Cassels

Canadian Securities Litigation Outlook 2021 Update

TRENDS TO WATCH FOR CAPITAL MARKETS PARTICIPANTS

Trends to Watch

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The Cassels Securities Litigation Group is pleased to present our sixth annual Canadian Securities Litigation Outlook, in which we provide our analyses of key securities litigation developments over the past year and our thoughts on the topics and issues that we expect to see trending in the year to come.

This year, we examine six securities litigation-related topics including the enhanced focus on environmental, social, and governance initiatives by all market participants; regulatory updates arising out of British Columbia, Alberta, and Ontario; regulation of market manipulation; key developments in cryptocurrency regulation and enforcement; disclosure obligations in the era of COVID-19; and securities class actions developments.

Please contact any member of the Cassels Securities Litigation Group to discuss these developments and trends, and their impacts on market participants.

Enhanced Focus on Environmental, Social and Governance (ESG) Initiatives by All Market Participants

Environmental, social and governance (ESG) practices have become the key factors used to measure the sustainability and ethical impact of a business. News and articles relating to ESG issues and initiatives in the public markets have been almost a daily source of content in the past year, from high-profile shareholder activist challenges to address climate change, notably Exxonmobil and Chevron, to the increased focus of regulators on ESG risk and other disclosure, as discussed below.

This ESG focus has created a significant opportunity for those who genuinely embrace and tackle ESG issues. It is now the reality that corporations *must* adopt and evolve ESG policies to remain competitive and compliant. While factors such as return on investment and profits remain significant measures of a corporation's success, investors are increasingly looking to other metrics (such as commitment to net-zero carbon emissions and increasing diversity amongst corporate boards) when making investment decisions. Canada's most powerful pension funds have jointly called for issuers to provide broader and more consistent information to investors. Shareholder activism is another pressure point requiring increased corporate and board attention to ESG issues.

This article discusses increased regulatory initiatives to mandate climate-related disclosure and enhance other ESG-related disclosure and provides an update on corporate diversity initiatives. It is clear that the application of ESG considerations to business strategy and decision-making is not a trend or passing phase; it is here to stay.

REGULATORY ACTION TOWARD INCREASED ESG-BASED DISCLOSURE

On October 18, 2021, the Canadian Securities Authority (CSA) published for comment a proposed rule that would mandate climate-related disclosure.[1] National Instrument 51-107 *Disclosure of Climate-Related Matters* will implement a "comply-or-explain" regime, under which public issuers will be required to disclose their greenhouse gas (GHG) emissions and the related risks or explain why they have not done so. The implementation of these additional disclosure requirements will be phased in on a three-year basis.

The proposed requirements address the need for more consistent and comparable information to help inform investment decisions, and contemplate disclosure by issuers related to the four core elements of the recommendations developed by the Task Force on Climate-related Financial Disclosures[2]: governance, strategy, risk management, and metrics and targets. Further, the proposed requirements reflect the CSA's aspiration to align Canada's capital markets with the growing international movement toward similarly mandated climate-related disclosure.

The inconsistencies and deficiencies of the current optional ESG-based disclosure regime highlight the need for mandatory disclosure requirements. For example:

- of the 222 companies listed on the S&P/TSX Composite Index, only two-thirds have disclosed their greenhouse gas emissions;[3] and
- only 27% of TSX companies have stated emissions targets, only 15% of which have stated a detailed plan for achieving those targets.[4]

The current patchwork of ESG disclosure has come under criticism from various market participants for its lack of uniformity, including from the Canadian Institute of Chartered Accountants, which has called for a universal approach mirroring that currently in place for accounting practices.[5] Similarly, the Chief Investment Officer at Wealthsimple Inc. has publicly criticized the inconsistent approach and the difficulty this imposes on investors looking to invest in a socially responsible manner. The proposed climate-related disclosure requirements seek to address these concerns, at least in part, providing for a means of delivering more consistent and comparable information to allow for more informed investment decisions.

ESG INVESTMENT MEDIUMS: GREEN AND SUSTAINABILITY BONDS

The increasing investor interest in "green investing," such as ESG-linked investment mediums, is also being addressed by regulators, as demonstrated by the OSC approved amendments to the TSX Rule Book to accommodate trading of these types of mediums.[6] Issuers have responded by issuing "Green Bonds" and "Sustainability-Linked Bonds" (SLBs), both of which have been firmly embraced by Canadian investors. The value of sustainable funds has increased exponentially, which brings its own regulatory challenges and risks, including greenwashing, as discussed below.

Green Bonds essentially require that the investment proceeds are allocated for use only in "green" or sustainable initiatives, and they require the issuer to track and to report on that use. SLBs provide a more flexible vehicle without the ongoing disclosure obligations of Green Bonds, but require the issuer to set ESG-based goals with an accompanying timeline to realize those goals. The availability of both bonds has resulted in quantifiable and significant growth in this segment of the Canadian market:

- in August 2020, Brookfield Renewable announced its commitment to issuing $425 million in Green Bonds by August 2022;[7]
- the Canadian market for Green Bonds has risen from $2.6 billion in the first quarter of 2021 to a record $4.9 billion in the second quarter of 2021;[8]
- Dream Industrial Real Estate Investment Trust issued $400 million in Green Bonds in June of 2021, while Allied Properties REIT issued $600 million in Green Bonds in January of that year;[9]
- in June 2021, Telus Communications Inc. sold $750 million in SLBs, and Enbridge Inc. sold $1 billion worth of SLBs;[10]
- in the first three quarters of 2021, there were five separate ESG-linked corporate debt deals in the Canadian market where $500 million or more in bonds were issued, this compares to only one ESG-linked deal of this size in all of 2020;[11]
- in September 2021, the Ontario Teachers' Pension Plan (OTPP) stated its intention to issue Green Bonds as a way of funding some of its investments in climate solutions and sustainable companies,[12] this comes only months after the OTPP became an anchor investor in Brookfield Asset Management's Global Transition Fund, the largest pool of private money globally aimed at accelerating the shift to a net-zero economy;[13] and
- as of the end of September 2021, BMO, National Bank of Canada, and RBC had each raised more than $750 million through the issuance of ESG-linked bonds.[14]

The proliferation of these ESG-related investments is largely a positive development for both investors and issuers but like any emerging trend, also increases risk of investor manipulation through misleading disclosure about the nature of investors. Further, a failure to meet stated ESG-related goals can lead to not only regulatory attention and public criticism, but also shareholder activism.

Greenwashing, whether intentional or inadvertent, erodes investor confidence in the markets and detracts from genuine efforts to support ESG causes by responsible market participants.

