# New Proposals for Securities Regulation

*June 5, 2002*

**A NEW WAY TO REGULATE**


BRITISH COLUMBIA SECURITIES COMMISSION

# Table of Contents

# EXECUTIVE SUMMARY

These Proposals were developed from the concepts contained in our Concept Paper, *New Concepts for Securities Regulation*, published for comment in February 2002. The Proposals reflect the comments we received on the Concept Paper and our further study.

We are publishing these Proposals for comment and will be actively consulting with industry and investors, our fellow regulators, self-regulatory organizations (SROs), and other stakeholders to discuss the Proposals in detail. If you wish to comment on our Proposals or are willing to participate in focus group consultations, please contact us at our website at www.bcsc.bc.ca/bcproposals.

The Concept Paper included sections on Trade Disclosure (the disclosure obligations of insiders, significant shareholders and control persons) and Mutual Funds. Proposals relating to these concepts are under development and will be released later this year.

## I. Summary

Under these Proposals:

***Continuous market access system***

1. All material information about public issuers will be available in the market at all times. With this base of up to date continuous disclosure, issuers will be able to go to market instantly, without having to prepare a prospectus and have it reviewed by a regulator.

2. The hold periods and resale restrictions on securities under the current "closed system" will be eliminated for public issuers.

***Registration***

3. Codes of Conduct will be mandated for dealers and advisers that substitute general principles for detailed, complex and prescriptive rules.

4. Registration exemptions will be simplified.

5. Registration requirements will be uniform throughout Canada. A registrant will be able to obtain registration throughout Canada by dealing with only one regulator.

6. Only firms will be registered. Individuals will not be registered, but will be subject to essentially the same regulatory control as today.

7. Canadian investors will have improved access to foreign registrants.

***Investor remedies***

8. Investors will have new remedies against issuers, dealers and advisers, and against people who make misrepresentations or engage in fraud, market manipulation or unfair practices.

***Enforcement and public interest powers***

9. The Commission will be able to order those who engage in market misconduct to give up their ill-gotten gains.

10. The Commission will be able to make orders against professionals who intentionally contravene securities legislation.

# II. Background

## 1. The Concept Paper Consultation Process

In March 2002 we held town hall and focus group consultation sessions with interested market participants in Vancouver, Calgary, Winnipeg, Toronto and Montreal. A total of 590 people attended these sessions, representing all sectors of the industry, investors, SROs and other regulators.

In addition, we received over 30 comments on the Concept Paper from market participants.

We wish to thank all those who took the time to participate in our consultation sessions or send us comments (many did both). The comments we received were thoughtful and assisted us greatly in our development of the concepts into Proposals.

It is clear that there is a thirst for a new look at securities regulation in Canada. Commenters welcomed the "fresh look at the existing securities regulatory regime", praised the "bold approach" of the Concept Paper and described it as a "thoughtful and progressive approach". None of this, of course, means there is unanimous support for the ideas in our Concept Paper, but it does indicate that market participants agree there are problems with the current system and are ready and willing to engage in the process of finding solutions.

These are the major themes that emerged from the consultation process:

- Strong support for the mission for this project: "Impose the minimum burden necessary to provide investor protection and market integrity". Most commenters want more efficient and effective regulation and agree that a principles-based, rather than a rules-based, approach to regulation makes sense.

- Strong demand for uniformity of legislation and rules; most feel that complexity must be addressed as much as possible in the course of developing uniform legislation.

- Support in principle for most of the concepts, at least to the point of encouraging us to develop the ideas further. Many need to know more details before deciding whether the concepts are feasible, but none of the concepts was rejected outright.

- Little support, if any, for the existing closed system regime.

- Overwhelming support for a "registration passport" system, under which registrants could become registered rapidly nation-wide by dealing with only one regulator and one set of requirements.

- Recognition of the need for improved enforcement powers and remedies for investors.

A copy of the formal comments we received in response to our request for comments, and a summary of the comments we received during the March consultations, are available on the BCSC website at www.bcsc.bc.ca/bcproposals. Our response to the most significant concerns expressed by commenters is in Appendix J to this paper.

## 2. The current landscape

### *The CSA Uniform Securities Law Project*

The Canadian Securities Administrators' (CSA) Uniform Securities Law (USL) Project is creating a uniform securities act and set of rules for adoption throughout Canada.

The USL Project provides an opportunity to do two things that would substantially improve the efficiency and competitiveness of Canada's securities markets. We can both eliminate the differences among securities legislation in different provinces, and simplify and update a system of regulation that has grown too complex and has failed to keep pace with a rapidly changing market.

One of the main themes from the consultation process is the desire for uniformity. There is also strong support for reducing complexity. We have had constructive discussions about our ideas with the CSA USL Committee on the subject of addressing the complexity issue as effectively as possible as we develop uniform legislation and rules.

### *Cost benefit analysis*

It was our intent from the outset to test the costs and benefits associated with our ideas. We have hired an economist and this process is underway. We are gathering data and will soon be developing the analysis.

### *The market environment*

Two major events have shaken public confidence in securities markets and the regulation of those markets: the tech stock collapse and the Enron scandal. With these events in mind, many are skeptical of an approach to regulation that calls for a reduction in regulatory burden and the avoidance of prescriptive rules. More rules, not fewer, is what is needed, they say.

We have two responses to that. First, many regulators and market participants are far from sure that more rules are the answer.

The recent events have prompted many regulators, market participants and industry observers to re-examine the approach to regulation. Several leaders in regulation and industry have spoken publicly on this issue in recent months. Many of them have made observations that

should give regulators and legislators pause before rushing to impose lots of new prescriptive rules to "tighten up" the system.

Sir David Tweedie is Chairman of the International Accounting Standards Board. In a statement delivered to the United States Senate Banking Committee on February 14, 2002, he said the following:

> . . . business failures seldom have a single simple cause. They are usually much more complex than they first seem and the rush to a single answer is usually wrong.
> . . .
> The IASB has concluded that a body of detailed guidance (sometimes referred to as bright lines) encourages a rulebook mentality of "where does it say I can't do this?" We take the view that this is counter-productive and helps those who are intent on finding ways around standards more than it helps those seeking to apply standards in a way that gives useful information. Put simply, adding the detailed guidance may obscure, rather than highlight, the underlying principle. The emphasis tends to be on compliance with the letter of the rule rather than on the spirit of the accounting standard.
> . . .
> We plan to develop standards based on clear principles, rather than rules that attempt to cover every eventuality.

Howard Davies is Chairman of the Financial Services Authority in the U.K. In a speech to the China Securities Regulatory Commission on April 22, 2002 on the subject of corporate governance, he said the following:

> People are more important than processes. . . . One lesson of recent corporate collapses in the US and in Europe seems to be that no corporate structure can guarantee success if the individuals within it do not operate with the right degree of independence, with the right kind of expertise, and do not devote the required amount of time to the important role of non-executive director.

At a recent meeting of leaders of Canadian financial regulators, industry organizations and public companies, the moderator (a person with a long and distinguished career in the securities industry) observed, "Absent individual integrity, the system will not function, regardless of command and control 'solutions'. Where individual integrity fails, there must the axe fall; and not on swiftly and ill-considered legislated/regulated systemic reforms."

We share the views of these observers. If anything, the events of the past few months confirm the need for an approach to regulation along the lines we described in the Concept Paper:

1. Keep the right balance between regulatory restrictions and market freedom.
2. Make the rules as simple and clear as possible.
3. Foster a culture of compliance in industry.
4. Act decisively against misconduct.
5. Equip investors with effective self-protection tools.

Our second response is that our Proposals are all about making regulation more, not less, effective. We are proposing improved disclosure in many areas, a greater focus by registrants

on what is right for their clients and the market, and more accountability for all market participants. In the process, we are proposing to remove unnecessary regulatory clutter that imposes costs on industry but adds little in the way of investor protection.

***Calls for a national regulator***

The debate over a national regulator is again in full swing and is likely to continue for some time. Some of its proponents appear to view it as a panacea for all the faults in our regulatory system, but it is not. We can confidently predict that a national regulator would have faults of its own. Some would emerge only after the fact, but some we can identify right now.

As a national organization with regional operations, it would have several additional layers of bureaucracy. The balancing of regional interests, now played out in open debate among provinces, would be internalized, and we would lose the safety valve of regional rules or opt outs. The result would inevitably be more “one size fits all” or, more accurately, “one size fits none” solutions.

If a national commission absorbed the existing provincial commissions, it would inherit considerable talent, expertise, and experience. But the talent in the regional offices would soon dissipate because of the inevitable centralization of decision-making. Market participants in western Canada would increasingly have to deal with officials several time zones away, who have never heard of them or their issues.

The existing system has faults too, but it also has many strengths. We have the flexibility to respond to regional issues with tailored solutions that might not work elsewhere. We can innovate at the regional level to try out, with limited risk, ideas and approaches that might later be adopted nationally. We can provide service and decisions to market participants in each region, without having to ask permission from any head office. Most important, we can stay on top of issues at the regional level and respond with appropriate regulatory action.

However this debate is ultimately resolved, it puts the cart before the horse. Moving to national regulation would be time consuming, disruptive and expensive. Our time and resources are better spent getting on with the job of preparing uniform securities legislation and rules, and with making our system of regulation more efficient and effective.

***The Draft Report of the Ontario Five Year Review Committee***

The Ontario Five Year Review Committee released its Draft Report just before the end of May. We have not had time to review the report in detail, but we note that the Committee has identified many of the same policy issues that we address in our Proposals. Although the Committee’s recommendations and our Proposals do not always arrive at the same conclusions, there is much common ground about what the issues are. This is an excellent foundation for an informed and healthy public debate.

Several of the Committee’s recommendations are directly relevant to aspects of our Proposals and we have referred to them where appropriate throughout the paper.

# III. The Proposals

## 1. The Continuous Market Access System

Chapter 1 describes our Proposal for a new offering and continuous disclosure system. The system, called Continuous Market Access (CMA), is an integrated disclosure system designed to replace the current prospectus-based system with one based on up to date continuous disclosure of all material information about the issuer. Under this Proposal:

1. CMA issuers are subject to an enhanced regime of periodic continuous disclosure and must disclose all material information on an ongoing basis.

2. Once an issuer becomes a CMA issuer, it may issue securities on the basis of its continuous disclosure record. An issuer will no longer be required to use a prospectus, although it must disclose the terms of the offering in a press release.

3. Since there is no prospectus requirement under CMA, there are no prospectus exemptions and consequently, no resale restrictions or hold periods on securities of these issuers. For them, the closed system disappears.

4. In addition to underwriters, other appropriate organizations can fulfill the due diligence function.

5. Issuers that are subject to a credible system of foreign regulation can enter the CMA system and use their home jurisdiction documents to comply with Canadian requirements.

## 2. Registration

Chapter 2 describes our registration Proposals. Under these Proposals:

1. The Code of Conduct replaces several existing detailed, complex and prescriptive rules with general principles.

2. The Code replaces existing provisions relating to registrants' qualifications, ongoing proficiency, "know your client" and "suitability", fair dealing, conflict of interest, compliance systems and client complaints.

3. By casting registration requirements in general, principled terms, we create a framework that protects both investors and Canadian markets while encouraging innovation.

4. Firms are responsible for enforcing the Code and are accountable to regulators and liable to investors for breaches of the Code by those who work for them.

5. Registration exemptions are simplified to reflect the CMA environment, changes in the financial services industry, and our enforcement experience.

6. A registrant can apply for or amend registration in any jurisdiction in Canada by making application to the registrant's "home" jurisdiction. Categories and conditions of registration and application requirements are uniform throughout Canada.

