Calculating Participation Fees

Corporate Finance Branch

February 11, 2015

OSC ONTARIO SECURITIES COMMISSION

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Presentation Outline

Welcome and Introduction to the OSC SME Institute

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OSC SME Institute - Objectives

Our goal is to:

- Help SMEs navigate the regulatory waters
- Demystify regulatory requirements so companies can focus on building their business
- Reduce SMEs’ cost of compliance so that this money can be better spent on strategic initiatives
- Provide an opportunity for informal dialogue with OSC staff

Introduction to OSC Rule 13-502 *Fees*

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Introduction to OSC Rule 13-502 *Fees*

- Objective of the Rule
- Purpose of participation fees
- Recent history of the Rule

Objective of the Rule

- As a self-funded agency, the OSC sets its fees with a view of discharging its regulatory responsibilities on a cost recovery basis

- Our mandates are,
  - to provide protection to investors from unfair, improper or fraudulent practices; and
  - to foster fair and efficient capital markets and confidence in capital markets

- Financial Summary (in thousands):

	2014	2013	2012
Fee Revenue	$98,441	$86,930	$85,182
Expenses	$97,663	$96,052	$91,138

Objective of the Rule (cont'd)

- The two main types of fees charged under the Rule are participation fees and activity fees
- Participation fees make up approx. 85% of total fee revenue
- Activity fees are generally charged when a document of a designated class is filed. Generally, the activity fee charged for filing a document of a particular class is based on the average cost of reviewing documents of that class. (e.g., reviewing prospectuses, registration applications and applications for discretionary relief)

Purpose of participation fees

- Participation fees,
  - are based on the cost of a broad range of regulatory services that cannot be practicably or easily attributed to individual activities or entities
  - are set based on estimates of OSC operating costs for upcoming periods
  - are intended to serve as a proxy for the market participant's use of the Ontario capital markets
  - levels are set using a tiered structure. Fees for issuers are based on average market capitalization in a fiscal year

Recent history of the Rule

- The Rule was first introduced in March 2003 with three classes of issuers – Class 1 (Canadian issuers with listed securities), Class 2 (Canadian issuers without listed securities) and Class 3 (foreign issuers)

- Participation fees were determined based on market capitalization in the most recently completed financial year

- Market capitalization was calculated based on the aggregate market value of an issuer's equity securities, corporate debt and preferred shares

Recent history of the Rule (cont'd)

- In April 2006, the Rule was amended to introduce the current issuer class structure.

- Most significant change was to divide Class 3 issuers into three classes: Class 3A (*di minimis* presence), Class 3B (traded mostly outside Canada) and Class 3C (traded mostly inside Canada)

- Participation fees were still determined based on an issuer's market capitalization in the most recently completed financial year

Recent history of the Rule (cont'd)

- The Rule was last amended in April 2013 with the introduction of the *Reference Fiscal Year* (RFY)
- The concept of RFY was introduced to allow for greater predictability of the amount of fees payable by issuers and receivable by the OSC
- The OSC undertook to carefully monitor participation fees collected, assess the impact of the RFY and also consider whether any adjustments were necessary

Issues Raised by Market Participants

Issues raised by market participants

- What year end to use for calculating market capitalization
- What securities are required to be included in the calculation and at what value
- Participation fees do not change when market capitalization or capital structure changed

What year end to use for calculating market capitalization

- Some issuers were unaware that RFY is now used for calculating market capitalization

- Some issuers were using *Previous Fiscal Year* (PFY) when they were supposed to use RFY – being the last fiscal year ended before May 1, 2012

- Only new issuers since May 1, 2012 should be using PFY

- Using the right year end will impact the amount of participation fees payable

What year end to use for calculating market capitalization (cont'd)

- Examples:

1. Reporting issuer with December 31 year end – the last fiscal year ended before May 1, 2012 was December 31, 2011 – therefore RFY is December 31, 2011 when determining fees for 2015

2. Reporting issuer with March 31 year end – the last fiscal year ended before May 1, 2012 was March 31, 2012 – therefore RFY is March 31, 2012 when determining fees for 2015