The CSA have signalled their intention to focus on enhanced ESG-related disclosure and enforcement efforts to address greenwashing and other misleading ESG-related disclosure. For example, the OSC and the AMF are both members of the Sustainable Finance Task Force created by the International Organization of Securitas Commissions, which includes a focus on improving sustainability-related practices and disclosure in the asset management industry.[15]

CORPORATE DIVERSITY: MORE PROGRESS IS NEEDED

Diversity of representation at the corporate board level and in the "C-suite" remains another key ESG-related priority for investors and regulators alike. Unfortunately, despite several years of attention and focus on this issue, lack of board diversity remains an issue for both new and old public companies:

- the results of a follow-up report to the 2020 "BlackNorth" initiative, a pledge by many Canadian corporations to increase diversity at the board and management levels, showed little progress, with many companies declining to comment. Of the 209 signatories to the BlackNorth initiate, 105 reported having neither increased the number of Black employees nor elevated Black people to executive roles or the Board level. Only about 15 companies reported having more Black senior employees or having increased Black representation at the Board level;[16] and
- a study conducted in August of 2021 on the 61 companies newly listed on the TSX in 2021 revealed that, of the 318 board seats amongst those companies, 79 (25%) were held by women. For newly public companies, this number was only 19% of available seats. Further, only 3 of the 61 companies had a woman as Chair of the board. These statistics are consistent with the numbers seen across all Canadian public companies; in fact, 27% of Canadian public companies do not even have a single female director at all.[17]

The pace of progress in achieving racial and gender diversity in the Canadian public markets is concerning; however, there is momentum for further change. Proxy advisers Institutional Shareholder Services and Glass Lewis & Co have stated their intention to increase their requirements for gender diversity in Canadian companies in 2022. Glass Lewis has indicated that it intends to recommend that investors vote against the Chair of a company's nominating committee, unless there are at least two female directors.[18] Board diversity is likely to remain a key priority for shareholder activism in 2022.

LOOKING FORWARD IN 2022

In 2020, we predicted that ESG-related issues would continue to gain steam in 2021, and we have certainly seen a heightened awareness of, and reaction to, ESG issues like those discussed above. While these issues are challenging and systemic, it appears that regulators, issuers, and investors alike are genuinely focussing their collective efforts on addressing and progressing ESG issues, and we look forward to this trend continuing in 2022.

Securities Class Actions Trends

We believe that the following securities class action developments are largely issuer/defendant friendly, but their impact on the number and types of future securities class action filings remains to be seen.

FIRST MERITS DECISION BRINGS HOPE TO DEFENDANTS

The leave test for secondary market disclosure misrepresentation cases under Part XXIII.1 of the Ontario *Securities Act* (the *Securities Act*) has been well developed through case law, including by the Supreme Court of Canada. While this test is intended to be a significant screening mechanism, and has been described as "more than a speed bump," the courts are still clearly guided by the principle that the *Securities Act* is remedial legislation that should be interpreted broadly and purposively.[1] The resulting reality is that a large percentage of proposed secondary market cases survive the leave motion, and most of these cases then go on to settle.[2]

Notably, 2021 saw the first decision of a secondary market securities class action on its merits. The plaintiff in *Wong v. Pretium Resources* alleged that the mining company defendant made a misrepresentation by omission when it did not disclose in a timely manner the negative opinion of one of its consultants concerning the mineral resources estimate prepared by another consultant. While Justice Belobaba had previously granted leave to the plaintiff to proceed with this claim,[3] he dismissed the claim on its merits on the defendant's summary judgment motion, finding that there was no misrepresentation and that, in any event, the defendants were entitled to a reasonable investigations defence.[4]

The significance of this decision is the commentary and insight on the relationship between the test for leave to proceed with a secondary market class action and a finding on the merits of the action. Justice Belobaba noted that while "leave to proceed will be granted if there is enough evidence to clear the 'reasonable possibility' hurdle," the defendants may still prevail "when the matter is litigated in full and the plaintiff's hurdle is the more demanding 'balance of probabilities.'"[5]

In addition to demonstrating that the merits threshold is more onerous than the leave threshold, this decision provides useful guidance to issuers when making disclosure decisions. At the merits hearing, sufficient evidence was presented to allow Justice Belobaba to dislodge his initial views of the significance of the negative opinion of the consultant and to conclude that the defendant "acted properly throughout" in coming to its conclusion that the negative opinion was unreliable and, therefore, not a material fact that had to be disclosed. Helpfully, Justice Belobaba also commented that "[n]othing is achieved by flooding the market with unhelpful information" and that the idea of "simply disclosing everything and letting the market make sense of it has been unequivocally rejected."[6]

We hope that this first merits decision will encourage defendants to persist in defending the merits of secondary market class actions once leave has been granted, as plaintiffs and defendants alike can only benefit from further case law guidance in this area.

IMPACT OF ONTARIO CLASS ACTION AMENDMENTS

As we discussed in last year's Outlook, Ontario's class proceedings legislation underwent significant changes through amendments that apply to class proceedings commenced after the effective date of October 1, 2020. Among other things, the amended certification test under the *Class Proceedings Act, 1992* requires that common issues in a proposed class action *predominate* over individual ones, and the proposed action be *superior* to any other reasonably available means of resolving the claims of the plaintiff class or the conduct of the defendant. The amended legislation also encourages pre-certification motions by defendants, where preliminary motions may narrow or dispose of issues in a proceeding.

While the majority of the amendments have yet to be tested or applied by the Ontario courts, a recent decision confirmed the legislative intention regarding pre-certification motions, finding that a motion that can arguably dispose of the proceeding in whole or in part, or can narrow the issues or the evidence, *must* be heard before certification, *unless* the court orders that the two motions be heard together.[7] This decision confirms that the new amendments should enable defendants to move earlier and more aggressively against weak or problematic claims. On the other hand, we may see plaintiffs filing certification and leave motion records more quickly, so that they are better positioned to ask that any preliminary motions be heard in tandem with leave and certification.

2021 FILINGS

While the year is not yet done, it appears that securities class action filings in Canada are declining as compared to 2020, when the number of new filings surpassed 2019 and matched the prior record set in 2011.[8] Further, while four of the fifteen class actions filed in 2020 were against reporting issuers in the cannabis industry (as compared to five in 2019), we are not aware of any cannabis-related class actions being filed in 2021 – which may be attributed to the maturing of issuers operating in the cannabis industry. Moving forward, we expect to see a rise in secondary market disclosure class actions in the Environmental, Social and Governance area.