7. Only firms need to register. Firms are responsible for the conduct of their representatives. Information about representatives can be shared between regulators and firms and among firms regarding information about representatives. Information about representatives, such as the firm they represent and their disciplinary history, is available to the public.

8. Foreign registrants can open accounts for Canadians and advise them in connection with the foreign market so long as they do not solicit business from residents of Canada. Solicitation includes any promotional activity directed specifically at Canadian residents but does not include mere exposure of the foreign firm to Canadians through normal-course advertising that Canadians might happen to see (for example, the firm's web site, or advertising on US television channels carried by Canadian cable or satellite companies).

## 3. Investor Remedies

Chapter 3 describes our Proposal for new investor remedies. These remedies will provide enhanced redress for some investors and will act as a deterrent against market misconduct.

Under this Proposal:

1. An investor can sue a CMA issuer, its directors and officers and, in some situations, experts and underwriters, for misrepresentations in documents, or public oral statements, or for failing to disclose material information on a timely basis.

2. A client of a registered firm can sue the firm, its directors and officers, and the client's representative for failure to comply with the applicable code of conduct.

3. An investor can sue anyone who participated in fraud, market manipulation, misrepresentation, or engaged in unfair practices.

4. There are a number of provisions to protect defendants against abusive litigation.

5. Securities legislation will contain a separate class action regime available to investors using the statutory rights of action in the Act.

## 4. Enforcement and Public Interest Powers

Chapter 4 describes our Proposal for new enforcement and public interest powers. Under this Proposal:

1. The Commission can order persons who breach securities laws to give up their ill-gotten gains. (We are not proposing the restitution concept contained in the Concept Paper.)

2. The Commission can order that a professional cannot appear or practice before the Commission.

3. Anyone can apply to the Commission for a compliance or restraining order if the person can show a breach of securities law.

## IV. Your Guide To This Paper

The four Chapters explain the Proposals in detail. Throughout the paper we have identified issues on which we are particularly interested in hearing comments. These are set off in boxes from the surrounding text. We are, of course, interested in comments on any aspect of the Proposals.

Legislative-style provisions are summarized or included in the paper for all the Proposals. These have been drafted merely to illustrate how the Proposals might be implemented from a legal standpoint. Formal legislative drafting principles have not been applied and there has been no attempt to include all of the technical drafting that will ultimately have to be addressed at the formal legislation stage. We have also not yet turned our minds to the anti-avoidance language that might be necessary for some of the Proposals.

The legislative-style provisions are all consolidated in Appendix A.

We have prepared three documents to assist your understanding of how the CMA system is intended to work: the form of AIF, a set of Guidelines for using the CMA system, and a sample AIF prepared for a fictitious junior biotechnology company. These are in Appendices B, C and D respectively.

Appendix J contains our responses to the most significant concerns expressed by commenters on the Concept Paper.

The remaining appendices contain tables reconciling our Proposals with existing provisions and other background information.

# CHAPTER 1
# THE CONTINUOUS MARKET ACCESS SYSTEM

## I. Summary

We are proposing a new offering and continuous disclosure system. The system, called Continuous Market Access (CMA), is an integrated disclosure system designed to replace the current prospectus-based system with one based on up to date continuous disclosure of all material information about the issuer.

Under this Proposal:

1. CMA issuers are subject to an enhanced regime of periodic continuous disclosure and must disclose all "material information" (a newly defined term) about their business and affairs on an ongoing basis.

2. A CMA issuer may issue securities based on its continuous disclosure record. An issuer need not use an offering document to offer securities, although it must disclose an offering in a press release.

3. Since there is no prospectus requirement under CMA, there are no prospectus exemptions and, therefore, no resale restrictions or hold periods on securities of these issuers. For them, the closed system disappears.

4. The registration requirement for trading in or advising on securities remains.

5. In addition to underwriters, other appropriate organizations can fulfill the due diligence function.

6. All reporting issuers are automatically in the system; new issuers enter the system by filing a prospectus-like entry document – their initial annual information form (AIF).

The Ontario Five Year Review Committee notes in its Recommendation 36 that "…the closed system is overly inclusive, inefficient and complex…". We agree with this observation. These Proposals address many of the issues raised by the Committee about the closed system. We look forward to seeing the comment the Committee's Draft Report will generate.

## II. Background

***Why a new system***

In the Concept Paper published in February 2002, we identified several problems with the current prospectus-based system. These include:

- The complexity, cost and inconvenience of the current prospectus, exemptions and closed system regimes.
- The limited relevance of the prospectus in the investment decision process (most investors rely on the advice of their advisers and do not read or rely on the prospectus).
- The current system focuses on the primary market, which represents about 2% of the trading in Canadian markets. The remaining 98% of trading occurs in the secondary market.
- The varying standards of disclosure among the primary, secondary and exempt markets.

The Proposal addresses these problems.

With material information publicly available to investors on a current basis, a prospectus or other offering document is no longer needed to present new material information about the issuer. And, since there are no prospectuses under CMA, there is no need for prospectus exemptions or resale restrictions.

The focus under CMA is on continuous disclosure. CSA will soon be introducing new continuous disclosure rules that will be uniform throughout Canada. These rules, with a few modifications, will provide a platform of available, up to date, material information sufficient for a CMA issuer to offer its securities to the public (see "Continuous disclosure under CMA" below).

The material information standard applies to all disclosure under CMA. Therefore, all investors are treated the same, whether they buy securities from the issuer or buy or sell the issuer's securities in the market.

***CMA compared to the current system***

Investor and market protection concerns are addressed equally well under CMA as they are in the current system. These are the protections:

**Disclosure.** Under the current system, issuers disclose material facts (and other prescribed information) at the time of offering, and material changes between offerings. Investors have a statutory right of action for misrepresentation in the prospectus, but not for other disclosure. Under CMA, a comprehensive disclosure document is filed annually and all material information is available to the market on a continuous basis. Investors have a statutory right of action for misrepresentation in all continuous disclosure documents.

**Disclosure review.** Under the current system, regulators review prospectuses (although not all prospectuses are reviewed). Under CMA, regulators review an issuer's initial AIF when it enters the system. In most cases, Commission staff's review of the initial AIF will not be as detailed as the review conducted today. However, they will review the initial AIF for the most important aspects – the quality of the issuer's management and other public interest concerns. More importantly, and in keeping with the importance of the secondary market, the Commission will be conducting reviews of issuers' ongoing compliance with disclosure requirements, with a special focus on new and problematic issuers.

**Due diligence.** Both systems provide for third-party due diligence reviews of the issuer's disclosure (see "Entering and offering securities under CMA: Underwriting and due diligence" below).

**The role of other market participants.** CMA does not contemplate any changes to the roles of auditors, experts, analysts and institutional investors. Auditors and other experts certify certain elements of the issuer's disclosure, and analysts and institutional investors process continuous disclosure and incorporate it into the market through their investment decisions. All of this continues under CMA.

***CMA compared to IDS***

In January 2000, CSA published a Concept Proposal for an Integrated Disclosure System (IDS). IDS as proposed provided reporting issuers with faster access to markets using an abbreviated offering document that incorporated the issuer's public disclosure. It was voluntary – users of the system had to opt into an enhanced continuous disclosure regime. IDS was designed to fit current legislation.

Since IDS was introduced, the landscape has changed. The enhanced continuous disclosure regime IDS contemplated will apply to all issuers under the CSA continuous disclosure proposal. Under the CSA USL Project, the legislation can be amended to fit any system.

Like IDS, CMA is an integrated disclosure system, and in designing it we have borrowed many features from IDS. CMA has enhancements that are now possible in the new landscape. For example:

**Universal system.** IDS was open to almost all issuers but it was voluntary so that issuers with less need for rapid access to the market did not have to meet enhanced continuous disclosure obligations. However, once all issuers are subject to these obligations, they should all have rapid market access.

**Prospectus disclosure.** Apart from information about the offering, most disclosure in an IDS prospectus was incorporated by reference from the continuous disclosure record. The continuous disclosure record is the basis of CMA disclosure.

**Prospectus review.** IDS anticipated streamlined screening by regulators similar to the screening we anticipate doing on initial AIFs. Both IDS and CMA anticipate a rigorous continuous disclosure review program, which under CMA is one of the main reasons that regulatory vetting at the time of subsequent offerings is not necessary.

**Underwriters.** IDS required an underwriter for all offerings. CMA requires due diligence (due diligence providers other than registrants are permitted) for all issuers on the IPO; senior issuers are not required to have a due diligence provider for subsequent offerings.

**Certificates.** IDS required the issuer and the underwriter to sign prospectus certificates. This is a mechanism to establish civil liability that is not necessary under CMA. Under CMA, issuers have statutory liability for misrepresentations in the issuer's continuous disclosure on an ongoing basis; due diligence providers are liable on the basis of the record at the time of the offering.

# III. Details of the Proposal

## 1. Who's in the system, who's outside the system

Under the Proposal, these issuers are in CMA:

- All issuers that are reporting issuers under the current system immediately before the new system becomes effective (on entering CMA, any resale restrictions or hold periods on an issuer's previously issued securities disappear)
- Issuers who file an initial AIF that is accepted by the Commission (see "Entering and offering securities under CMA – Entering the system: the IPO" below)
- "approved foreign-regulated issuers" (see "Foreign-regulated issuers" below)

These issuers are not in CMA:

- "restricted issuers" (described below)
- foreign issuers that are not "approved" (see "Foreign-regulated issuers" below)

***Restricted issuers***

Under the Proposal, restricted issuers are so-called because they can sell securities only to certain classes of investors, and secondary trading in their securities is restricted to those same investors. This, in effect, retains a closed system for restricted issuers, which is consistent with Recommendation 39 of the Ontario Five Year Review Committee.

We propose that the classes of investors in a restricted issuer be those described in Multilateral Instrument 45-103 *Capital raising exemptions* (adopted by BC and Alberta in April 2002) and in some of the existing prospectus exemptions:

- Investors in private issuers (as currently defined)
- Family, close personal friends, and close business associates (the companion policy to MI 45-103 explains "close personal friend" and "close business associate")
- Investors who buy under an offering memorandum (under MI 45-103 an issuer can sell any amount of securities to any person if it gives the investor an offering memorandum and the investor acknowledges in writing a blunt risk warning)
- Accredited investors (financial institutions, pension and investment funds, substantial corporations, and wealthy individuals)
- Employees and consultants
- Vendors of properties and other assets
- Persons outside Canada in compliance with applicable foreign laws

A restricted issuer must not have its securities listed, quoted or traded on any domestic or foreign marketplace (exchange, quotation reporting system or market). A restricted issuer that wants to provide greater liquidity to its investors will have to enter CMA.

## 2. Continuous disclosure – the core of the CMA system

In today's system and under CMA, there are two types of continuous disclosure – periodic disclosure and timely disclosure. Periodic disclosure requires the issuer to update its disclosure record at regular intervals, for example, by issuing quarterly and annual financial statements. Timely disclosure refers to public dissemination of information from time to time that could reasonably be expected to affect the market price of the issuer's securities.

Under CMA, an issuer must disclose new material information and keep its continuous disclosure record current so that all material information is disclosed. This is not very different than the obligations of a listed issuer today, although CSA will be introducing new requirements to harmonize and enhance current continuous disclosure requirements across the country, and there will be further minor enhancements under CMA (see "Continuous disclosure under CMA" below).

What is different under CMA is that issuers and their management will be liable to investors for misrepresentations in the issuer's continuous disclosure record. The materiality standard is central to what constitutes a misrepresentation; it clarifies what must be disclosed, and when.

### *A. The materiality standard*

The starting point for all disclosure obligations under CMA is the new materiality standard.

Under the Proposal, a CMA issuer must disclose "all material information" in its entry document (the initial AIF) and in all its continuous disclosure documents, and must disclose new material information as soon as practicable.

