



CCLS Education Sub-Committee Seminar

Cannabis Overview

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Cannabis Legalization

- **Political, legal and social climates are changing in favor of cannabis:**
 - Canadian medical marijuana regulations became effective in 2014, creating a new corporate industry segment
 - The Canadian federal government introduced the *Cannabis Act* in April 2017 which legalized the recreational use of cannabis on October 17, 2018
 - Other countries and certain U.S. states have legalized cannabis in some form and other foreign jurisdictions continue to explore liberalization measures around cannabis law

Cannabis Industry Background

- 2017 – Medical cannabis industry was worth **\$400 million**
- **\$5.9 billion** in potential revenue anticipated to be generated by the Canadian medical and recreational markets
- Biggest three licensed producers in Canada — Canopy Growth Corp., Tilray and Aurora Cannabis — have a combined market capitalization of more than **\$35 billion**

Cannabis Industry Background

- Examples of businesses operating within the cannabis industry include:
 - Agriculture technology
 - Ancillary products and services
 - Biotechnology: Businesses that focus on the pharmaceutical applications of cannabis by developing treatments to target illnesses and diseases
 - Consulting services
 - Consumption devices
 - Cultivation and retail
 - Cannabis products and extracts
 - Holding companies
 - Industrial hemp
 - Organic farms

Regulatory Background

- CSA Staff Notice 51-342 *Staff Review of Issuers Entering Into Medical Marijuana Business Opportunities* (2015)
 - Identified concerns regarding misleading, promotional or unbalanced disclosure which does not identify details about the nature of an issuer's plans/contracts, or all of the material risks/barriers/costs to achieving announced milestones

Regulatory Background (cont'd)

- Since 2015, several different types of reporting issuers have emerged:
 - Canadian medical cannabis issuers
 - Issuers operating in U.S. states that have legalized medical or recreational cannabis
 - Issuers operating cannabis businesses outside North America
 - Issuers who are indirectly involved, or involved on an ancillary basis, in the cannabis industry
 - And more recently Canadian recreational cannabis issuers
- The number of issuers involved in this industry, as well as their level of capital markets activity, has increased substantially

Issuers with U.S. Cannabis-Related Activities

- **Emerging and high-risk industry as issuers with cannabis-related activities in the U.S. assume added risks due to conflicting state and federal laws**
 - Policy and regulatory circumstances surrounding the treatment of U.S. cannabis-related activities are uncertain
 - U.S. federal law relating to cannabis could be enforced at any time, putting issuers with U.S. cannabis-related activities at risk of being prosecuted and having their assets seized
 - Despite these risks, we continue to see issuers access business opportunities in the U.S. cannabis industry and these issuers are raising capital in Canada
 - **CSA Staff Notice 51-352 (Revised) – *Issuers with U.S. Marijuana-Related Activities* (2018)**
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Issuers with U.S. Cannabis-Related Activities (cont'd)

- **CSA Staff Notice 51-352 (Revised) contains disclosure expectations in 4 areas**
 - All issuers with U.S. cannabis-related activities
 - U.S. cannabis issuers with direct involvement in cultivation or distribution
 - U.S. cannabis issuers with indirect involvement in cultivation or distribution
 - U.S. cannabis issuers with material ancillary involvement

Issuers with U.S. Cannabis-Related Activities (cont'd)

- **Disclosure expectations in regulatory filings**

- Information should be “clearly and prominently” disclosed in prospectus filings and CD filings such as AIF and MD&A
- Issuers who enter our capital markets through a RTO or spinoff transaction should include these disclosures in their listing statement

- **Ongoing monitoring**

- These disclosures, and any related risks, should be evaluated, monitored and reassessed by issuers with U.S. cannabis-related activities on an ongoing basis
- These disclosures should be supplemented, amended and communicated to investors in public filings, including in the event of U.S. government policy changes or the introduction of new or amended guidance, laws or regulations

Recent U.S. Developments

- Over half of the U.S. states have enacted legislation to legalize and regulate the sale and use of medical cannabis
- Ten of those U.S. states, along with the District of Columbia, have also legalized the recreational use of cannabis notwithstanding the fact that cannabis remains a Schedule 1 controlled substance under the *Controlled Substances Act of 1970 (CSA)*

Recent U.S. Developments (cont'd)

- **December 2018 - Farm Bill became law**
 - removed hemp including cannabidiol (**CBD**) derived from hemp from the CSA's definition of "marihuana"
 - legalized hemp as an agricultural commodity which can now be legally cultivated
 - hemp and its derivatives cultivated and produced in compliance with federal and state laws and regulations is now legal
 - does not legalize CBD derived from "marihuana" (as such term is defined in the CSA), which is and will remain a Schedule I controlled substance under the CSA
- **"Strengthening the Tenth Amendment through Entrusting States (STATES) Act"**
 - would lift the CSA's restrictions on cannabis for individuals or corporations operating in compliance with U.S. state law
 - would mark the start of a cannabis industry migration to the U.S. market
 - no assurances as to when any such bill will pass or if it will pass

CSA Engagement with Cannabis Issuers

- **Scope of reviews**

- Multiple CSA jurisdictions
- Included reporting issuers with varying levels of involvement in the industry
- Included reporting issuers operating in a variety of different countries and under a variety of different regulatory frameworks

Areas of interest

- Fair value accounting and related disclosure implications
 - Compliance with U.S. disclosure expectations
 - Other items such as promotional and unbalanced disclosure
- Review findings - CSA Staff Notice 51-357 *Staff Review of Reporting Issuers in the Cannabis Industry* (2018)

Reaction by Other Securities Regulators

- The U.S. Securities and Exchange Commission (**SEC**) issued an alert in September 2018 to warn retail investors about marijuana-related securities offerings. As part of the SEC's ongoing collaboration to protect retail investors, the SEC's Office of Investor Education and Advocacy (**OIEA**) and Retail Strategy Task Force (**RSTF**) issued the investor alert about marijuana-related investments. In the alert, OIEA and RSTF urged investors to consider the risks of investment fraud and market manipulation before investing in a marijuana-related company. The alert points out that a guaranteed high rate of return on your investment is a red flag of fraud.
- The North American Securities Administrators Association (**NASAA**) also recently published an investor advisory in October 2018 cautioning investors about schemes and risks associated with marijuana-related investments. The advisory provides information about common marijuana-related investment schemes and the unique risks associated with marijuana-related investments, including reverse merger and pump-and-dump schemes, and jurisdictional legality.

Cannabis Investments – Risks

OSC Investor Office

- Evolving regulation
- Rapid growth but uncertain future
- Inflated share price
- Increased competition and M&A activity
- US expansion
- Black market



Panel Discussion