KEY TAKEAWAYS

The combination of the more stringent test for certification and the first decision on the merits suggest that defendants who face securities class actions in Ontario may have a better chance of success on preliminary motions and/or in defending cases on their merits post-leave. Issuers who find themselves on the receiving end of a new securities class action need experienced class action counsel who can provide reasoned advice on the best forum for success. Issuers who face difficult disclosure decisions will similarly benefit from experienced advice on any related litigation risk.

Regulating Market Manipulation – Challenges and Change

The regulation of market manipulation, and activist short selling in particular, has been at the forefront of recent efforts to modernize the Canadian securities landscape. In late 2020, the Canadian Securities Administrators (CSA) released a consultation paper to solicit the public's views about activist short selling and its potential impact on Canadian capital markets. Shortly after that, in early 2021, the Ontario Capital Markets Modernization Taskforce (the Taskforce) released a report in support of regulatory reform which included recommendations for increased regulation of short selling.[1] The CSA and the Taskforce were both focused on finding a balance between fostering efficient and innovative capital markets while still ensuring investor protection. Recognizing the need to achieve this goal, the Government of Ontario published draft legislation for the new *Capital Markets Act* (the Draft CMA).[2] The Draft CMA was released for comment on October 12, 2021, and addresses the CSA's considerations in its consultation paper, the responses received, and the numerous recommendations put forward by the Taskforce.

Ultimately, the increased scrutiny of market manipulation is justified given the proliferation of social media as a means for disseminating negative information designed to artificially decrease the share price of targeted issuers for personal gain. Canadian securities legislation includes general prohibitions that regulators may use to combat unwanted activist short selling activity, including prohibitions against market manipulation, making misleading statements, and fraud. However, the CSA is considering (and the Taskforce has recommended) regulatory intervention to specifically target such activity. New regulatory or remedial provisions could improve investor protection and market efficiency while still allowing for legitimate and appropriate short selling behaviour to continue unimpeded.

WHAT IS ACTIVIST SHORT SELLING?

The term "activist short selling" is used to describe instances where investors take a short position in a security and then make a public statement with the intention of causing the security's price to fall (sometimes referred to as a "short report"). If the value of the security declines, the short seller realizes a profit.

The CSA conducted an empirical analysis between January 2010 and September 2020 regarding short selling activity. The findings are summarized as follows:[3]

- in this period, a total of 73 Canadian issuers have been the target of 116 activist short selling campaigns;
- the most active years were 2015 (19 campaigns), 2016 (21 campaigns) and 2018 (22 campaigns), and there were 12 campaigns in 2020 as of September of that year;
- contrasted with the United States, where there is an average of 21 US targets annually for every 1,000 US listed issuers, Canada never had more than five Canadian targets for every 1,000 Canadian listed issuers;
- short sellers gravitate toward the securities of issuers and sectors where there is a perceived overvaluation (for example, 2018 saw 35% of new campaigns target the cannabis industry);
- campaigns tend to be focused on larger issuers – the median and average market capitalization of targets were $867 million and $4.5 billion, respectively;
- activist short selling campaigns tend to be successful – about 75% of targets experienced a negative price impact on the day of the first campaign announcement and up to one month following;
- fraud is the most common allegation made by activist short sellers – of all 116 campaigns, 40% involved allegations of fraud directed at the issuer, with the most common type of fraud allegation being a stock promotion (or "pump and dump") scheme;
- approximately 73% of target issuers pursued some type of response to the activist short selling campaign (common responses included either changing or replacing top executives, hiring a new auditor or independent investigator, halting the issuer's stock from trading, pursuing a lawsuit against the activist short seller or announcing a capital market transaction); and
- following activist short selling campaigns, about 29% of targeted issuers experienced a "negative outcome" aside from a fall in the issuer's share price (the most common "negative outcome" was a class action lawsuit).

Advocates of activist short selling suggest that the practice contributes to market efficiency and price discovery by identifying and correcting artificially inflated positions. Critics, however, focus on the inherent harm caused to the public market by deliberate attempts to destroy shareholder value for personal gain. These concerns are compounded by what many believe is an insufficient regulatory framework in Canada to deter and protect against short seller misconduct. There is, additionally, the question of whether the activist trading recently seen in the United States will see "copycat" cases in Canada.[4]

THE CURRENT REGULATORY FRAMEWORK, ENFORCEMENT, AND REMEDIES

The debate about whether the actions of short sellers are, in fact, beneficial or abusive to the market highlights one of the key questions to be answered by securities regulators: how can regulators effectively manage and prosecute those who act with the intent of manipulating stock prices? Concerns relating to the inherent harm caused by deliberate attempts to destroy shareholder value for personal gain are compounded by what many believe is an insufficient regulatory framework in Canada to deter and protect against such misconduct.

Canadian securities legislation contains general prohibitions on market manipulation, making misleading statements and fraud, which may be used by regulators to combat much of the activist short selling activity that regulators consider undesirable.[5]

However, the evidentiary threshold necessary to impose liability under such legislation, which requires finding a real market impact caused by the misleading/untrue statement, is seen as an obstacle to effective prosecution, including because of new complexities caused by the growing use of social media as a means for activist short sellers to broadcast their message. It is often too difficult to show a "misleading appearance of trading activity" and/or an "artificial price" because proving that would require:

- a determination of the "real" supply and demand for the stock; and
- a finding that this "real" market activity was distorted by the investor in question.

Therefore, despite the express prohibition, market participants are rarely held accountable under these provisions.

It is also unclear what type of evidence would be required to demonstrate an attempt to create an "artificial" stock price, as opposed to actions that are the result of a free and fair market. Given the number of short selling campaigns that successfully drove down stock prices over the last decade (approximately 70 according to the CSA), investors need better guidance to ensure that market activity does not cross the line into manipulation.

Additionally, there is no mechanism under Canadian securities law for issuers or investors to directly seek damages against activist short sellers for statements made in the context of short selling campaigns. Although issuers and/or investors may commence civil proceedings, procedural delay and a lack of precedent-setting case law makes this a less effective and uncertain mechanism for redress.

REGULATORY REFORM

Technological advancements, including the proliferation of social media and online broker activity, have had a significant impact on the fairness, volatility, and transparency of the capital markets. The CSA identified that the rise in use of social media may contribute to market manipulation, and there is increasing concern that Canadian legislation addressing market manipulation is less effective than those in other jurisdictions.[6] It is therefore not surprising that regulators are considering reform to reduce the ease with which market manipulation occurs.

For example, the CSA has proposed enforcing more stringent reporting and disclosure obligations on activist short sellers as well as a minimum hold period for short positions. The Taskforce recommended specific prohibitions from making misleading or untrue statements about public companies, which would prevent institutional short sellers from being able to "short and distort" stocks. This recommendation would allow the Ontario Securities Commission to take enforcement action against any person or entity who makes statements:

- known to be misleading or untrue (or the truth of which is recklessly disregarded); and
- which would be expected to affect the market price or value of the securities, or influence investment decision-making of a reasonable investor.