The concept of misrepresentation (from which civil liability flows) is based on material information. Not all errors are misrepresentations. If an issuer makes an error in its public disclosure, the issuer and its management will not be liable to investors unless the error amounts to a "misrepresentation" – a misstatement or omission of material information.

#### *Why change the materiality standard?*

The current legislation has two materiality concepts – "material fact" and "material change". They are both defined in terms of the significance of their impact on the market price of an issuer's securities.

However, the definition of material fact is broader than material change, and the two definitions are used for different purposes. For example, prospectuses require full, true and plain disclosure of "all material facts". Timely disclosure must be made when there is "a material change". Issuers and other persons cannot trade securities of the issuer if they have knowledge of "a material fact" or "a material change" that has not been publicly disclosed.

Under the Proposal, CMA will not distinguish between investors who buy from the issuer and investors who buy in the secondary market – they both have the right to the same, appropriate level of disclosure when they make their investment decisions. The distinction between material facts and material changes no longer makes sense in this system.

However, the solution is not as easy as simply choosing "material fact" or "material change" as the new standard.

Requiring current "material fact" disclosure under CMA is problematic because that term has a close association with the prospectus requirement. However, the current prospectus forms require disclosure of information that is not, strictly speaking, "material". So applying the "material fact" standard in the CMA context may lead to a misunderstanding that issuers must maintain prospectus-level disclosure at all times, which would be impractical and unnecessary.

"Material change" is not an appropriate standard because it may not require disclosure of all information that ought to be disclosed.

The problems with the current definitions of material fact and material change need to be addressed whether or not CMA is adopted because civil liability for continuous disclosure will probably be included in the Uniform Securities Act. Our Proposal for a new materiality standard should be implemented throughout Canada by including it in the Uniform Securities Act, no matter what happens with CMA.

***The new materiality standard*** [1]

Under the Proposal, the current definitions of "material fact" and "material change" are replaced by the following definition:

**"material information" means information relating to the business or affairs of an issuer that would reasonably be expected to result in a significant change in the market price or value of any of the issuer's securities.**

***Discussion***

A full discussion of the materiality test is in Appendix F. This summarizes the rationale for the standard.

**We have chosen a market impact test.** There are two primary approaches to defining what is "material". In most Canadian jurisdictions, materiality is tested in terms of the effect of the information on the price or value of the issuer's securities (the market impact test). In the US, materiality is tested in terms of whether a reasonable investor would consider the information important in making an investment decision (the reasonable investor test).

We are proposing that the market impact test under our current legislation be retained, for these reasons:

- It is the information that investors need to know. Other information may be interesting – even important – but unless it is reasonable to expect that the information will result in a significant change in the market price or value of the issuer's securities, the investor suffers no economic harm if it is not disclosed. When investors learn of the other information, they can sell their securities and suffer no harm because, by definition, the information has not affected the market price.

[1] This Proposal describes the materiality standard for securities other than mutual fund securities. A similar approach will be applied to the materiality standard contained in our proposal relating to mutual funds, to be published later.

- The standard must be clear and practical. We are proposing that issuers and their management have civil liability for misrepresentations. In that regime, they should not have to guess what might be of significance to investors. Under a reasonable investor test, issuers would have to consider an infinite and unknowable number of factors when deciding whether information is material.

- A reasonable investor standard may be counterproductive to meaningful disclosure because it can lead an issuer to disclose all existing information for fear of leaving anything out, generating what one US court called "an avalanche of trivial information" that obscures the truly material information.

- If misrepresentation is alleged, it is useful to be able to measure the materiality of the statement that is alleged to be false or misleading using standard market models developed by financial economists.

**We have removed the retroactive assessment in the current definition.** In the current definition of material fact, an event is also material if it "significantly affects" the market price. This part of the definition allows materiality to be determined retroactively on the basis of actual market activity, even if there was no reasonable ground for management to expect, when they decided whether the fact was material, that the fact would have a significant effect on the market price.

We do not think issuers and their management should be liable if they exercised reasonable business judgment based on the information that was available to them at the time of determining whether a given event was material.

**We have removed the reference to pending decisions.** The current definition of material change includes a decision to implement a change by senior management who believe that confirmation of the decision by the directors is probable. We consider this to be more relevant to when disclosure must be made (see "Timely disclosure" below).

**We assume that the market responds rationally to material information.** Management must consider materiality in the context of an efficient free market that processes all disclosed information.

**We apply the standard consistently.** Under the Proposal, the standard is applied consistently:

- as the minimum required disclosure in an issuer's CMA entry document,
- to determine an issuer's continuous disclosure obligations,
- to determine liability for misrepresentation, and
- to prohibit insider trading.

***Ontario Five Year Review Committee***

In its draft report, the Ontario Five Year Review Committee recommends replacing the market impact test with the US reasonable investor test. However, they note that it may be a change without a difference because US courts tend to consider market impact when applying the reasonable investor test. The Committee found compelling arguments on both sides of the

debate, but was ultimately persuaded by the need for increased regulatory harmonization with the US.

We have reached a different conclusion. One reason for the difference in our views may be that we believe that the "full, true and plain" or prospectus-level disclosure standard, which some equate to the reasonable investor standard, is not the appropriate standard for a continuous disclosure regime.

Also in its draft report, the Five Year Review Committee recommends that the Act not be amended to require disclosure of "material information". They recognize the appeal of making this change, but are not recommending it for two reasons:

1. The issue of *when* to disclose becomes more problematic when material information or facts (such as merger negotiations and financial difficulty) must be disclosed, especially when the disclosure can and will be reviewed in hindsight, and particularly if there is civil liability.

   We respond as follows:

   - We are proposing that the timely disclosure provisions recognize that there are certain circumstances where an issuer may defer disclosure. Those circumstances, and the conditions on which disclosure could be deferred, are discussed below (see "Timely disclosure").

   - We are removing the retroactive portion of the material change definition and reviewing management decisions on disclosure on the basis of the business judgment rule. We are also providing a safe harbour for release of material information.

2. Disclosure of material information would impose a significant burden on issuers to continually monitor matters external to them for the purpose of informing investors.

   In response, we do not believe that, under the standard we are proposing, issuers will need to behave any differently in this regard than they do today. Under the Proposal, we assume the market processes information that is public. Therefore external events will be processed by the market and be reflected in the issuer's stock price whether or not the issuer discloses those events. The only time an issuer would need to consider disclosure in light of publicly known external events is if the effect on the issuer is material and inconsistent with the general impact on issuers in its sector.

We are pleased to see that the Five Year Review Committee has identified these same matters as important in ensuring that Canadian securities regulation meets its public policy objectives. Although we have initially come to different conclusions, there is much common ground in our understanding of the issues. We believe that healthy public debate will lead to a full consideration and the best resolution of the issues.

## *B. Continuous disclosure under CMA*

The CSA will soon publish for comment a new harmonized continuous disclosure rule that will provide a platform for our CMA Proposal. This new rule does not depend on the adoption of

CMA. It could be adopted in all Canadian jurisdictions no matter what happens with our Proposal. If the proposed CSA rule is implemented, issuers all across Canada will be subject to the same requirements for ongoing disclosure.

The new CSA rule will harmonize and consolidate all current continuous disclosure requirements into one instrument that will apply to all reporting issuers in Canada, except for mutual funds, which will be governed by a separate instrument. The new rule covers financial disclosure, management's discussion and analysis (MD&A), annual information form (AIF) disclosure, material change reporting, and other reporting and disclosure requirements. It allows Canadian issuers more flexibility in using US GAAP and GAAS and shortens filing deadlines for financial statements. It also introduces new reporting requirements for significant acquisitions.

The following describes the continuous disclosure regime for issuers under our CMA Proposal. The proposed regime is substantially similar to that which CSA is proposing, with a few differences that we have noted throughout our discussion below:

***Financial Statements***

- **Shortened filing deadlines.** Filing deadlines for senior issuers are shortened to 90 days for annual statements and 45 days for interims. ("Senior issuers" are issuers that are exempt from the Toronto Stock Exchange's acceptance requirement for proposed material changes.) Filing deadlines for other issuers are shortened to 120 days for annuals and 60 days for interims.

- **Delivery only on request.** Issuers need only deliver financial statements and MD&A to securityholders on request. (An issuer's governing corporate law may require otherwise.)

- **Board review of interim statements.** Board review of interim financial statements will now be required (this is already a requirement in BC and Ontario). The board can delegate this function to the audit committee.

- **Canadian or US GAAP and GAAS permitted.** Securities and Exchange Commission (SEC) issuers (including Canadian issuers that file with the SEC) will be permitted to use US GAAP and US GAAS. There will also be some relief for other foreign issuers. (Relief for foreign issuers from the proposed CSA rule is contained in a separate proposed rule described below under "Relationship to proposed CSA rule".)

- **Cost analysis for development stage issuers.** Cost analysis for development stage issuers will now be required (this is already a requirement in BC).

***Annual Information Forms***

- **All issuers must file AIFs.** Under our Proposal, all CMA issuers must file an AIF. The CSA rule does not require an AIF if the issuer has assets and revenues of less than $10 million and a market capitalization of less than $75 million. Under the CMA system, it is the AIF that provides an annual statement of material information which, when updated by the issuer's other continuous disclosure filings, gives the issuer a disclosure platform

from which it can offer securities immediately into the market. Since CMA eliminates the requirement for a prospectus, it is important that all CMA issuers file an AIF.

Under the proposed CSA rule, SEC Forms 10K and 20F will continue to be acceptable as alternative forms of AIF. Under CMA, approved foreign-regulated issuers will be able to use these and other annual reports that are acceptable for use in their home jurisdiction.

- **New form introduced.** The AIF form under CMA is in Appendix B. There is less prescribed content in the proposed CMA AIF form than in the existing and CSA-proposed forms of AIF.

  The CMA AIF is described in detail below (see "The AIF under CMA").

***Management's Discussion and Analysis***

- **MD&A requirement.** Annual and quarterly MD&A will be required across Canada (this is already required in BC and Ontario).

- **Board review required.** The board will have to review MD&A, but they will be able to delegate this function to the audit committee.

- **SEC MD&A recommendations.** Recent SEC MD&A recommendations have been incorporated in the proposed CSA rule. We will monitor public comment on this aspect of CSA's proposal.

***Significant Acquisitions***

- **New requirement to file Business Acquisition Reports.** Under the proposed CSA rule, an issuer will have to file historical financial statements and a description of any significant acquisition in a Business Acquisition Report (BAR) within 75 days of the date of the acquisition. This disclosure is modeled on the parallel requirements in the current prospectus rules. The proposed CSA rule will include a number of provisions designed to simplify and reduce the requirements for acquisitions involving small businesses.

  We will monitor public comment on CSA's proposal.

***Proxy requirements and information circular***

- **Separate annual filing in lieu of information circular eliminated.** The disclosure that was required in BC Form 51-903F *Annual filing of reporting issuer* will be incorporated into the new AIF.

- **Executive compensation.** Under CMA, issuers must disclose compensation information for all senior management (senior officers and inside directors) and independent directors. This is a change from the current requirements, which only require disclosure about an issuer's chief executive officer and four highest paid executive officers.

Under CMA, we are proposing that an issuer disclose executive compensation on a group basis for all its senior management other than its chief executive officer – we will still require individual details about the CEO. The existing requirements to disclose executive compensation on an individual basis were introduced in late 1993. The primary reason for requiring this disclosure was the assumption that public scrutiny would ensure that companies more closely aligned pay with corporate performance. Whether mandating disclosure of individual compensation has had the desired effect remains to be seen; however, we do not think it is necessary to mandate that executive compensation be shown on an individual basis, other than for the issuer's CEO. Through group disclosure, investors can assess compensation paid to executive management as a whole, its relationship to current performance, and its comparability to similar companies.