3. Issuer with December 31 year end became a reporting issuer in 2012 – therefore uses December 31, 2014 when determining fees for 2015

What securities to include and at what value

- Some issuers claimed that it is confusing to understand what securities should be included and at what value

2.7(1)(b) the market value at the end of the reference fiscal year, as determined by the reporting issuer in good faith, of each class or series of securities of the reporting issuer not valued on the last trading day of any month under paragraph (a), if any securities of the class or series

(i) were initially issued to a person or company resident in Canada, and

(ii) trade over the counter or, after their initial issuance, are otherwise generally available for purchase or sale by way of transactions carried out through, or with, dealers

What securities to include and at what value (cont'd)

- Unlisted equity securities are required to be included in the calculation – NOT just listed equities. Eg: warrants, privately placed shares, multiple voting shares

- Debt securities are also required to be included in the calculation – irrespective of whether they are listed or not. Eg: convertible debentures, subordinated debt, medium term notes

- Issuers are required to calculate the market value of these securities in good faith – staff can and will request supporting documentation

Participation fees do not change when market capitalization or capital structure changed

- Issuers expressed concerns that changes in capital structure are not always considered in the determination of participation fees. Eg: redemption or maturity of debt securities, shares buy back, new issuance of securities

- Issuers who had a decline in their market capitalization across the fee cycle do not receive a reduction in their fees. Similarly, those who experienced growth in market capitalization did not see an increase in their fees

Changes to the Rule

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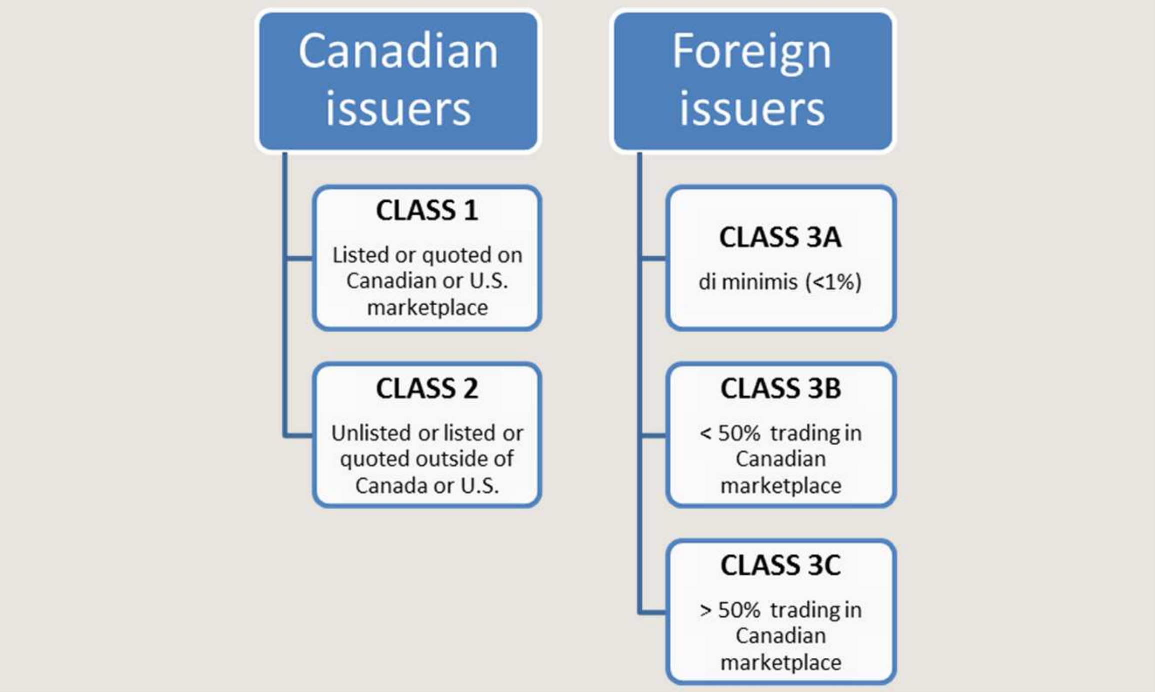
Changes to the Rule

- Changes to how issuers are classified
- Change to when market capitalization is calculated
- Changes to how market capitalization is calculated
- Other notable changes
- Effective date