The evidence would not need to demonstrate that the market was actually distorted, just that there was an intention to impact the market or influence the "reasonable investor's" decision-making. The Draft CMA incorporates the Taskforce's recommendations in this regard and has the potential to significantly alter the regulatory framework for market manipulation.

Along similar lines, the British Columbia Securities Commission recently proposed new enforcement tools to combat market manipulation schemes and misrepresentations on social media.[7] These pending changes follow recent amendments to British Columbia securities laws which remove the requirement to establish that a misrepresentation had an actual impact on the share price in cases of alleged market manipulation, thereby removing the need to prove "real" vs. "artificial" market activity.

LOOKING FORWARD

Many stakeholders agree that regulatory and legislative changes are necessary to inhibit those who seek to artificially manipulate stock prices for their own profit. It is apparent that any changes to the current regulation of market manipulation should:

- address the impugned activity itself to ensure that activist trading, no matter its form, occurs in a manner that is not abusive or unfair to other market stakeholders; and
- permit effective enforcement of securities law to ensure that those who intend to manipulate the market can be prosecuted for their misconduct.

Such reform, if done correctly, will give Canada a competitive edge by ensuring investor protection while maintaining active and efficient capital markets.

Disclosure Obligations in the COVID-19 Era

As the COVID-19 pandemic continues to cause considerable social and economic uncertainty, reporting issuers across all industries must remain diligent in disclosing the impacts of the pandemic – whether realized or anticipated – on their business operations, current financial condition, liquidity, and future prospects. The Canadian Securities Administrators (CSA) has indicated that they are committed to closely monitoring potentially misleading disclosure related to COVID-19,[1] but over a year and a half into the pandemic, no Canadian securities regulator has announced charges against any reporting issuers for improper COVID-19 disclosure.

The CSA has conducted studies throughout the COVID-19 pandemic to review disclosure filings and analyze issuers' compliance with National Instrument 51-102 *Continuous Disclosure Obligations*. Most recently, the CSA published CSA Staff Notice 51-362 (SN 51-362), which summarized their findings and offered guidance on improved disclosure practices.[2] SN 51-362 offers important guidance on how issuers should disclose issues relating to COVID-19 and provides insight into how reporting issuers can avoid the scrutiny of Canadian regulators with respect to pandemic-related disclosure.

CASE STUDIES FROM THE UNITED STATES

While we have not yet seen any Canadian proceedings against issuers with respect to inadequate COVID-19 disclosures, the Securities and Exchange Commission (SEC) has announced charges against two issuers for making misleading disclosure related to COVID-19. As the SEC often sets trends followed by Canadian regulators, Canadian reporting issuers may yet see similar proceedings brought in Canada.

THE CHEESECAKE FACTORY: MISLEADING DISCLOSURE THROUGH OMISSIONS

On December 4, 2020, the SEC announced that it had settled proceedings against the chain restaurant establishment, The Cheesecake Factory Incorporated (Cheesecake Factory). The SEC charged the Cheesecake Factory with having omitted material information from its public filings on the impacts of COVID-19 on its business operations and financial condition.[3]

The SEC alleged that the Cheesecake Factory stated in its March and April 2020 public filings that its restaurants were "operating sustainably," when in fact it was losing approximately $6 million in cash per week and only had a projected 16 weeks of cash remaining from the date of its disclosures.[4] The SEC stated that the Cheesecake Factory also failed to disclose its financial concerns and the steps it was taking to conserve its financial position – for example, the Cheesecake Factory had notified each of its landlords that it would be unable to pay April rent.[5] Moreover, to seek additional liquidity, the SEC alleged that the Cheesecake Factory had privately disclosed its actual cash position and projected earnings to lenders and potential private equity investors.[6] These allegations would, if found to be true, establish that the Cheesecake Factory failed to satisfy its disclosure obligations.

The Cheesecake Factory and SEC ultimately settled the proceedings, with no admission or denial of the findings presented in the SEC order, for a fine of $125,000.[7]

PARALLAX: MISLEADING DISCLOSURE THROUGH OVER-PROMOTION

On July 7, 2021, the SEC announced charges against Parallax Health Sciences Inc. (Parallax), an integrated digital healthcare company, for making misleading statements as to the opportunities arising out of COVID-19.[8] The SEC also charged Parallax's CEO and CTO for their role in approving the alleged inaccurate disclosures.[9]

The SEC alleged that Parallax issued a series of press releases in March and April 2020 that falsely claimed that Parallax would capitalize off the pandemic by offering COVID-19 related health products on an overambitious timeline.[10] Specifically, Parallax stated that it had medical and personal protective equipment (PPE) for "immediate sale" and that it was working on a COVID-19 screening test that would be "available soon."[11] The SEC alleged that:

- Parallax never had the PPE it offered to sell;[12]
- Parallax was insolvent and lacked the necessary capital to develop the screening test;[13]
- even if Parallax had the capital needed to fund its promised products, the screening test would take over a year to develop, and several other factors prevented the company from acquiring the PPE (for example, the company lacked the FDA registrations required to import and sell PPE);[14]
- Parallax misled investors by falsely positioning itself as capitalizing on opportunities created by the pandemic;[15] and
- Parallax's CEO drafted the relevant press releases for the purpose of boosting the company's declining stock price (and the stock prices did in fact increase after the misleading press releases were published).[16]

Parallax and its officers agreed to settle the proceedings without admitting or denying liability. If the court approves the settlement, Parallax and each of the named officers will pay penalties of $100,000 and $45,000, respectively.[17] In addition, the CEO will be prohibited from acting as a public company officer or director and from participating in an offering of penny stock for five years and the CTO will be prohibited from participating in an offering of penny stock for three years.[18]

SN 51-362: COMMON DISCLOSURE DEFICIENCIES AND THE CSA'S RECOMMENDATIONS

While Canadian regulators have yet to announce charges against any reporting issuers, SN 51-362 identifies certain common deficiencies in Canadian issuers' COVID-19 disclosures that need improvement.

In SN 51-362, the CSA assessed the adequacy of issuers' disclosure of present and anticipated impacts of COVID-19 on businesses' operations, financial condition, liquidity, and future prospects.[19] The CSA found that while most issuers provided quality and detailed disclosures, there were several common deficiencies in need of improvement.[20] In short, the CSA specified that it is not sufficient for an issuer to simply report that COVID-19 has or will impact their business, but rather issuers must also provide precise details as to how COVID-19 has or may impact their specific business, and outline the methodology used to attribute the business-impacts to COVID-19.