The CSA is studying the executive compensation disclosure of 75 of Canada's largest publicly traded companies. The purpose of the study is to determine if Canadian companies are meeting their reporting obligations in this area. We will review the results of this study and consider whether we should further refine CMA's rules to take them into account.

Under the proposed CSA rule, an issuer will have to comply with the new SEC Equity Compensation Disclosure requirements that are being incorporated into the new information circular form. We will monitor and consider the public comment on this aspect of the CSA rule.

***Material change reports and timely disclosure obligations***

- **No material change report under CMA.** Under CMA, issuers must announce new material information by press release. We will eliminate the separate requirement for a material change report and provide instead for a supplemental information form. (We will retain a document that an issuer can use for confidential filings with the Commission.) The CMA approach differs from that proposed by CSA – the CSA rule does not make any significant changes to the current requirements for an issuer to announce material changes by press release and to follow the press release with a material change report.

  Under the current system, issuers sometimes "test" for materiality by issuing a press release to observe market reaction. Then, if the market price is significantly affected, the issuer uses the material change report to make "full" disclosure. This should no longer be necessary under CMA because the retroactive aspect of determining materiality has been eliminated and the standard for disclosure has been clarified.

  Some issuers say that the requirement in some jurisdictions to issue a press release "forthwith" or "promptly" means that they do not have time to make complete disclosure, so the material change report allows them to provide fuller disclosure after they have had time to reflect on the event. This problem is solved under CMA by requiring disclosure "as soon as practicable", which is intended to allow management the time to ensure that the disclosure is accurate and complete. This has the added advantage that all material information ends up in the press release, not buried in another report (see "Timely disclosure" below).

- **Supplemental information form.** We recognize that an issuer may wish to disclose information in addition to the material information it discloses in a press release. (This is another way the material change report is currently used.) We agree that there should be a vehicle for this type of disclosure, so we are introducing a supplemental information form that CMA issuers may file on SEDAR (the electronic system used in Canada for filing securities documentation). (This concept is not contained in CSA's proposed rule.)

- **Confidential material information form.** The CMA system retains a confidential filing process that issuers can use to advise the Commission that there is undisclosed material information that, if disclosed, would be unduly detrimental to the issuer.

## *C. The AIF under CMA*

The AIF plays a pivotal role in the CMA system. It is the document used by an issuer both to enter the system and to consolidate and update all material information about the issuer's business and affairs on an annual basis thereafter.

***How we developed the form***

The proposed form, which is in Appendix B, requires disclosure of all material information about the issuer, its management and any securities being offered. While the form mandates some specific disclosure, it prescribes much less detailed disclosure than the current long form prospectus.

We believe issuers and their management should have more latitude, and responsibility, to decide what information falls in the category of material information, and consequently, must be included in the AIF. Therefore, the AIF is designed to be flexible, both as to the level of detail presented and as to the presentation itself – but the standard of disclosure is the same for all issuers: they must disclose all "material information". (This standard is discussed above under "The materiality standard".)

In developing the CMA AIF, we considered existing disclosure documents, including the forms for the long form prospectus (BC Form 41-601F), the short form prospectus (Form 44-101F3) and related AIF (Form 44-101F1) and the offering memorandum (Form 45-103F1 and Form 45-103F2) adopted by Alberta and BC under MI 45-103. We also considered the Small Company Offering Registration Form (U-7) developed by the North American Securities Administrators Association.

The initial AIF under CMA is significantly shorter than existing Canadian prospectus forms, but it requires no less material information than the current forms. What we have removed from the current forms is much of the detail and prescription and some of the items requiring disclosure of non-material matters. In some cases, we have done this by moving the substance of the provisions in the prospectus forms to the first chapter of the CMA Guidelines so that issuers are only required to make the disclosure if it is material information. (The Guidelines are in Appendix C.)

One example of our shift in focus from prescription to guidance is found in section 1.1 of the CMA AIF, "The business". Where Item 6 of the current long form prospectus prescribes in detail what issuers must disclose about their business, the AIF requires only that the issuer "describe

the business". However, we outline in the Guidelines the types of things that all issuers, and junior issuers in particular, will want to consider when preparing their AIFs.

The simplified initial AIF and Guidelines under CMA allow issuers the flexibility to package their disclosure to suit the market where their securities will trade.

***A summary of the form***

The form is divided into five parts:

- Part 1 – The business
- Part 2 – Risk factors
- Part 3 – Management and other persons involved with the issuer
- Part 4 – General corporate information
- Part 5 – The transaction

Part 1 requires a discussion of the issuer's business, history and development.

Part 2 requires a discussion of risk factors.

Part 3 requires disclosure about the issuer's directors, senior officers, significant shareholders (those holding 10% or more of the issuer's voting securities), promoters and other key persons (people who are crucial to the issuer's business).

Part 4 requires information about the issuer's corporate structure and share and loan capital. It also requires that the issuer include with its AIF the financial statements and MD&A that will be required under the new CSA continuous disclosure rules.

**Request for Comment 1: We have not yet determined what financial statement and MD&A requirements we will impose under CMA. We are reviewing the requirements under the long form prospectus rules, as well as those that CSA is proposing as part of its continuous disclosure rules. We are also considering whether to require issuers to include financial statements and MD&A with all subsequent AIFs, rather than separately. We invite your comment on these issues.**

Part 5 requires disclosure about the transaction, which in most cases, will be the issuer's initial public offering. The issuer must provide information about the securities being offered and the intended use of proceeds.

Draft Guidelines to the CMA system are in Appendix C and include guidelines to completing the form. A sample initial AIF is described in Appendix D.

**Request for Comment 2: Chapter 1 of the CMA Guidelines sets out a list of possible disclosure items for derivative transactions (see section 5.2). The list is based on provisions found in the long and short form prospectus forms. We invite your comment on whether, given the great variety of instruments in the derivatives category, it is useful to attempt to list disclosure items and, if so, whether this list is appropriate and provides sufficient guidance.**

In the CMA Guidelines we encourage issuers to use plain language in completing their AIFs. We believe it is important for an issuer's disclosure to not only provide investors with the information they need to know to make an investment decision, but also to do so in a way that investors can understand. We also recognize our responsibility to help issuers and their counsel understand the disclosure obligations we impose, and therefore have applied plain language principles in drafting the AIF and Guidelines.

***Some changes from existing prospectus forms***

The following summarize some of the more significant differences between the CMA AIF and the long from prospectus form (BCF 41-601F). We have included as Appendix E a general table of concordance.

- **Material contracts.** An issuer need no longer specifically disclose or file its material contracts, although the Guidelines remind issuers that the terms and conditions of key contracts are often material information that must be disclosed.

- **Executive compensation.** (See "Continuous disclosure under CMA" above.)

**Request for Comment 3: As with our requirements for disclosure of executive compensation, we have required issuers to disclose shareholdings on a group basis (see section 3.7 of the AIF in Appendix B). Should this information be disclosed on an individual basis?**

- **Certificates.** A certificate is a mechanism to establish civil liability that is not necessary under CMA. Under CMA, issuers have statutory liability for misrepresentations in the issuer's continuous disclosure on an ongoing basis; due diligence providers are liable on the basis of the record at the time of the offering.

- **Statement of investors' rights.** We have changed the prescribed statement about an investor's rights to reflect the new investor rights that we are proposing in Chapter 3.

- **Trading history**. The issuer is not required to disclose trading history in its AIF. Where there is a public market for the issuer's securities, this information is readily available.

- **Identification of auditors and experts.** We will not specifically require the issuer to identify its auditor and all counsel responsible for providing opinions, since the auditor's report and other expert reports and opinions that are publicly available contain this information.

- **Special warrant disclosure.** Disclosure relating to special warrants is eliminated, as there should be no need for these offerings in CMA.

## *D. Timely disclosure*

A CMA issuer must make timely disclosure of all material information about its business and affairs (see "The materiality standard" above). Under our Proposal, "timely" means "as soon as practicable".

This standard of timeliness allows an issuer's management to make appropriate timely disclosure decisions using the business judgment rule. That is, "Did management exercise reasonable business judgment in determining whether the information was material, based on the information available to them at the time the decision was made?" Management must make reasonable inquiry to ascertain relevant information. The actual market impact of the disclosure when it is ultimately made will not be considered in determining liability, although it may be relevant to determine damages.

There are three circumstances under the Proposal in which an issuer may defer making disclosure:

1. **Unestablished information**. An issuer may defer disclosure while it is establishing the material information. This is intended to give management the time to review the information, determine whether it is material information, become reasonably confident with its accuracy, and put it into context. For example, when an issuer is conducting a drilling program and is receiving results as the program proceeds, the issuer need not release the results as it receives them. Management ought to review the results for reasonableness, and consider them in the context of known exploration information.

2. **Uncertain event**. When it is uncertain whether an event will occur, management must balance the likelihood that the event will occur and the anticipated impact of the event on the market price or value of the issuer's securities if it were to occur, to determine whether the materiality threshold has been crossed, and if so, when. For example, if an issuer begins merger discussions and it is reasonable to expect that the merger would result in a significant change in the price or value of the issuer's securities, we expect that management would defer any announcement at least until negotiations had begun in earnest, to prevent undue speculation in the issuer's securities and negative impact on the transaction. However, once certainty increases to the point where management believes the information is material, disclosure must be made. If release of the information may be unduly detrimental to the issuer's interests, management may consider making the confidential filing described in the next paragraph.

3. **Undue detriment**. As is the case today, an issuer may defer disclosure of material information if, in the issuer's reasonable opinion, the disclosure would be unduly detrimental to the issuer's interests. Under the Proposal, the issuer fulfills its timely disclosure

obligations if it files a confidential report with the Commission detailing the material information and the reasons why the issuer should not issue a press release at that time. For example, if an issuer goes into technical default on a material loan transaction, entitling the lender to call the loan, disclosure of the lender's entitlement to call the loan could lead to a general loss in confidence in the issuer. If management reasonably believes that arrangements will be made with the lender to correct the default, management may fulfill its timely disclosure obligation by filing with the Commission a confidential report of the material information, together with its reasons why public disclosure should not be made at that time. (The executive director may require the issuer to disclose the material information if the public interest outweighs the issuer's interest in confidentiality.)

Once the basis for deferring disclosure has ended, if the information is still material information, the issuer must disclose it. Disclosure of material information cannot be permanently deferred.

The CMA regime provides management with guidance, flexibility and protection:

- Issuers are responsible for having systems in place:
  - to bring important information to management's attention,
  - for management to review the information, to determine its materiality and to disclose material information, and
  - to prevent trading in the issuer's securities by the issuer, its directors and senior officers and anyone with knowledge of the information until the information is disclosed, and to monitor market activity during these periods.

- The issuer will not be liable for deferring disclosure of unestablished information, uncertain events, or unduly detrimental material information that is disclosed in confidence to the Commission, if the information is held in confidence, there is no evidence that the information has leaked to the market, and there is no trading in the issuer's securities by the issuer, its directors or senior officers or anyone with knowledge of the undisclosed material information.

- If market activity indicates that the information has leaked or if selective disclosure is unintentionally made, the issuer must issue a clarifying statement immediately. Neither the issuer nor its management will be liable to investors so long as a clarifying statement is made within 24 hours. This defence will not be available to anyone who has engaged in tipping, insider trading, fraud, or market manipulation.

- The issuer has no general duty to correct or update third party statements or rumours unless:
  - the issuer or its management is responsible for the rumour,
  - the issuer or its management are closely associated with the statements (such as analyst reports where the issuer has provided the information to the analyst or encouraged the report), or
  - there is undisclosed material information that appears to have leaked.