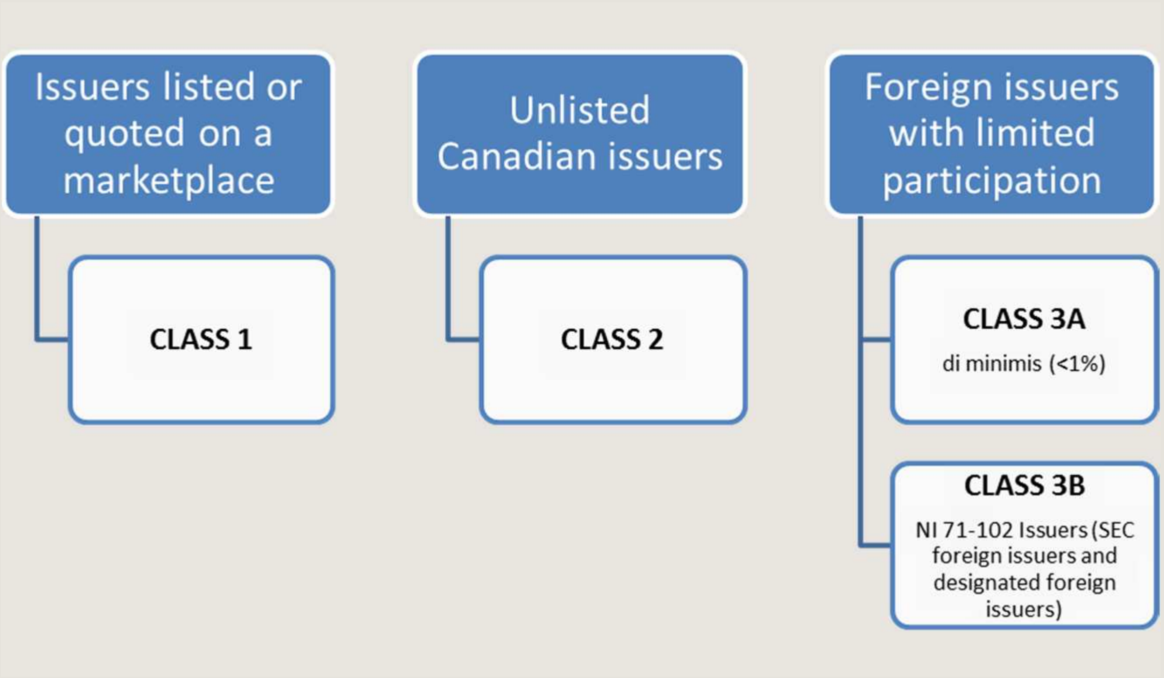
Changes to how issuers are classified

Current Classes



Changes to how issuers are classified (cont’d)

New Classes



Changes to how issuers are classified (cont'd)

- Class 1 issuers will include all issuers who are listed or quoted on a marketplace
- Class 3C eliminated – Class 3C issuers were paying the same rate as Class 1 issuers. Issuers no longer required to determine whether trading in Canadian marketplace was over 50% or not

Changes to how issuers are classified (cont'd)

- The location of the marketplace is no longer relevant – those listed outside of U.S. or Canada will be in Class 1 (previously Class 2)

- Class 3B issuers will be those who are either "designated foreign issuers" or "SEC foreign issuers" as defined under NI 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers*

Change to when market capitalization is calculated

- Issuers will be required to determine their participation fees payable using their most recent financial year information. No longer use RFY

- The key advantage of this change for issuers is that the fees will more closely track current market conditions and also the capital structure of the issuer

- The disadvantage of this change is that it will reduce the predictability of fees payable by issuers and receivable by the OSC

Changes to how market capitalization is calculated

Current calculation (Class 1 and Class 3C issuers)

Listed and quoted debt securities	**Listed and quoted equity securities**
Unlisted debt securities (initially issued to Canadians and generally available through, or with dealers)	**Unlisted equity securities** (initially issued to Canadians and generally available through, or with dealers)

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Changes to how market capitalization is calculated (cont’d)

New calculation (Class 1 and Class 3B Issuers)