The tables below summarize common deficiencies that the CSA noted in each area of disclosure,[21] as well as the CSA's guidance for how issuers may improve their disclosure compliance in the era of COVID-19.

MANAGEMENT DISCUSSION AND ANALYSIS (MD&A)

COMMON DEFICIENCIES	CSA GUIDANCE FOR ISSUERS
• Providing lists of responses and risks without necessary detail to address the anticipated impact to the issuer • Using boilerplate language and disclosing generally-known trends rather than COVID-19 impacts specific to the industry or issuer • Insufficient evidence showing that costs and other impacts are specifically attributable to COVID-19 • Inadequate detail regarding issuers' ability to meet working capital requirements, meet planned growth initiatives, or fund planned activities and expenditures	• Provide detailed, meaningful, and issuer-specific disclosure on how COVID-19 has impacted its industry and day-to-day operations • Avoid boilerplate language and generic list-making • Provide thorough descriptions of material impacts and liquidity risks of COVID-19, and where possible, quantify material factors and provide up-to-date risk factors • Disclose methodology used in management's assessments and explain how link to COVID-19 is known

FINANCIAL STATEMENTS

COMMON DEFICIENCIES	CSA GUIDANCE FOR ISSUERS
• Providing "lists" of generally known, non-entity-specific economic risks • Failure to identify reasons for impairments of non-financial assets or only noting "negative economic impacts of COVID-19" as an impairment indicator for all cash generating units • In some "close call" situations, failure to disclose mitigating actions that factored into the conclusion that an issuer will continue as a going concern • Inadequate updates to early judgments and measurement uncertainties in interim financial statements • Failure to provide corresponding disclosure in financial statements • Failure to consider the impact of COVID-19 on associates and joint ventures in determining whether there is a "loss event" • Failure to provide corresponding disclosure in financial statements where MD&As disclose increased liquidity, market risk, or credit risk	• Provide detailed disclosure of ability to meet working capital requirements, meet planned growth initiatives, or fund developmental activities and capital expenditures • Disclose key assumptions management based its determination of recoverable amounts on • Use probability weighted scenarios where possible, rather than providing a single best estimate • Disclose all material uncertainties that management is aware of that may cast significant doubt on the issuer's ability to continue as a going concern • Disclose judgments and mitigating actions to support a determination that a "close call" was avoided • Consider whether there have been changes to credit risk. Factors to consider include risk concentrations, risk to expected credit losses, and any significant assumptions being made

NON-GAAP FINANCIAL MEASURES (NGMS)

COMMON DEFICIENCIES	CSA GUIDANCE FOR ISSUERS
• General failure to disclose, under 5% of issuers disclosed NGMs adjusted for COVID-19 impacts • Inadequate explanation of how adjustments were attributable to the COVID-19 pandemic • Misleading disclosures of NGMs where adjustments were made for COVID-19 expenses without adjusting for government subsidies	• Consider how NGMs adjusted for COVID-19 assist investors, how management uses the measure, and why management thinks it may be useful to explain the impact of COVID-19 • Be specific in describing adjustments and be wary before concluding that an adjustment is non-recurring, infrequent, or unusual • Include balanced adjustments and consider the impacts of government subsidies, insurance recoveries, and tenancy relief

FORWARD-LOOKING INFORMATION (FLI)

COMMON DEFICIENCIES	CSA GUIDANCE FOR ISSUERS
• Insufficient detail of assumptions related to FLI • Failure to update MD&A to reflect updated FLI	• Provide a reasonable basis for providing FLI and provide sufficient detail as to how FLI was derived • Update MD&A to consider what is reasonably likely to cause actual results and disclose what differs from previously provided FLI

MATERIAL CHANGE REPORTING

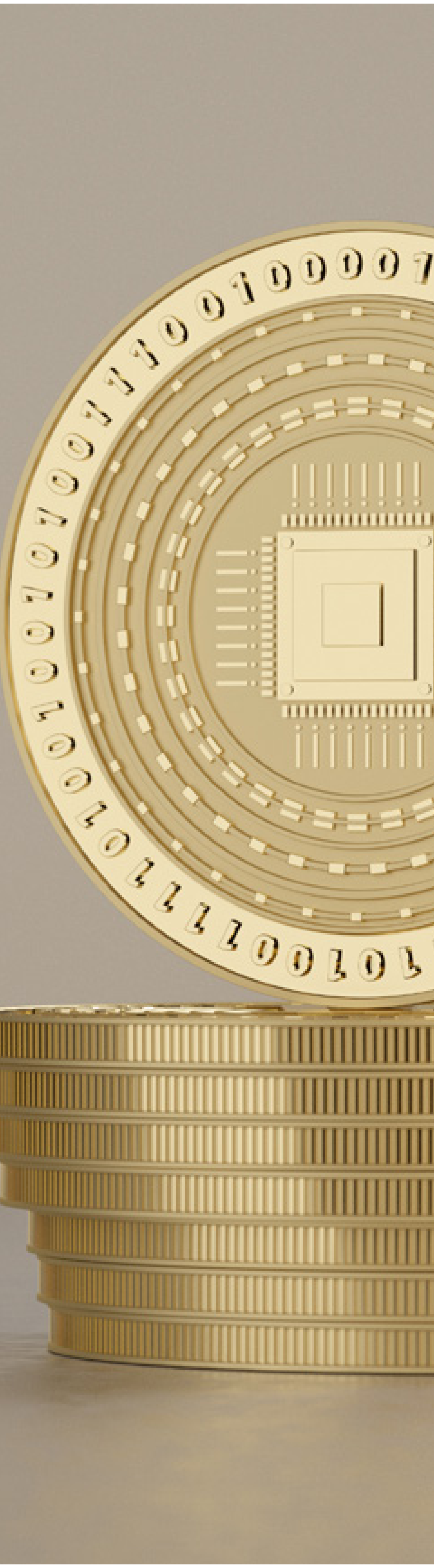
COMMON DEFICIENCIES	CSA GUIDANCE FOR ISSUERS
• Failure to account for unique or significant impacts of COVID-19 based on issuer's industry or business	• Provide detailed, entity and industry specific disclosure of the impact of COVID-19 • Definition of "material change" varies by jurisdiction, so understand how "material change" is defined by an issuer's principal regulator

PROMOTIONAL DISCLOSURES

COMMON DEFICIENCIES	CSA GUIDANCE FOR ISSUERS
• Overly promotional material that lacks specificity (particularly in the biotech or pharma industry) • Overstating a positive impact of COVID-19 or making assumptions at too early a stage of the pandemic to understand the true impact	• Be complete, balanced, and focused on material information • Avoid making any statements or omitting any facts that make a disclosure untrue or misleading

LOOKING FORWARD

SN 51-362 is a valuable resource for all market participants. As we continue to experience the economic and business disruption of the pandemic, issuers must remain diligent in disclosing the realized and anticipated impacts of COVID-19 on their businesses.



