

6.

Financing a Business Operation



A foreign investor seeking to raise capital for Canadian business operations may choose debt financing, equity financing, or a combination of both.

Debt Financing

Canada's financial system provides a stable and effective infrastructure for financial services entities to conduct business both within the country and around the world. The Bank of Canada (an independent central bank) administers an anti-inflationary monetary policy and expedites inter-bank operations; chartered banks and trust companies provide deposit, credit, and payment services; and insurance companies offer protection against a wide range of risks.

Banks

Canada's banking system has a long history of stability. The World Economic Forum continually ranks Canadian banks among the most stable in the world. During the 2008 global financial crisis, Canada's banking system demonstrated its strength due to prudent management, sound regulation, and high capitalization.

Domestic and foreign banks operating in Canada are governed by the federal Bank Act. Chartered domestic banks provide deposit facilities, money transfer services, credit, and a variety of investment services. Canadian banks have a highly developed network of branches within the country and are also very active in foreign markets.

Foreign banks are also present in Canadian financial markets.

Through Canadian subsidiaries or bank branches, foreign banks in Canada generally provide wholesale banking services and business lending rather than retail services.

Non-Banks

Although they are less active internationally than chartered banks, Canadian trust and loan companies incorporated at the federal level can also take deposits and offer loans. Many of them specialize in making loans secured by mortgages.

Life insurance companies manage segregated investment funds, including pension funds. They are not permitted to take deposits but can provide medium- to long-term financing.

Types of Loans

Lenders offer two principal types of loans to businesses: (a) operating loans, designed to assist in the coverage of current business expenses, and (b) term loans, for capital investments or acquisitions. Operating loans typically have a short to medium term and usually bear interest at a rate linked to the market. Term loans often have a medium to long term, require scheduled repayment over a defined period of time, and are repayable on the occurrence of prescribed events of default or on demand.

Many financiers will require security for their loans on the assets of the borrower. All of the Canadian provinces except Quebec have enacted personal property acts modelled on Article 9 of the US Uniform Commercial Code. Even though the Quebec regime has different concepts and procedures, it is similar in many respects to the regulations in the other provinces. In Quebec, the Civil Code governs such matters. Most provinces in Canada have also enacted securities transfer legislation, modelled on the *US Uniform Securities Transfer Act*, that governs the transfer of securities and other investment property. Lenders that do not have a personal interest in the corporation may require that its shareholders maintain a certain level of equity investment. In addition, lenders may also require personal guarantees from the shareholders of private corporations.

Government Assistance Programs

At the federal level, the Business Development Bank of Canada assists small and medium-sized businesses by providing financing, consulting services, and securitization. The federal government offers assistance to small businesses through the Canada Small Business Financing Program (CSBFP). It is designed to assist small businesses in securing financing by providing guarantees for their loans from conventional lenders. Provincial governments may also offer assistance programs.

Equity Financing

Corporations can also be funded by way of equity financing.

In order to issue equity securities, a corporation must comply with the securities regulation regimes in Canada.

Securities Legislation

Each of the 13 provinces and territories in Canada has its own securities regulator.

Although there is no federal securities regulator, such as the US Securities and Exchange Commission (SEC) or the UK listing authority, the provinces make efforts to coordinate and harmonize regulations. Through the passport system, which is based on mutual recognition of regulatory systems and delegation of powers, and the Canadian Securities Administrators, an umbrella organization for the provincial and territorial securities regulators, market participants can generally deal with one regulator. Therefore, the approval of one provincial or territorial securities commission allows for registration in another province or territory.

While Ontario does not participate in the passport system, it can be a principal regulator, thereby giving market participants in the province access to the capital markets in passport jurisdictions by dealing with Ontario only.

The federal government previously proposed legislation that would have established a national securities regulator; however, in December 2011, the Supreme Court of Canada ruled that the legislation violated the constitutional division of powers.

In response, the federal government, in conjunction with the governments of Ontario and British Columbia, announced the establishment of a Cooperative Capital Markets Regulatory System (CCMR) in September 2013 to harmonize the various provincial securities acts and serve as a capital markets watchdog.

Currently, the governments of British Columbia, Ontario, Saskatchewan, New Brunswick, Newfoundland and Labrador, Nova Scotia, Prince Edward Island, and Yukon and the federal government are jointly engaged in the implementation of the CCMR and have invited the governments of the other provinces and territories to join. In 2018, the Supreme Court of Canada ruled that the implementation of the CCMR was constitutionally valid. Implementation of the CCMR has since been delayed due to the COVID-19 pandemic.