Chapters I and III of the CMA Guidelines (see Appendix C) include a discussion of materiality to help issuers better understand their disclosure obligations.

### *E. Continuous disclosure compliance reviews*

The integrity of CMA depends on good continuous disclosure. Therefore, CMA requires an organized, disciplined and high profile program of continuous disclosure compliance review. Ideally, CSA will adopt national continuous disclosure review standards and administer the program through a mutual reliance or similar regime.

Under CMA, we will continue to take a risk-based approach, focusing our efforts on new CMA issuers (who will likely be scrutinized closely for an initial period after they enter the system), issuers that have had compliance problems, issuers undergoing rapid change and other issuers meriting attention, in addition to random selections.

During a compliance review, we will look at the issuer's disclosure as a whole to see whether it accurately reflects the issuer's business and financial position. We will generally not require issuers to re-file documents so long as the deficiencies in those documents are not material. Our expectation is that in most cases, we will use the process to provide instructive comment to be taken into account by the issuer on future filings.

However, where an issuer's continuous disclosure record is misleading, we will require that it be corrected and may prohibit the issuer from offering securities until it has been. Depending on the seriousness of the matter, we may also pursue enforcement action.

## 3. Entering and offering securities under CMA

### *A. Entering the system: the IPO*

Under this Proposal, issuers that are currently reporting issuers will automatically be in the CMA system. They can take advantage of CMA's streamlined offering process as soon as CMA is in effect, assuming their continuous disclosure record is complete and up to date.

An issuer that wants to "go public" enters CMA by filing its initial AIF (see "The AIF under CMA" above for a discussion of the proposed AIF form). The initial AIF discloses all material information about the issuer's business and affairs and, if applicable, the transaction it plans to complete. (In most cases, we anticipate that the issuer will be entering the CMA system in connection with its initial public offering.)

An issuer can also enter CMA by using a share exchange take over bid circular or business combination information circular containing information similar to that in the initial AIF. To qualify, the circular would have to be prepared to the same standard as the initial AIF – that is, it must disclose all material information about the issuer's business and affairs and the transaction.

Under CMA, securities Commission staff vet the initial AIF or other entry document. In most cases our review will be focused on identifying:

- Unsuitable directors and officers
- Significant non-compliance with the disclosure requirements of the form
- Public interest concerns

The following are examples of public interest concerns staff will consider:

- The past conduct of the issuer or its officers, directors, promoters or control persons
- The knowledge and expertise of the issuer's officers and directors
- The financial condition of the issuer or its officers, directors, promoters or control persons

If the issuer cannot satisfy concerns raised by staff, the executive director may refuse to accept the issuer's initial AIF. As today, the executive director must not refuse to accept an issuer's initial AIF without giving the issuer an opportunity to be heard.

Under the Proposal, an issuer is not required to deliver the initial AIF or any other document to investors, but it must make the initial AIF and any other offering document publicly available by filing it on SEDAR.

If an issuer is filing its initial AIF in connection with an offering, the issuer may begin offering its securities once it receives notice from the executive director that its initial AIF has been accepted for filing.

### *B. Subsequent offerings*

After the issuer is public, it is subject to the continuous disclosure regime – all its material information is available to the market at all times and trading history is available. CMA issuers are also subject to the Commission's comprehensive program of continuous disclosure review (see "Continuous disclosure compliance reviews" above).

Therefore, no mandated offering document is necessary. If an offering is material (as most general offerings will be), the CMA issuer must issue and file a press release before offering securities. As we have indicated in the Guidelines (see Appendix C), the press release will likely describe the offering itself, the type of securities being offered, how the issuer intends to use the proceeds, and any underwriting or due diligence arrangements.

After completing the offering, and because of the issuer's timely disclosure obligations, the issuer issues and files another press release, disclosing the fact that the transaction has completed, how much money was raised and any other material information.

While there is no mandatory offering document for subsequent offerings under CMA, issuers may prepare offering documents if they wish. In fact, we expect that many issuers will produce documents that will contain information that is meaningful to investors to help them market and sell their securities.

The issuer's public record must contain all material information about its business and affairs when it offers securities. Once an issuer is in the CMA system, the issuer must not present material information for the first time in an offering document. If there is material information that should be disclosed before an offering, the issuer must disclose it by press release.

If an issuer uses an offering document to make a general offering of its securities, the issuer must file the document on SEDAR and it becomes part of the issuer's continuous disclosure

record. However, the regulator will not vet the document as a condition to the offering. (The regulator may review the document later as part of a continuous disclosure review.)

An issuer should take a balanced approach in presenting information in an offering document to ensure that the offering document does not contain a misrepresentation. If an offering document contains a misrepresentation, or if the issuer uses unfair practices to sell the securities, the issuer will be subject to civil liability and enforcement action.

## *C. Underwriting and due diligence*

### *The role of the registrant today*

Today, we require an issuer that conducts a public offering to sell its securities through registrants and to have a registrant sign a certificate in the prospectus. Acting in this capacity, the registrant fulfills four functions:

- **Due diligence.** The registrant is liable for misrepresentations in the prospectus, subject to a due diligence defence. As a result, the registrant conducts due diligence to satisfy itself that it has no reason to believe that the prospectus contains a misrepresentation.
- **Gatekeeper.** The registrant performs a gatekeeper function when it decides to do a particular deal as opposed to others, and when it acts as an issuer's sponsor for an exchange listing.
- **Pricing.** The registrant negotiates the price of the issue at arm's length. This is particularly important for IPOs, when there is no market trading history.
- **Distribution.** The registrant finds buyers for the issuer's securities.

This model has not worked for all issuers. Some issuers in the junior market tell us that the cost of registrants is often prohibitive relative to the benefits they provide. In their opinion:

- The cost for a registrant to conduct due diligence is not commensurate with the benefit it provides (this view is shared by some senior issuers as well).
- Worthy issuers may not meet registrants' criteria and therefore never get to market.
- Registrants expect junior issuers to arrange for the distribution of the major portion of the issue.
- Issuers have limited negotiating power so the negotiating of price is not between equals.

### *The role of the registrant under CMA*

We have reconsidered the model and propose to uncouple the registrant's roles, and permit appropriate non-registrants to perform the gatekeeper, due diligence and pricing functions.

### *Use of due diligence providers*

Under CMA, due diligence providers may be either registrants or other competent third parties. Therefore, we are proposing a model in which non-registrants, such as venture capital companies, law firms, accounting firms, or financial institutions, could perform the due diligence function. This model is in operation under the London Stock Exchange Alternative Investment Market.

These due diligence providers could also act effectively as gatekeepers by ensuring that the organization of an issuer's business and affairs are appropriate for the public market, without barring worthy issuers who do not meet the traditional criteria of registrants.

Since these providers act at arm's length, they could be just as effective as the present system for ensuring fair pricing. Allowing non-registrants to act as due diligence providers could also lead to more competition and potentially lower costs to issuers.

We would require due diligence providers to meet proficiency and financial adequacy criteria.

Under the Proposal, due diligence providers are liable to investors if there is a misrepresentation in the offering document (if any) or the issuer's continuous disclosure record at the time of the offering, subject to a due diligence defence. (In an IPO the issuer's continuous disclosure record would generally consist of the issuer's initial AIF and any other document the issuer or its agent used to market the offering.)

- **Junior issuers.** Under the Proposal, an issuer that is not a senior issuer must retain a due diligence provider for its initial AIF all offerings.

- **Senior issuers.** A senior issuer must use a due diligence provider for its initial AIF and an IPO, but not for subsequent offerings. (We are currently considering the criteria an issuer would have to satisfy to be a "senior issuer". Specifically, we are considering whether to mirror the criteria the TSX uses to exempt an issuer from section 502 of the TSX Company Manual, which requires listed companies to obtain prior Exchange acceptance for filing of all proposed material changes. For industrial companies, the criteria for exemption are $7,500,000 in net tangible assets, $300,000 in earnings from operations in the previous year, pre-tax cash flow of $700,000 in the previous year and pre-tax average cash flow of $500,000 for that year and previous year.)

  The reason for exempting the largest issuers from this requirement is that once they are in the CMA system, there are factors that increase the credibility of their public disclosure so that the need for a due diligence provider is reduced. These factors include analyst, institutional investor and business media following, as well as significant financial exposure for misrepresentations.

***Use of registrants; direct selling***

Under the current system, issuers must use registrants to sell their securities, unless there is an exemption from the registration requirement. In this context, a registrant's role is to provide suitability advice to investors.

In Ontario, local Rule 32-501 *Direct purchase plans* permits reporting issuers to establish direct purchase plans in Ontario to sell securities directly to investors without using a registrant. The investor is warned that the sales are made without the involvement of a registrant and therefore the investor will not receive any investment advice and is solely responsible for assessing the suitability of the investment.

- **Junior issuers.** Under the Proposal, junior issuers must use registrants to sell their securities to investors, unless there is an exemption from the registration requirement. We are not proposing direct selling by junior issuers because they are generally not well

known to retail investors and the investor protection function served by a registrant's involvement is important, unless there is another exemption available because of other circumstances, such as a close relationship with the issuer, where the investor protection a registrant affords is not generally required.

- **Senior issuers.** Under the Proposal, senior issuers can sell directly to investors on conditions similar to those in the Ontario local rule. Large, established issuers that are well known to retail investors may have sufficient market interest to support a direct purchase program. In this case, investors may choose to forgo the advice of a registrant, or alternatively, may buy the issuer's securities on the secondary market through a registrant.

We note the Ontario Five Year Review Committee's Recommendation 21, which recommends against Internet offerings without registrants. We will be monitoring public comment about their recommendation.

### *D. Private placements*

Under the Proposal, CMA issuers can continue to access the private placement market as they do today.

### *E. MJDS*

Under the multijurisdictional disclosure system (or MJDS), eligible Canadian issuers can raise money in the US by filing with the SEC a Canadian prospectus with some minimal additional disclosure. This system simplifies the US offering process for Canadian issuers enormously and is highly valued by its users.

We will maintain a separate set of prospectus rules and forms for Canadian issuers who wish to access the US market under MJDS. Canadian regulators will continue to review, comment on and issue receipts for prospectuses filed by these issuers.

## 4. Registration exemptions

While CMA disposes of prospectuses and, therefore, the need for prospectus exemptions, the system will still have a registration requirement, as well as exemptions from that requirement.

Under CMA, we will simplify the trading and advising exemptions to reflect the simpler regime possible in a CMA environment as well as changes in the financial services industry and our enforcement experience. The regime preserves exemptions from registration as a dealer, based on trading activity, that exist today for reporting issuers and that have companion prospectus exemptions.

The proposed trading and advising exemptions are discussed in Chapter 2, Part 2.

## 5. Foreign-regulated issuers

Currently, foreign issuers selling securities in Canada must either file a prospectus or rely on an available exemption. Also, foreign issuers that file a prospectus or list on a Canadian exchange become reporting issuers and are subject to Canadian continuous disclosure requirements. Some relief from these rules is currently provided for US issuers under MJDS, but we expect that the current rules discourage foreign issuers from offering their securities in Canada, or listing their securities on a Canadian exchange, which reduces investment opportunities for Canadians.

CMA is designed to provide issuers that are regulated in countries with mature market-based economies freer access to our markets to increase investment opportunities for Canadians in a way that does not unduly compromise investor protection or market integrity.

***Approved foreign-regulated issuers***

Under the Proposal, CMA opens our markets to "approved foreign-regulated issuers". An issuer is an AFRI if:

- its securities are principally traded on a market or markets outside Canada, and
- it
  - has a class of securities registered under section 12 of the US *Securities Exchange Act of 1934* (the 1934 Act) or files reports under section 15(d) of that Act (an SEC reporting issuer), or
  - is subject to a designated foreign system of securities regulation.