Key Developments in Cryptocurrency Regulation and Enforcement

As the cryptocurrency industry continues to grow in Canada, regulators are challenged to strike a balance between enforcing regulations and fostering innovation in a fast-paced, ever-changing market.

Cryptocurrency, while relatively new, is not an invention of the last couple of years. Bitcoin, considered by many to be the marquee crypto asset, became available more than a decade ago. Nevertheless, the concept still seems novel to regulators and investors alike. Regardless of one’s own experience, understanding, or familiarity with the crypto market, it is undeniable that the continued growth of this market has been accompanied by a variety of difficulties for regulators. In response, Canadian regulatory authorities have been forced to apply creative and flexible solutions to the regulation of the cryptocurrency industry.

REGULATORY MOVEMENT

In the past year, the Ontario Securities Commission (OSC), alongside the Canadian Securities Administrators (CSA), has doubled down on its commitment to regulate the cryptocurrency market, citing the intention of protecting investors as its focus. Following up from the Staff Notice 21-327 (SN 21-327), issued in January 2020 and addressed in our article last year,[1] the CSA has issued three additional Staff Notices: 21-329[2] (SN 21-329), 51-363[3] (SN 51-363), and 21-330[4] (SN 21-330 and, collectively, the Staff Notices).

SN 21-329: GUIDANCE FOR CRYPTO ASSET TRADING PLATFORMS: COMPLIANCE WITH REGULATORY REQUIREMENTS

SN 21-329 builds on the message espoused in SN 21-327 that securities legislation and registration requirements apply to crypto entities. In SN 21-329, the CSA provides further detail and clarity on its expectations that crypto entities satisfy these requirements. SN 21-329 also acknowledges the need for, and recommends adopting, an interim approach toward requiring crypto trading platforms (CTPs) to register as investment dealers with the Investment Industry Regulatory Organization of Canada (IIROC). The CSA recognizes that the registration process is lengthy and complex and has, therefore, proposed a phased approach which will allow entities to continue to operate while undergoing the registration process.

SN 51-363: OBSERVATIONS ON DISCLOSURE BY CRYPTO ASSETS REPORTING ISSUERS

Regulators also published SN 51-363 advising on the level of disclosure that is expected from these newly registered crypto entities at the time of their initial registration and on an ongoing basis. The discussion in SN 51-363 is tailored toward issuers dealing with crypto assets. The CSA noted that the disclosure in these entities' annual filings, concerning the issuer's engagement with crypto assets by way of mining, trading, or holding of those assets, contained a multitude of deficiencies. SN 51-363 provides guidance aimed at rectifying these deficiencies.

SN 21-330: REQUIREMENTS RELATING TO ADVERTISING, MARKETING AND SOCIAL MEDIA USE

Most recently, the CSA issued SN 21-330 as a warning to CTPs that advertising activities and marketing strategies, which they had engaged in prior to registering as a public issuer, may be in breach of securities legislation. SN 21-330 points to broad public statement-making and social media use as examples of activity that, while previously a regular part of their operations, may contravene the applicable regulations.

STAFF NOTICES: TRENDS AND TAKEAWAYS

Each Staff Notice recognizes the need for securities regulatory authorities to adopt a flexible approach when regulating the crypto market. Further, each Staff Notice functions as a warning to issuers regarding the type of activity that can result in enforcement actions and provides guidance to issuers to ensure that they take the necessary steps to comply with applicable regulations.

REGULATORY EXCEPTIONS: THE CSA REGULATORY SANDBOX

The CSA continues to provide exemptive relief from some securities law requirements by way of its "regulatory sandbox," permitting two new temporary exceptions in the previous year:

- **Finhaven Capital Inc. (Finhaven)**: In November 2020, Finhaven was permitted to offer a secondary trading platform to certain investor clients who held a digital wallet with Finhaven, allowing those clients to privately negotiate secondary trades of digital securities. This exemptive relief was provided in British Columbia, Alberta, Saskatchewan, Manitoba, and Ontario, and is set to expire at the end of 2022; and
- **Blockfilm Inc. (Blockfilm)**: In March 2021, Blockfilm was granted exemptive relief to operate a digital platform across Canada that allows investors to invest in new film and film-like projects. The relief was provided Canada-wide for a two-year term.

ENFORCEMENT: REGISTRATION REQUIREMENT

On the same day as the CSA's publication of SN 21-329, the OSC published a news release stating that they expected CTPs to bring their operations in line with Ontario securities laws. The news release also required CTPs to contact the OSC by April 19, 2021 to discuss the steps they would take to ensure compliance.[5] The OSC followed this release with swift action, bringing enforcement actions against four CTPs that failed to comply.[6]

No decisions with respect to these entities have been issued yet, but we expect that the outcome will provide insight into how CTPs may be regulated moving forward.

OTHER NEWS AND DEVELOPMENTS

The crypto industry continues to expand in Canada as a whole. Wealthsimple Inc. (Wealthsimple), which was offered exemptive relief under the CSA's regulatory sandbox last year, was recently approved to offer trading of 14 new cryptocurrencies on its platform.[7] The decision also permitted Wealthsimple to move its clients' assets between various crypto wallets from other crypto exchanges.

Meanwhile in Alberta, Tetra Trust Company (Tetra Trust) became the first Canadian firm granted regulatory approval to provide custody services of cryptocurrency, making it the first regulated custodian based in Canada permitted to store digital assets. This provides some domestic comfort to Canadian investors, as crypto assets purchased through local sites, such as Wealthsimple, will now be stored by Tetra Trust in Calgary rather than by the American counterparts Gemini and Coinbase that previously served this role.[8]

There have also been market consequences to the increasing regulation – oversight and enforcement of crypto companies has given rise to negative outcomes, as some crypto companies forsake the Canadian market altogether rather than comply with the new regulations. For example, Binance, one of the world's largest cryptocurrency exchanges, is the most recent noteworthy entity to make this decision, ceasing operations in Canada after being called to register as a CTP.[9] This is a trend that Canadian investors may continue to see as long as other markets continue to be underregulated.

LOOKING FORWARD

The Canadian regulatory authorities continue to adopt a flexible approach while simultaneously calling for compliance with the applicable regulations. In the wake of SN 51-363, it is possible we will see enforcement actions against crypto-based companies for deficiencies in initial or ongoing disclosure. The OSC's approach following the issuance of SN 21-329 demonstrates its expectation that companies will take measures to comply immediately with Staff Notices.