Changes to how market capitalization is calculated (cont'd)

Current calculation (Class 3B Issuers)

Listed and quoted debt securities

Listed and quoted equity securities

Changes to how market capitalization is calculated (cont'd)

New calculation (Class 1 and Class 3B Issuers)

Changes to how market capitalization is calculated (cont'd)

- Participation fees are based on average quarter end market capitalization – better tracking in cases where capital structure has changed during the year

- Use of fair value disclosed in audited annual financial statements for debt securities

- No longer requires the inclusion of unlisted equity securities – can be difficult or costly to value

- Remember to keep supporting documentation in case we ask

Other notable changes

- New requirement for certification/sign-off by an Officer of the issuer. This change is expected to bring more rigor to the fee calculation process undertaken by issuers and improve our confidence in the accuracy of the calculations and fees paid

- No longer required to pay pro-rated participation fee following an IPO

Effective date

- Subject to Ministerial approval, the new Rule will come into force on April 6, 2015

- Trigger date for fees (i.e. the date the fee becomes payable) by a reporting issuer is immediately "after" a reporting issuer's financial year:

  - example 1: For an issuer with December 31, 2014 year end, trigger date is January 1, 2015. This means fee is determined using the current rule (RFY) and current rates

  - example 2: For an issuer with April 30, 2015 year end, trigger date is May 1, 2015. This means fee is determined using the new rule (PFY)

Effective date (cont'd)

- Payment of the participation fee must be made by the earlier of the date on which the annual financial statements are due, and the date on which the annual financial statements are filed

- The date by which the fees must be paid or the date on which the fee payment is actually made is not relevant to whether the fee amount is determined based on current rule or new rule

Brief Update on Activity Fees

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Brief update on activity fees

- Application for relief from two or more sections of the Act, a regulation or a rule will be paying $7,000

- The same application fee applies to any application where the relief is evidenced by the issuance of a receipt for the applicant's final prospectus

Brief update on activity fees (cont'd)

- In addition to a take-over bid or issuer bid circular, the filing of an info circular in connection with a special meeting to consider the approval of a reorganization, merger, arrangement, etc will also attract the same $4,500 fee

- $2,500 fee required for prospectuses that incorporate by reference technical reports. Currently, the fee is charged only when the technical report accompanies a prospectus

Case Studies

Case study 1

- Reporting issuer has common shares (listed on the TSXV) and warrants (unlisted) outstanding at year end

	Common Shares	Price	Capitalization
Q1	10,000,000	$5.00	$50,000,000
Q2	10,000,000	$5.50	$55,000,000
Q3	12,000,000	$5.00	$60,000,000
Q4	12,000,000	$6.50	$78,000,000
Average			$60,750,000

Case study 1 (cont'd)

- The market capitalization is $60,750,000 being an average of the quarterly market capitalization

- The warrants are not listed so they are not included in the calculation of market capitalization

- Under the new Rule, the issuance of an additional 2,000,000 shares is taken into consideration, and so is the fluctuation in the share price

Case study 2

- Reporting issuer has Class A shares (listed on the TSX and NYSE) and Class B shares (unlisted) outstanding at year end
- It also has senior notes (unlisted) with face value of $150,000,000 and fair value (per audited financial statements) of $147,000,000
- Trading volume on the TSX is higher than on the NYSE

	Class A Shares	TSX Price (C$)	NYSE Price (C$)	Capitalization
Q1	80,000,000	$35.00	$35.05	$2,800,000,000
Q2	80,000,000	$36.40	$36.45	$2,912,000,000
Q3	80,000,000	$39.50	$39.55	$3,160,000,000
Q4	160,000,000	$19.25	$19.25	$3,080,000,000
Average				$2,988,000,000

Case study 2 (cont'd)

- Market capitalization = $2,988,000,000 for the Class A shares + $147,000,000 for the senior note = $3,135,000,000

- The Class B shares are not listed so they are not included in the calculation of market capitalization

- Since trading volume is higher on the TSX, market capitalization is calculated using the TSX prices and not the NYSE prices

- We also use the fair value of $147 million for the senior notes and not the $150 million face value

Questions?

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