Registration and Disclosure Requirements

To protect investors and market integrity, some obligations are imposed upon corporations and other entities that issue securities. Issuers and sellers must comply with registration and disclosure requirements.

No person or company is permitted to trade in a security, act as an underwriter, or engage in the business of advising others to buy

or sell securities without being registered unless a statutory exemption is available or a discretionary exemption order obtained.

In Canada, distributions of securities create disclosure obligations.

A distribution of securities includes the issuance of securities by an issuer, the trading of securities by control block shareholders, and the resale of securities initially issued in exempt transactions. Unless a prospectus exemption is available, a distribution must generally be made by way of a prospectus containing full, true, and plain disclosure of all the material facts relating to the securities being issued. Where a prospectus contains a misrepresentation (an untrue statement of a material fact or an omission), purchasers who acquired securities during the distribution period have certain statutory remedies: a right of rescission or, alternatively, a right of action for damages against the issuer and its directors, each underwriter who signed the prospectus, and all the experts who filed consents under the prospectus.

There are several exemptions from the registration and prospectus requirements. The prospectus exemptions are largely harmonized across Canada. Some of them were introduced because certain purchasers are sophisticated and do not require prospectus-level disclosure. Examples include the “accredited investor exemption,” which applies to individuals who pass either a net asset or net income test and to various corporate entities, and the “minimum amount investment exemption,” which applies to corporate entities that purchase securities for an aggregate cost of at least \$150,000. Some other exemptions reflect that the purchaser might already be familiar with the issuer and/or its securities. An example of this is the “private issuer exemption,” which allows private

issuers to sell securities to certain categories of purchasers (such as directors, officers, and employees) without filing a prospectus.

Companies that take advantage of the prospectus exemptions often provide voluntary disclosure documents such as an offering memorandum. As with a prospectus, a person who purchases securities under an offering memorandum that contains a misrepresentation has a statutory right of action or, alternatively, a right of rescission. Securities issued in reliance upon a prospectus exemption may be subject to resale restrictions (and are thus sometimes priced at a discount due to their illiquidity), whereas securities distributed by way of a prospectus are generally freely tradable.

A distribution of securities made by way of a prospectus triggers additional disclosure obligations. Public companies (which are called “reporting issuers”) are required to make disclosure immediately of any “material change” in the affairs of the reporting issuer that would reasonably be expected to have a significant effect on the market price or the value of its securities. Among other things, this includes disclosure regarding actual or proposed changes in the control of the reporting issuer, the acquisition or disposition of material assets, a significant increase or decrease in near-term earnings prospects, and changes in dividends.

Stock Exchanges

Canadian equity markets were significantly consolidated in 2008 when the Toronto Stock Exchange (TSX) merged with the Montréal Exchange. The TSX is now the only Canadian exchange for senior issuers. The TSX Venture Exchange focuses on small capital companies, and the Canadian Securities Exchange focuses on micro capital and emerging companies.

The Montréal Exchange trades derivatives. It has also created the Montréal Climate Exchange, a Canadian environmental products market, in cooperation with the Chicago Climate Exchange.

Foreign Issuers' Access to Canadian Financial Markets

The multijurisdictional disclosure system (MJDS) adopted by the SEC and Canadian securities regulatory authorities eliminates many of the major obstacles for US issuers offering securities in Canada. It facilitates cross-border securities offerings, issuer bids, takeover bids, business combinations, and continuous disclosure filings.

The MJDS permits eligible Canadian and US issuers to satisfy certain offering and reporting requirements by submitting disclosure documents that comply with the requirements of the home country of the issuer supplemented with certain additional disclosure requirements. Under the MJDS, a US issuer can extend the distribution of securities to Canada without having to produce an entirely new prospectus conforming to the requirements and obligations of Canadian securities law.

Private Equity and Venture Capitalists

Corporations can also secure financing through private equity funds. These provide financing for various stages of growth, including start-up capital, financing for development, and the funding of mergers or acquisitions.

Venture capitalists invest in startups and small businesses that they believe have long-term growth potential. Venture capitalists typically take a minority equity position in the corporation in exchange for having a say in the decisions of the corporation.