Interested investors should monitor whether companies continue to leave the Canadian market in favour of jurisdictions with more lenient, or no, regulation. Until global regulation is at least comparable with the measures currently in place in Canada, the domestic market may not be attractive enough to justify the costs of compliance for some companies. Unfortunately, the trade-off between investor protection and facilitating rapid growth in the crypto industry appears to be unavoidable at this time, and history has indicated that the Canadian regulatory authorities will prioritize investor protection.

Securities Regulation Updates and the Impact of COVID-19 in Ontario, British Columbia, and Alberta

This article provides a progress update on the Ontario Securities Commission's execution of its Statement of Priorities for 2021-2022, the report of the Ontario Capital Markets Modernization Taskforce, the recent amendments to British Columbia's *Securities Act*, the Alberta Securities Commission's strategic pillars, and the impact of COVID-19 on the securities regulatory landscape.

UPDATE ON THE ONTARIO SECURITIES COMMISSION'S FOCUS FOR 2021-2022

On June 29, 2021, the Ontario Securities Commission (OSC) published its 2021-2022 Statement of Priorities (the Statement).[1] This Statement was published following public consultation, through which the OSC received sixteen comment letters. Overall, commentators advised that the goals of investor protection and reducing regulatory burden should remain top priorities for the OSC.

In the Statement, the OSC sets out four strategic goals:

- **Promote Confidence in Ontario's Capital Markets**: Including by improving climate-change related disclosures, integrating new mandates for fostering capital formation and competition, and strengthening oversight of crypto asset trading platforms and other dealers.
- **Reduce Regulatory Burden**: Including by developing an enhanced framework for reducing burden and modernizing regulation and continuing to implement burden-reduction initiatives.
- **Facilitate Financial Innovation**: Including by cultivating an environment that supports development of innovative financial business models.
- **Strengthen the OSC's Organizational Foundation**: Including by modernizing the OSC's technology platform, fostering inclusion, equity, and diversity, implementing the structural changes set out in the *Securities Commission Act*, 2021,[2] and continuing to monitor and adapt to the impacts of COVID-19.

On September 2, 2021, the OSC released its 2021 Annual Report outlining the progress made on these goals.[3] This progress includes timely and impactful enforcement action; facilitating financial innovation through the creation of the Office of Economic Growth and Innovation; and strengthening the OSC's organizational foundation through modernizing its technology platform, including its initiative to implement SEDAR+, the Canadian Securities Administrator's national system for all market participants for filing, disclosure, payment, and information searching in Canada's capital markets.[4]

THE ONTARIO CAPITAL MARKETS MODERNIZATION TASKFORCE AND THE *CAPITAL MARKETS ACT*

In early 2021, the Ontario Capital Markets Modernization Taskforce (the Taskforce) released a report in support of regulatory reform.[5] The Taskforce recommended that a new statute, the *Capital Markets Act*, serve as the legislative vehicle to implement the recommendations, replacing the current *Securities Act* and the *Community Futures Act*.[6] On October 12, 2021, the Government of Ontario published a draft of the *Capital Markets Act* (the Draft CMA), which is intended to improve regulatory structure, modernize enforcement, and enhance investor protection, with a view to implementing regulation as a competitive advantage. The Draft CMA will remain open for stakeholder consultation and comment until January 21, 2022.[7] Some of the key Taskforce recommendations incorporated into the CMA include:

- extending civil liability for offering memorandum misrepresentation to parties other than the issuer, this would include directors and promoters of the issuer, experts, influential persons, and every person who has signed the prescribed disclosure document (section 183);[8]
- providing the OSC with broader designation powers and rule-making authority to provide regulatory clarity to businesses with unique offerings, such as crypto-asset trading platforms that are not already securities or derivatives (sections 3 and 127);[9] and
- creating a prohibition to deter and prosecute misleading or untrue statements about public companies and attempts to make such statements (section 94(2) and (3)).[10]

Through the Draft CMA and the *Securities Commission Act*, 2021, the Ontario Government is also introducing legislative amendments to support the following key changes:[11]

- the OSC mandate will be expanded to include fostering capital formation and competition in the markets to facilitate economic growth;[12]
- the OSC's structure will change, splitting the role of OSC Chair and Chief Executive Officer (CEO) into two distinct and separate positions;[13] and
- the legislation will separate the OSC's oversight and adjudicative responsibilities – the OSC's Board will continue to provide financial, regulatory, and operational oversight, while a separate Tribunal will be created to oversee adjudicative matters.[14]

UPDATE ON THE BRITISH COLUMBIA SECURITIES ACT AMENDMENTS

Various amendments outlined in British Columbia's *Securities Amendment Act,* 2019 (the Amendments) came into force on March 27, 2020. The Amendments provide the British Columbia Securities Commission (BCSC) with new enforcement, compliance, investor protection, and sanction collection tools.[15]

Many of the Amendments provide the BCSC with the strongest powers to address misconduct in financial markets among securities regulators in Canada. The BCSC has begun using these powers to support efforts to detect, disrupt, and deter securities misconduct.[16] As of August 2021, the BCSC has commenced almost 300 actions to disrupt misconduct (many of which emerged as a result of the COVID-19 pandemic).[17]

UPDATE ON THE ALBERTA SECURITIES COMMISSION'S STRATEGIC PILLARS 2020-2021

To support its mission of fostering a fair and efficient capital market in Alberta and protecting investors, the Alberta Securities Commission (ASC) has presented three strategic pillars:[18]

- **Intelligent Regulation Aimed at Fostering a Thriving Capital Market**: To achieve this goal, the ASC has supported the Government of Alberta's *Red Tape Reduction Implementation Act, 2021*[19]. This legislation includes amendments to the *Securities Act* (Alberta) and the *Business Corporations Act* (Alberta) that enable companies to raise capital more efficiently in Alberta and allows for the continued modernization of Alberta's securities law.[20]

- **Proactive and Comprehensive Compliance Oversight, Enforcement and Education**: To achieve this goal, the ASC expanded its enforcement tools through its participation in programs with other regulators, such as the CSA's Market Analysis Program, which is a data repository and analytics system aimed at identifying and analyzing market misconduct.[21]

- **Fostering a Culture of Engagement**: To achieve this goal, the ASC pivoted to virtual presentations and webinars to provide stakeholders with relevant and timely information, engage investors and empower staff.[22]

COVID-19 IMPACT TO THE SECURITIES LANDSCAPE

The CSA continues to monitor the capital markets to assess the impact of COVID-19 on market participants. On February 25, 2021, the CSA undertook a review of issuers' disclosure during the COVID-19 pandemic and published a guide to pandemic-related disclosure. The CSA noted that boilerplate disclosure is not sufficient. Issuers are required to not only report that their business has or may be impacted by COVID-19, but also to specify how COVID-19 has or may impact their business. Issuers must also outline the methodology used to determine that COVID-19 – as opposed to some other market factor – impacted (or may impact) their business.[23]

LOOKING FORWARD

The OSC, ASC, and BCSC have focused their efforts on developing more efficient regulation that balances easing the regulatory burden with investor protection. The impact of COVID-19 is still reverberating in the capital markets and has led to greater efficiencies in how parties are required to prepare, process, and provide information. We expect a forward momentum which encourages these efficiencies and creates a market that fosters innovation.