We will designate a foreign system if it has:

- rules for investor protection and market integrity, including continuous disclosure requirements,
- an effective infrastructure for administering and enforcing the rules, and
- a track record of effective securities regulation.

We will designate a foreign regulatory system that meets these criteria, even if its requirements do not exactly correspond with ours. Assessing whether foreign systems should be designated will in some cases involve extensive study. Initially, we will designate the SEC reporting system for issuers that have a class of securities registered under section 12, or that file reports under section 15(d), of the 1934 Act, and the reporting systems for public companies in the UK and Australia. We will consider expanding the list of designated foreign systems if there is significant demand from Canadian investors.

Any issuer whose securities primarily trade outside Canada (including a Canadian issuer) may use SEC reporting documentation to satisfy Canadian disclosure requirements. SEC reporting requirements are sufficiently rigorous to address Canadian investor protection concerns.

***Benefits to AFRIs***

Under the Proposal, an AFRI:

- can enter CMA and satisfy Canadian continuous disclosure requirements using SEC reporting documents or other home jurisdiction documents.
- is exempt from Canadian insider bid, issuer bid and going private transactions and from restricted share disclosure requirements.
- is exempt from insider reporting and early warning requirements if it complies with foreign regulatory requirements.
- is exempt from the special disclosure rules that apply to mining and oil and gas issuers.

We are also considering whether approved foreign-regulated issuers should be exempt from other requirements of Canadian securities legislation, such as the requirements relating to take over bids and proxies, so that they would only need to comply with one set of requirements in these matters as well.

***Use of US or home document by AFRIs***

Approved foreign-regulated issuers can use the documents required by the foreign system to comply with Canadian continuous disclosure requirements under CMA if:

- their continuous disclosure is publicly accessible, whether on SEDAR, EDGAR (the US equivalent of SEDAR) or another filing system accessible through the internet,
- they direct investors to their continuous disclosure, for example by a notation on SEDAR that directs investors to EDGAR, and
- they caution investors that they are subject to a foreign regime of securities regulation that differs from that in Canada.

***Relationship to proposed CSA rule***

In connection with its proposed new rule for continuous disclosure (see “Continuous disclosure under CMA” above), CSA will also be proposing a new rule to provide relief to foreign issuers from that rule. There are two main differences between the proposed CSA rule and CMA as to the issuers that can use foreign documents to satisfy Canadian continuous disclosure requirements:

- The proposed CSA rule does not permit Canadian issuers to file foreign documents (with a limited exception that Canadian based issuers can prepare their financial statements in accordance with US GAAP).
- In addition to foreign issuers that are SEC reporting issuers, the proposed rule extends relief to foreign issuers in 15 listed jurisdictions but only if less than 10% of their securities are held in Canada.

***Restriction on publicly traded foreign-regulated issuers with no continuous disclosure***

We have special concerns about opening our market to publicly traded issuers who are not subject to any continuous disclosure requirements. For example, issuers whose securities are quoted on the US pink sheets do not have to register their securities under section 12 of the 1934 Act or have to report under section 15(d) of that Act, and therefore they may not be subject to any continuous disclosure reporting requirements at all.

Continuous disclosure is crucial to CMA. Therefore, these issuers cannot use CMA to sell securities unless they comply with Canadian continuous disclosure requirements or the foreign equivalents.

Canadian investors who wish to purchase securities in these issuers may continue to do so in the secondary market.

# CHAPTER 2
# REGISTRATION

## Part 1: Code of Conduct

## I. Summary

We are proposing a Code of Conduct for registrants. Under this Proposal:

1. The Code replaces several existing detailed, complex and prescriptive rules with general principles.

2. The Code replaces existing provisions relating to registrants' qualifications, ongoing proficiency, "know your client" and "suitability", fair dealing, conflicts of interest, compliance systems, and client complaints.

3. By casting registration requirements in general, principled terms, we create a framework that protects both investors and Canadian markets while encouraging innovation.

4. Firms are responsible for enforcing the Code and are accountable to regulators and liable to investors for breaches of the Code by those who work for them.

## II. Background

***Why a Code of Conduct***

In the Concept Paper published in February 2002, we said that the registration system works best when registrants are focused on their broader obligations to their clients and the market and are accountable for meeting them. The current system contains many complex, detailed requirements. We identified two problems with the current system. First, sometimes registrants follow the detailed rules and do not consider their broader obligations. Second, prescriptive rules also make it difficult for us to keep regulatory requirements aligned with commercial practice. The market changes far faster than we can revise rules. The current system does not offer the flexibility that is needed for the fast pace of change in the industry.

The idea behind a Code of Conduct is to replace complex, prescriptive and sometimes arbitrary rules with general principles. Such principles are designed to form the basis for an individualized approach to the creation of a firm's compliance system. General principles force firms to think about the reasons behind the rules as opposed to blindly following them. We want to avoid the "loophole" mentality that comes with detailed, complex rules. Firms and their representatives must consider each Principle and ask themselves whether behaviour falls within the spirit of a specific Principle or violates it.

By casting registration requirements in general, principled terms, we create a framework that protects both investors and Canadian markets while encouraging innovation. Under a Code regime, firms are responsible for enforcing the Code and are accountable to regulators and liable to investors for breaches of the Code by their employees. We think this will motivate firms to take an active and continuing interest in compliance.

We have drafted Guidelines to accompany the Code. These Guidelines are designed to assist both the firm and individual registrants in interpreting the Principles set out in the Code. Although we have supplied examples in the Guidelines (where appropriate) of the types of behaviour we believe should be caught by each Principle, we have avoided taking a prescriptive "checklist" approach. The Code and Guidelines are in Appendix A and are also included below under "Details of the Proposal".

This approach allows each firm to take the Code's general Principles and develop them into a compliance system that works for that particular firm and its representatives. This means firms can design systems tailored to their particular needs that will yield better quality results. Time currently spent filling out forms and going through checklists can instead be spent on employee education, policy-making, supervision, and solving problems with the broad Principles as guidance.

Some firms may incur transition costs to adapt their compliance systems to a Code approach, but they will ultimately have more control over costs because they can design the details of their compliance systems rather than having the details imposed on them.

***The Code and SRO requirements***

Other organizations that regulate the securities industry have their own codes of conduct. For example, the Investment Dealers Association (IDA) has a Code of Ethics and Conduct that deals with ethics and compliance-related issues of importance to representatives of IDA member firms.

We will be consulting with the IDA and other SROs about our proposed Code. One objective of those discussions is to ensure that the Code in the rules and the regulatory objectives of the SROs are consistent with, and support, each other.

## III. Details of the Proposal

There will be separate codes of conduct for investment dealers, mutual fund dealers and portfolio managers. Many of the principles in these codes will be common but we feel there are enough differences among these groups that separate codes are necessary. The Code discussed in this paper is the one for investment dealers and illustrates the approach we will be taking to the other codes.

This Code applies to all "persons" (generally, these are firms) registered in the investment dealer category and, except for Principle 6, to representatives of those firms. The Code will be located in the *Securities Rules*.

Failure to follow the Principles set out in the Code could result in criminal liability, regulatory action and/or civil action for both investment dealers and their representatives.

The provisions of the Code that will appear in the Rules are in bold face type. The paragraphs that follow each Code provision will appear in the Guidelines.

## Principle 1 – Integrity and fairness

***Code and Guidelines***

**1. Meet appropriate standards of professional ethics, including honesty, integrity and fair dealing. Inform your client of all facts about your background that a reasonable client would consider important to the client-adviser relationship.**

The client-adviser relationship is based on trust. The client therefore needs to know everything about you, good and bad, that a reasonable client would want to know before entering that relationship.

You must act honestly and fairly in keeping with the highest professional and ethical standards. Conduct involving dishonesty, fraud, deceit or misrepresentation will violate this standard. Examples of this conduct are churning accounts or failing to be forthright with your client about your commissions or any limitation on your ability to service your client's investment needs. You should keep each client informed about your relevant employment and regulatory history.

Soliciting clients at their homes must be done within the bounds of fair dealing. You should do so only during reasonable times and you should respect an individual's request not to be contacted again. You should also make sure that the person making the call is not making statements that could be viewed as soliciting a trade in a security unless the person is registered. Firms may want to define employee policies for unsolicited communications with prospective clients to avoid infractions under the communication abuse sections of the *Competition Act* (Canada).

**2. Comply with all relevant laws and regulations that govern your profession and report infractions.**

You must keep yourself informed of the laws that govern your profession and you must abide by them. Apart from securities laws, this could include, for example, federal proceeds of crime and anti-terrorist legislation and some aspects of federal competition law. If you breach any relevant laws, report them to your firm; firms must report those infractions to the regulator.

***Discussion***

Principle 1 of the Code and the accompanying Guidelines replace:

- **Act, s. 49** ***Calling at or telephoning residence***
- **BC Instrument 33-506** ***Exemption from cold calling restrictions for Registered Dealers***

Section 49 of the Act prohibits calling at or telephoning residences, subject to some exceptions. It can be eliminated as communication abuses are covered by the *Competition Act* (Canada). BCI 33-506, which exempts certain registrants from the cold calling restrictions in the Act, is therefore also unnecessary once section 49 is repealed.

- **Act, s. 50(1)(c)** ***Representations prohibited***
- **Act, s. 54** ***Representation or holding out of registration***
- **Act, s. 55** ***Approval of commission or executive director not to be represented***
- **BC Notice 47-701** ***Blanket permission under section 50(1)(c) of the Securities Act***

Section 50(1)(c) of the Act prohibits a person from representing that a security will be listed unless the person first obtains the permission of the executive director. (BCN 47-701 provides blanket permission.) This section can be eliminated because section 50(1)(d), a more recent provision, contains a general prohibition against misrepresentations. It would be a misrepresentation to state that an issuer was expected to list its shares on an exchange if there is no reasonable basis for that statement, such as knowledge that the issuer had applied for a listing and that the application was being considered by the relevant exchange.

Sections 54 and 55 also prohibit specific misrepresentations (non-registrants holding themselves out as registrants, representations that the Commission has passed on the merits of a security, or the fitness of a registrant) and are also not necessary, for the same reason.

BCN 47-701 is unnecessary once 50(1)(c) is repealed.

- **Rules, s. 11** ***False representation prohibited***

This section says that a person must not use the words “portfolio manager”, “investment counsel”, “securities adviser” or “investment adviser”, or any other words in connection with the business of a person, in a way likely to deceive or mislead the public about the proficiency and qualifications of the person selling the securities. This provision is replaced by the requirement to be honest and to inform your client of all facts about your background set out in section 1 of Principle 1.

- **Rules, s.14** ***Fair dealing with clients***

This section requires a registrant to deal fairly, honestly and in good faith with the registrant’s clients. All of these obligations are covered by Principle 1.

- **Rules, s. 50** ***Information about registrant available on client’s request***

This section specifies certain information that a client can receive on request. Principles 1 and 6 impose a somewhat higher standard. They require registrants to inform clients about everything that is relevant to the adviser-client relationship, both at the time of opening the account and on an ongoing basis when there are material changes in that information.

## Principle 2 – Confidentiality

***Code and Guidelines***

**Hold in strict confidence all confidential information acquired in the course of the professional relationship with your clients, unless the client consents or the disclosure is required by law.**

In the course of your employment, you will receive information about the personal financial affairs of clients and prospective clients. You must keep that information in confidence. Receiving such information places you in a position of trust and responsibility and it is unethical to betray this trust in any way.

If personal information is disclosed, the damage to the client is the same whether the disclosure was willful or negligent.

