objection to the Passport System seems to be based on a concern that it may result in the sacrifice of the consistent application of *substantive* regulatory requirements in favour of *procedural* speed and efficiency².

Although, seen in this light, the OSC’s opposition to the Passport System is quite principled, much of the commentary received in response to both NI 11-102 and the Notice was very critical of the OSC’s decision or at least expressed disappointment that the CSA were not able to achieve unanimous agreement³.

Two Steps Forward?

NP 11-202 and NP 11-203 (both of which are supported by Ontario) are intended to supplement and to achieve an interface between the Passport System (which will be reformulated as a “multilateral instrument”) and Ontario. The intention in adopting NP 11-202 and NP 11-203 is to create a quick, efficient *procedure* for the review of prospectuses and exemptive relief applications by more than one CSA member while accommodating Ontario’s interest in retaining control of *substantive* issues in respect of which it disagrees with other CSA members.

¹ See OSC Notice 11-904 *Request for Comments Regarding the Proposed Passport System* on the OSC website at www.osc.gov.on.ca.

² When Multilateral Instrument 11-101 (“MI 11-101”, the predecessor to NI 11-201) was published, the OSC said: “...the Commission participated in the process to develop [MI 11-101] with the understanding that it would apply in areas that are highly harmonized and would ensure consistency in regulatory standards for all market participants across Canada”. The OSC objected to MI 11-101 (and now, apparently, to its successor, the Passport System) because it would apply *generally*, including to areas in which there is not currently a high degree of substantive harmonization. As an example, the OSC cited differences in audit committee requirements applicable to public British Columbia companies compared with public Ontario companies.

³ See the links, below, to the “Comments Received” in respect of the Notice and NI 11-102.

http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part1/Comments/11-904/com_11-904_index.jsp

http://www.albertasecurities.com/dms/1144/15625/16188_Comment_Letters_Compiled_July- NI_11-102.pdf

NP 11-202 – THE PROSPECTUS REVIEW PROCESS

The NP 11-202 prospectus review process will be used for virtually all types of prospectuses prepared under a national prospectus requirement, including mutual fund simplified prospectuses and annual information forms.

Process

Under NP 11-202, a market participant filing a preliminary, *pro forma* or final prospectus will file all the required documents and fees with its “principal regulator” (the “PR”) and with each regulator (a “non-principal regulator” or “NPR”) in the other provinces or territories in which it wishes to offer the securities. Ontario can be a PR.

If Ontario is the PR or if the document is simply not filed in Ontario, the prospectus is known as a “passport prospectus”. Under the “passport prospectus” process, *only* the PR will review the documents, communicate with the filer and issue a preliminary or final receipt. The issuance of the preliminary or final receipt will result in a “deemed receipt” by each of the other CSA members. The “passport prospectus” process will represent a procedural improvement over the existing mutual reliance review system (the “MRRS”) in that the NPRs will not review or provide any comments on the document.

If one of the other provinces is the PR and the document has also been filed in Ontario, the prospectus is known as a “dual prospectus”. The “dual prospectus” process will be similar to the current MRRS in the sense that the PR will co-ordinate its review with the OSC. Although Ontario will have the right to opt-out of a decision by the PR, if the PR and the OSC reach the same decision, the PR will issue a single receipt representing evidence of the OSC’s receipt and deemed receipts in the other jurisdictions. If the PR and the OSC do not agree on an issue, the filer might have to deal with the PR (on behalf of the other “passport jurisdictions”) and separately with the OSC and might end up requiring two separate receipts. Although not ideal, this process will still be an improvement over the MRRS since a filer would have to deal separately with, at most, two regulators.

Timing

For long form prospectuses (including mutual fund simplified prospectuses) the PR will use its best efforts to provide a first comment letter within 10 working days of the issuance of a preliminary receipt or of receiving a *pro forma* prospectus. For preliminary short form and preliminary shelf prospectuses, the PR will use its best efforts to provide a first comment letter within 3 working days of the date of the preliminary receipt.