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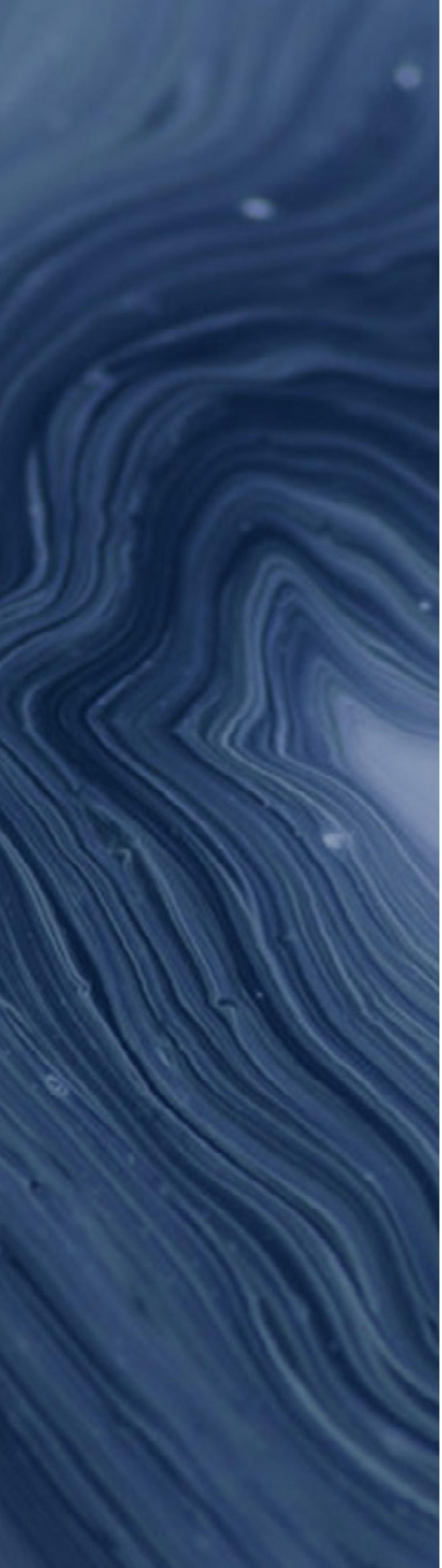

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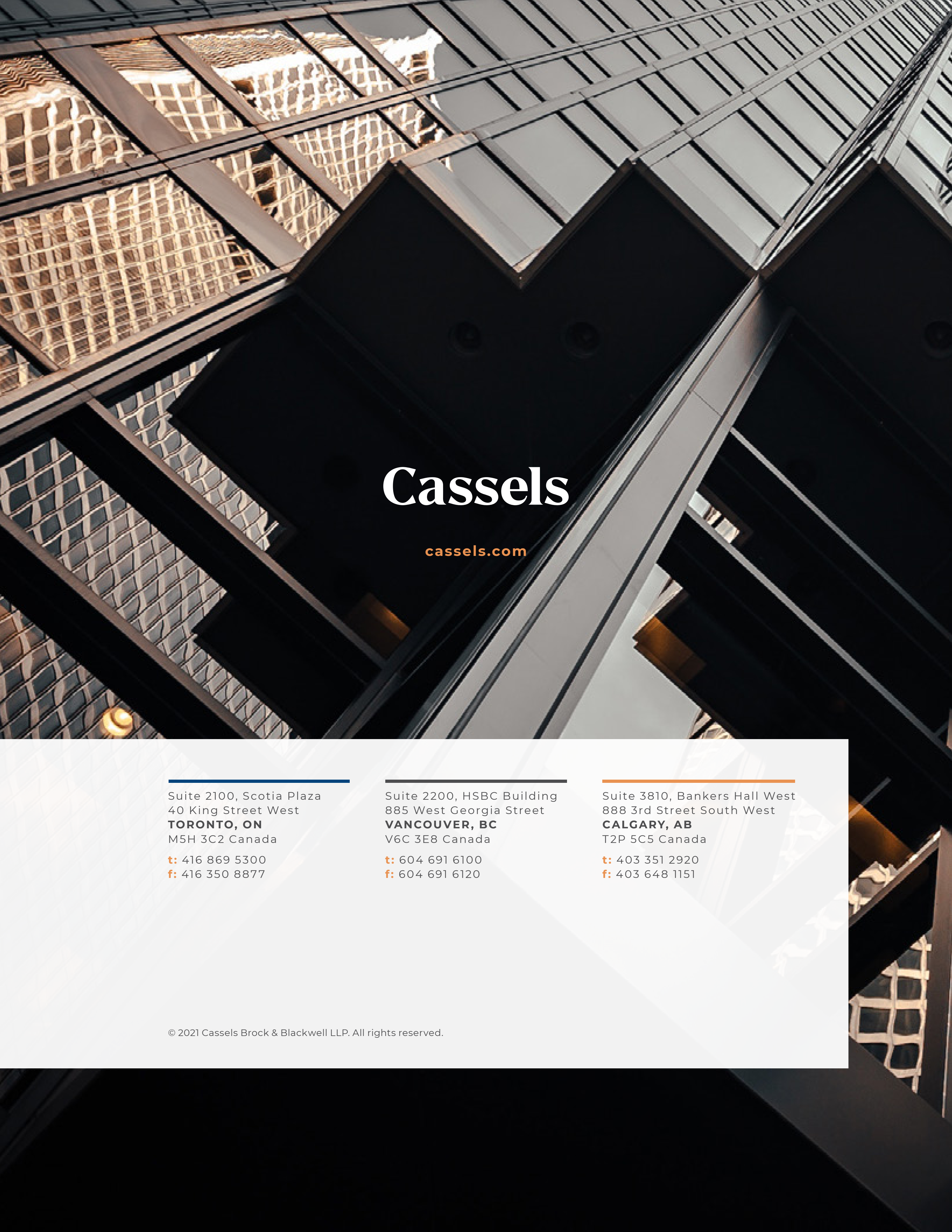

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