You may disclose your client's confidential information in two, and only two, situations. First, you may disclose if you get the client's consent, preferably in writing. Second, you may disclose if you are required to do so by law. This includes legally enforceable requests for information from the Commission or your SRO, or the requirements of Canadian money laundering and anti-terrorist legislation.

***Discussion***

Principle 2 of the Code and the accompanying Guidelines replace:

- **National Instrument 33-102 *Regulation of certain registrant activities* (Part 3)**

Part 3 of this Instrument prohibits a registrant from disclosing client information to third parties except as required by law or the rules of an SRO, or if the client consents.

## Principle 3 – Proficiency

***Code and Guidelines***

**Maintain the proficiency, skill and diligence necessary to properly advise and serve your clients.**

Your SRO or the Commission will continue to set the minimum proficiency standards for entering the securities industry, as well as mandating continuing educational requirements. However, in a rapidly changing financial marketplace, you must keep abreast of changes in products, regulations and other factors that will affect your ability to provide high standards of service to clients. Education, including continuing education, is a necessary component of professional skill.

Firms have several additional factors to consider in establishing rules or guidelines for representatives, including:

- The criteria for requiring re-qualification when a representative has been out of the securities industry for a period of time.
- The training requirements applicable before a representative is permitted to sell new products.
- Policies regarding part-time employment by its representatives in occupations outside of the securities industry.
- The special training and skills requirements of representatives engaged in underwriting activity.

***Discussion***

Principle 3 of the Code and the accompanying Guidelines replace:

- **Rules, s. 60** ***Designated compliance officer and branch manager***
- **Rules, s. 61** ***Salesperson, trading partner, director or officer, advising employee or advising partner, director or officer***

These sections require certain individuals to meet proficiency requirements imposed by the executive director. Because of the broad obligation in Principle 3 to maintain appropriate proficiency, there is no need to prescribe this requirement.

- **Rules, s. 62** ***Rewriting industry exams***

This section requires a registrant who has been inactive for three or more years to rewrite the relevant exams. This provision does not apply to IDA members as the IDA has its own rules for rewriting industry exams (which are effectively the same as the Commission's). Since we think firms and their SRO should be allowed to determine the appropriate policies in this area, we can remove section 62 from the Rules.

- **Rules, s. 63** ***Salesperson employed other than full-time***

This section prevents salespersons from working outside of the securities industry unless they obtain the executive director's consent. Section 63 was enacted for two reasons. First, it is designed to prevent a salesperson from becoming involved in conflict of interest situations through outside employment. Second, it is thought to ensure the salesperson's proficiency in the securities industry by focusing that person's full attention on securities-related employment. The proficiency concern is addressed through Principle 3. The conflict of interest point is discussed under Principle 5. Therefore, we can eliminate section 63 of the Rules.

- **BC Instrument 33-502** ***Registration requirements for members of the IDA***

This Instrument exempts IDA members from sections 62 and 77 of the Rules (see Discussion of Principle 4 below). Since both of these sections are replaced by the Code, we can eliminate this Instrument.

## Principle 4 – Know your client and suitability

***Code and Guidelines***

**1. Learn the essential facts about each client, including the client's identity, credit worthiness and reputation.**

**2. Determine the general investment needs and objectives of the client, the appropriateness of the recommendations you make to that client and the suitability of a proposed trade for that client (unless the client is entitled to decline suitability advice).**

Principle 4 combines what have traditionally been referred to as the "know your client" and "suitability" rules.

The first part of the Principle, "know your client", requires you to understand the client's identity, background, financial position and character so you can fulfill your role as a "gatekeeper" to the market. If your client is not an individual, knowing your client means knowing the individuals that control the client, its business and its financial circumstances.

The second part of the Principle, "suitability", means understanding the client's financial circumstances, risk tolerance and investment objectives so you will be able to determine what is suitable when recommending or selling products and services.

You should make every effort to give your clients objective and impartial information about their financial needs, and advise them of their various options. You should identify and explain to the client all negative aspects, including risks, of your recommendations. You should have a reasonable basis for the recommendations you make to your client.

In addition to clearly describing the product or service for the client and the ways in which the transaction will fulfill the needs of the client, product information includes disclosure of important assumptions underlying any illustrations or examples that have been provided to the client, as well as the fact that actual results may differ significantly from those shown. You should avoid using examples or illustrations that you know, or ought to know, are based on unusual results or a period that generated much better that normally anticipated performance.

The suitability obligation requires you to advise your client on factors other than the features of the investment itself. For example, if your client intends to invest using borrowed money, a discussion of the risks of leveraged investing would be appropriate.

Currently, clients may refuse suitability only when dealing with IDA member firms, and then only in the limited circumstances prescribed by the IDA.

**3. Your conduct and the conduct of your clients must not bring the reputation of the securities market into disrepute.**

You and your clients must not engage in any activity that will lower the public's confidence in the integrity of the securities industry such as engaging in wash trading, high closing or other types of market manipulation. The Code does not allow you to turn a blind eye to the actions of your

clients. You must take all reasonable steps to determine if your client's actions are bringing the integrity of the securities markets into disrepute.

4. **If your client refuses to comply with regulatory requirements, you must cease to act on behalf of that client.**

You should use all reasonable efforts to ensure that your client understands the relevant regulatory requirements and their implications at all stages of a transaction. If you become aware that your client is not complying with regulatory requirements, you should inform your compliance officer and advise your client to bring the matter into compliance. If your client refuses or fails to do so, you must not continue to act on behalf of that client, and you should consider whether you should bring the client's activities to the attention of the regulators.

***Discussion***

Principle 4 of the Code and the accompanying Guidelines replace:

- **Rules, s. 35** ***Statement to be provided to prospective client***

This section states that when opening an account for a client, the registrant must give the client a written statement "in the required form". The form required under this section is BC Form 91-903F *Risk disclosure statement (exchange contracts)*. We would no longer mandate this form of disclosure. It would be up to the registrant to determine whether these risks were relevant to or appropriate for a given client. Therefore, we can eliminate section 35 of the Rules.

- **Rules, s. 48** ***Know your client and suitability rules***

This section contains the existing "know your client" and "suitability" rules. It is replaced by Principle 4.

- **National Instrument 33-102** ***Regulation of certain registrant activities*** **(Parts 2 and 6)**

Part 2 of this Instrument prescribes delivery of a written disclosure statement to the client about the risks of leveraged investing and Part 6 prescribes delivery of a written disclosure statement to clients dealing with a registrant in offices in financial institutions. These provisions are not needed because they are covered by the general obligation in Principle 4 to disclose all risks related to a proposed investment.

## Principle 5 – Conflict of interest

***Code and Guidelines***

1. **Take all reasonable steps to avoid situations that are likely to involve a conflict of interest.**

2. **Resolve all significant conflicts of interest in favour of the client, using fair, objective and transparent criteria. If there is a conflict of interest between clients, use fair,**

**objective and transparent criteria to resolve those conflicts. In both cases, apply the criteria consistently.**

Conflicts of interest arise frequently in the securities industry. This Principle makes it clear that the client's interests always come first. The best way to ensure this happens is to have appropriate procedures in place to ensure that all conflicts of interest between the firm or sales representative and the client are resolved in favour of the client and to have a system that effectively monitors and enforces compliance with those procedures. These procedures should cover conflicts of interest arising in the context of trading, advising, making recommendations, and exercising your discretion in managed accounts.

Sometimes the conflict of interest is not between registrant and client, but between clients. For example, a registrant sometimes has to decide how to allocate investment opportunities among clients when an issue is oversold. This is best resolved if the registrant has appropriate procedures in place to deal with these situations, and a system to monitor and enforce compliance with those procedures. For example, this does not mean that all clients must have equal access to an offering of securities; it is open to a registrant to vary the allocation according to the degree of business the firm does with a given client. The guidelines for making these determinations must be transparent to all clients.

The onus of showing that the registrant has acted in the best interests of the client is on the registrant. This onus would be difficult to meet in some situations, such as arrangements to which you are a party where clients are required or expected to deal with a particular financial institution in connection with a trade in a security or to purchase particular securities to obtain other financial goods or services.

**3. Develop conflict of interest avoidance procedures and describe them to the client.**

You must develop conflict of interest procedures that address the conflict situations that arise in your business specifically. Disclosure of potential conflicts of interest must take place before the conflicts arise. This may be before taking on a new client, or before making any recommendation to, or accepting any instructions from, the client.

Conflict procedures should be communicated to each client at the beginning of the business relationship and in a way that is understandable and useful to that client.

"Blanket" disclosure about routine compensation arrangements in general is appropriate so long as you disclose changes to those arrangements promptly. However, in other cases (for example, referral fees), disclosure should be made on a case-by-case basis so that the client can consider the information in the context of any decision the client needs to make in the circumstances giving rise to the compensation.

**4. Disclose promptly to the client any information that a reasonable client would consider important in determining your ability to provide objective service or advice.**

Conflicts that you cannot avoid should be managed appropriately. You must fully disclose to your clients all conflicts of interest and all potential conflicts of interest that you know, or ought to know about. Certain conflicts are inherent in the relationship between you and your clients, such as the remuneration of any sort paid to you for the distribution of units of a mutual fund to a

client and recommendations you make in selling proprietary products or services of your firm or an affiliated company.

You have an obligation to ensure that your clients are aware of and understand these conflicts. Even when you believe that your actions are not affected by the conflict, you must ensure that even an appearance of a conflict is adequately addressed.

One of the most important areas for full disclosure is anything to do with compensation you receive that is related to the work you do for the client or to your relationship with the client. You must disclose fees received or paid for client referrals, sharing compensation with someone else (commission splitting), contingency fees and any compensation incentives you receive in connection with the client or the client's business (for example, trailer fees). The disclosure must be made before the client is required to make a decision about the transaction in question.

For example, sometimes several products would be suitable for a client but one product pays you significantly higher commissions or fees. This should be disclosed, because a reasonable client would likely consider that this difference in your compensation could affect your objectivity.

**5. When acting as an underwriter, act in the best interests of the investors. Disclose to investors any direct or indirect relationships between you and the issuer or seller that would lead a reasonable investor to question whether you and the issuer or seller are in fact independent from each other.**

The role of the underwriter includes performing due diligence and negotiating the price and terms of the offering. In performing these functions, the underwriter is acting on behalf of the public investors. Even when the underwriter is unrelated to the issuer or seller of the securities being underwritten, there are conflicts of interest involved, such as the underwriter's desire to earn the commission and underwriting fee and to be considered by the issuer for future underwriting and advising work.

When the underwriter and the issuer are not independent, the potential for conflicts of interest increases. This section requires that underwriters act in the best interests of the investors. Underwriters will have to be particularly vigilant in situations where there is less than complete independence. The obvious situation is cross-ownership of the underwriter and the issuer, either directly or through a parent entity. However, there can be other relationships between an underwriter and the issuer, or parties affiliated with them, that would lead a reasonable investor to question whether the underwriter and issuer were in fact independent of each other.

The best way to ensure that these conflicts are resolved in favour of the investor is to have appropriate procedures to ensure that outcome and to have a system that effectively monitors and enforces compliance with those procedures.

This section requires you to disclose to the investor the circumstances of any relationship that could reasonably be perceived as less than completely independent. The disclosure should be sufficient so that the investor fully understands the nature of the conflict and its relevance to the underwriting transaction.

In some cases, the conflict may be so direct that you may conclude that following your ordinary procedures and making disclosure to investors may not be sufficient to remove the potential for

real conflict, or at least the apprehension of conflict in the mind of the reasonable investor. An example would be your underwriting an issue of your own securities. In those cases, you may conclude that an independent underwriter should be involved in the transaction in a meaningful role to alleviate any concerns over the potential for real conflict.