Under the “dual prospectus” process, the OSC will use its best efforts to advise the PR of any significant concerns or to indicate that it is ‘clear for final materials’ within 5 working days of the preliminary receipt for a long form prospectus (including a mutual fund simplified prospectus) or of receiving the *pro forma* prospectus and within 2 working days of the date of the preliminary receipt for preliminary short form and preliminary shelf prospectuses.

NP 11-203 – THE PROCESS FOR THE REVIEW OF EXEMPTIVE RELIEF APPLICATIONS

Similar to the prospectus review system, NP 11-203 contemplates several different processes for the review of exemptive relief applications and also uses the PR and NPR concepts.

Process

If Ontario is the PR or no relief is being sought in Ontario, the application is known as a “passport application”. Under the “passport application” process, an applicant will file its application materials and fees *only* with the PR. Similar to the “passport prospectus” review system, *only* the PR will review the application, communicate with the filer and grant the exemptive relief decision. The issuance of the PR’s exemptive relief decision will result in an automatic exemption in each NPR jurisdiction.

If one of the other provinces is the PR and relief is being sought in Ontario, the application is known as a “dual application”. Under the “dual application” process, an applicant will file its application materials and fees with both the PR and with the OSC. The PR will co-ordinate its review with the OSC. Although Ontario has the right to opt-out of a decision by the PR, if the PR and the OSC reach the same decision, the PR will issue its exemptive relief decision which will also

evidence that the OSC has made the same decision. If the PR and the OSC are not able to reach the same decision, the applicant would have to deal directly with both the PR and the OSC and would receive a separate decision from each of them.

Finally, if the application is seeking a type of relief that is not addressed by the Passport System, the application is known as a “coordinated review application”. The “coordinated review application” process is identical to the existing MRRS process. The applicant will file application materials and fees in each jurisdiction in which it is seeking relief. The PR will coordinate the review and comments with each of the NPRs and the PR’s decision to grant exemptive relief will evidence each NPR’s decision, rather than simply resulting in an automatic decision by the NPRs.

Timing

Under NP 11-203, the PR will send to the applicant and to any NPR an acknowledgment of receipt, once it has received a complete and adequate application.

With respect to a “passport application”, a PR is not committed to any particular timeline for review.

With respect to a “dual application” or a “coordinated review application”, the NPRs will have 7 business days from receiving an acknowledgment of receipt from the PR to review the application, but, again, the PR is not committed to any particular timeline for its review.

MAYBE ONTARIO WAS RIGHT?

Both NP 11-202 and 11-203 contemplate that a PR will be responsible for reviewing prospectuses or applications “in accordance with *its* securities legislation and securities directions and based on *its* review procedures, analysis and precedents”. In other words, a PR is not expected to look to the analysis or precedents in other CSA jurisdictions when corresponding with filers or applicants or when making a decision.

To the extent that a PR is not required to consider precedents from other CSA jurisdictions or from the CSA as a whole, the delegation of all decision-making authority to a PR and the focus on that province’s laws, analysis and precedents may result in inconsistent outcomes for filers and applicants. In other words, Ontario’s concerns about the potential for *substantive* inconsistencies under MI 11-101 and the Passport System may be correct.

NEXT STEPS

The comment period for NP 11-202 and 11-203 is open until October 31.

The CSA has said that it expects to republish the Passport System as a multilateral instrument (i.e. MI 11-102), together with NP 11-202 and NP 11-203 in early 2008. They intend to implement NP 11-202, NP 11-203 and those portions of MI 11-102 dealing with prospectuses, exemption applications and continuous disclosure matters concurrently with National Instrument 41-101 *General Prospectus Requirements* in March 2008⁴.

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⁴ MI 11-102 will also contain provisions regarding registration issues. The CSA have indicated that they expect to implement those provisions, together with National Instrument 31-103 *Registration Requirements* and a “passport for registration” process in July 2008.

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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