**6. When providing security analyst services you must develop, establish and enforce conflict of interest policies that adequately address the conflicts of interest faced by analysts within their firms.**

Analysts are exposed to increasing pressures from internal and external sources as well as conflicts of interest. As a result, their reports and recommendations are not always as objective, candid, or independent as they might be. In attempting to remedy this situation, you must develop conflict of interest policies that address conflicts for analysts specifically. Some policies you may want to consider would be the required disclosure by the analyst of specific conflicts of interest in each research report and recommendation issued on a company (for example, if the advisor holds a long or short position in the company's shares). We also recommend that the disclosure be readable and displayed prominently, whether printed or disseminated electronically. You may also want to consider preventing any analyst employed by you from issuing research on a company when the analyst serves as an officer, director or employee of, or serves in any advisory capacity to, the company.

***Discussion***

Principle 5 of the Code and the accompanying Guidelines replace:

- **Rules, s. 16** ***Registrant's interest in other registrants***

This section requires the executive director's approval before a registrant or other specified person may have an interest in a dealer, underwriter or adviser. The conflict of interest obligations in Principle 5 are adequate to address any issues arising from these relationships.

- **Rules, s. 53** ***Disclosure of referral fees and commission splitting***
- **Rules, s. 54** ***No contingent fees without client's consent***

These sections require registrants to disclose to the client any referral fees and commission splitting, and prohibit registrants from charging contingency fees without the client's prior consent. Principle 5 deals with these situations and we discuss them as examples in the accompanying Guidelines. We do not specifically require prior consent to contingency fee arrangements, but section 4 of Principle 5 says that registrants must provide the information that section requires promptly. We would expect registrants to disclose contingency fees on the opening of an account that was established on a contingency basis, or on a trade-by-trade basis if the account was not set up on that basis generally. Either way, the client would have the information before trading.

- **Rules, s. 63** ***Salesperson employed other than full-time***

This section prevents salespersons from working outside of the securities industry unless they obtain the executive director's consent. Section 63 was enacted for two reasons. First, it is designed to prevent a salesperson from becoming involved in conflict of interest situations

through outside employment. Second, it is thought to ensure the salesperson's proficiency in the securities industry by focusing that person's full attention on securities-related employment. We do not think it is necessary to retain this restriction since the conflict of interest provisions in Principle 5 require that registrants put their clients' interests before their own. The proficiency concern is dealt with in Principle 3.

- **Rules, s. 75** ***Interpretation***

This section contains the definitions for Division 11 of the Rules *Registrants' Conflicts of Interest*. Since all of Division 11 is replaced by Principle 5, we can eliminate this provision. Note that section 76 of the Rules will be dealt with in connection with enforcement and Commission powers and sections 78 and 84 have been repealed.

- **Rules, s. 77** ***Conflict of interest rules statement***
- **BC Form 33-907F** ***Conflict of interest rules statement***
- **BC Form 33-908F** ***Statement and undertaking***

Section 77 of the Rules requires registrants to give specified disclosure about conflicts of interest to the client at the time the account is opened. (BCF 33-907F prescribes the disclosure.) It also exempts registrants from making the disclosure if the conflict scenarios that the mandated disclosure covers do not apply to them. To use the exemption, the registrant must file another form (BCF 33-908F) with the Commission.

Principle 5 replaces section 77 and both forms. Registrants are required to resolve conflicts in favour of the client. As well, unique conflicts in the underwriting area require registrants to put the interests of the client and the market first. The guidelines suggest that registrants put procedures in place to ensure these outcomes, and provide for transparency to the client by disclosure to the client on request. We think this is a more effective regime because it ensures that when disclosure is requested, the client will get information directly relevant to the procedures used by his or her registrant, rather than boilerplate disclosure at the time of account opening that provides little useful information.

- **Rules, s. 79** ***Limitations on trading***
- **Rules, s. 81** ***Limitations on advising***
- **Rules, s. 82** ***Limitations on the exercise of discretion***
- **Rules, s. 83** ***Limitations on recommendations***

These sections require specified conflict of interest disclosure in certain trading, advising and recommending situations, and when a registrant is managing a discretionary account. They are replaced by section 4 of Principle 5

- **Rules, s. 80** ***Confirmation and reporting of transactions***

This section requires specified disclosure in related-party situations to be included in the confirmation notice. The provision is no longer necessary since section 4 of Principle 5 requires the investor to be informed about conflict information.

- **Rules, s. 85 *Exceptions***

This section provides exemptions from Division 11 of the Rules. Since Principle 5 replaces Division 11, we can eliminate this section.

- **National Instrument 33-102 *Regulation of certain registrant activities* (Section 3.2 and Parts 4 and 5)**

Section 3.2 of this Instrument prohibits a registrant from requiring a client to disclose confidential information as a condition of supplying products or services to that client unless the client requests a product or service for which the method of settlement requires disclosure of client information.

Part 4 states that no registrant shall require a client to settle their account through the client's financial institution as a condition of supplying products or services.

Part 5 states that no person or company shall require another person or company to invest in particular securities as a condition of supplying products or services.

All of these provisions will be replaced by Principle 5. It is difficult to see how a registrant that was a party to these sorts of arrangements would be avoiding conflicts with the client or resolving them in the client's favour.

- **National Instrument 33-105 *Underwriting Conflicts* and related companion policy**

This Instrument would be replaced by section 5 of Principle 5. The companion policy to NI 33-105 says that the ideal underwriting relationship features complete independence between the issuer and the underwriter. Recognizing that these relationships are not always completely independent, NI 33-105 requires disclosure of less than independent relationships and requires the involvement of an independent underwriter in some circumstances.

The Instrument is extremely complex and in our view goes into more detail than is necessary to deal with this issue. However, it contains a useful test for defining a relationship that is not independent: one that "would cause a reasonable prospective purchaser of the securities being offered to question if the registrant and the issuer or selling security-holder are independent of each other for the distribution". We have used this test (in slightly redrafted form) as the primary test for determining whether independence is compromised and whether, as a result, disclosure must be made.

We have retained the requirement to disclose the conflicts but have not mandated the content of the disclosure. Instead, in the Guidelines, we state our expectation that the disclosure be sufficient so that the investor fully understands the nature of the conflict and its relevance to the underwriting transaction.

We do not mandate the use of an independent underwriter, although in the Guidelines we suggest circumstances when that should be considered. When an independent underwriter is used, we do not prescribe the role the underwriter should play. We suggest in the Guidelines that the role be meaningful in alleviating concerns over the potential for real conflict.

## Principle 6 – Compliance systems

***Code and Guidelines***

**1. Maintain an effective system to ensure compliance with this Code, all applicable regulatory and other legal requirements and your own internal policies and procedures.**

You are required to develop, implement and monitor a written compliance system that satisfies the requirements of the Code. The system you develop should be effective for your firm and its business procedures.

**2. Ensure that your compliance function possesses the technical competence, adequate resources and experience necessary for the performance of its functions.**

An effective system will provide for monitoring compliance with the system. This usually requires:

- staff, sufficient in number, independence and authority to effectively operate and enforce the system, and
- regular audits of the system's effectiveness.

If you have multiple branches you should consider the need for a compliance person in some or all of those branches. Perhaps the best way to achieve effective compliance is to have the compliance function in your firm independent from other functions and have the compliance reporting relationship reflect this. In small firms with few employees, senior management should assume compliance responsibilities.

**3. Ensure that all of your staff members who engage in trading or advising activities are appropriately qualified and supervised.**

You are responsible for all trading and advising activities by your representatives and therefore you must not only hire people with the appropriate qualifications but also supervise them. Those in supervisory positions should have sufficient experience to do so and should also be fully familiar with the firm's compliance system.

**4. Provide clients with all the information that a reasonable client would consider important respecting all transactions that you conduct on the client's behalf at the time of the transaction and on an ongoing basis.**

You should promptly send the client all relevant information relating to a trade, having regard to the type of security being traded. This includes the particulars of the trade, any consideration paid by the client in connection with the trade and any information about conflicts of interest that apply to the trade (see Principle 5). Relevant information would also include anything the client will need to know to prepare and file income tax returns.

You should send your clients statements that keep them informed about the status of their accounts and about the activity in the account since the last statement. The objective is to ensure the client has information on a current basis that is reasonable in the circumstances.

This would normally mean monthly, however, less frequent reporting may be reasonable in some circumstances (for example, if the volume and frequency of trading in the account is low, or if the client requests less frequent reporting).

**5. Separate underwriting functions from the firm's trading and advising functions.**

If you carry out both underwriting activities and trading or advising activities, you need to be particularly careful about information about upcoming offerings being generally accessible. You will need to ensure there is an effective system of functional barriers (known as "Chinese walls") to prevent the flow of information that may be confidential or price sensitive between the corporate finance group and the trading and advising groups. Lapses in this area may lead to allegations of tipping or trading on inside information.

**6. Notify the Commission immediately of any significant change in the information relating to the registration, and of the hiring or termination (including reasons), of any trading or advising representative.**

The information you provided when you registered as a firm or an individual is important to the Commission's assessment of your fitness as a registrant and to the Commission's ability to maintain contact with you. Therefore, any change in this information is significant and you must disclose it to the Commission.

You should fully disclose the circumstances of any termination, especially if your representative breached any provisions of the Code and this played any part in the termination. When asked by the regulators about a possible breach of a relevant regulation (whether committed by you or by your client), you should respond cooperatively and truthfully.

In the case of dually licenced individuals, it is the firm's obligation to inform the Commission of breaches by those individuals of other regulatory requirements because this goes to the person's character and suitability to be employed in the securities industry. For example, if the individual is an employee of a bank-owned investment dealer and is terminated for breaching a bank-related rule, you must inform the Commission of the reasons for that termination.

***Discussion***

Principle 6 of the Code and the accompanying Guidelines replace:

- **Act, s. 42** ***Notice of change***

This section sets out when registrants must notify the Commission of changes to their registration. Principle 6 broadens the requirement to include any changes to information previously provided to the Commission. In addition, we have incorporated some of the circumstances described in section 42 into the Guidelines to Principles 1 and 6 to clarify that information about changes to a registrant's registration may be important to clients as well.

- **Act, s. 51** ***Registered dealer acting as principal***

This section states that if a registered dealer intends, as principal, to effect a trade in a security with a person who is not a registered dealer, the registered dealer must disclose in all

advertising that it proposes to act as a principal to the trade. Section 4 of Principle 6 replaces this section of the Act.

- **Rules, s. 36** ***Confirmation of purchase or sale***

This section requires different confirmation notices for various types of securities. The SROs specify the form and delivery requirements relating to trade confirmations. Therefore, there is no need for the Commission to mandate detailed requirements in this area. Even if the SROs did not have the requirements they do, we would not mandate the current detailed requirements. Principle 6 imposes an obligation on the firm to provide the information that is important to the reasonable client having regard to the type of security being traded. Therefore, it is unnecessary to prescribe different forms of confirmations for different types of securities. This approach also provides a test for confirmations for new investment products developed in the future that are not specifically contemplated under existing rules.

- **Rules, s. 38** ***Statement of account***

This section specifies how often a registrant must provide statements of account and sets out what the statements must contain. The SROs specify the form and delivery requirements relating to statements of account. Therefore, there is no need for the Commission to mandate detailed requirements in this area. Even if the SROs did not have the requirements they do, we would not mandate the current detailed requirements. Under Principle 6, the firm must provide the information that is important to the reasonable client on an ongoing basis. In contrast to the prescriptiveness of section 38 of the Rules, this Principle also allows firms the flexibility to tailor their account reporting practices to the level of activity in the account and the client's wishes.

- **Rules, s. 44** ***Registrant's business procedures***

This section states that a registrant must establish and apply written prudent business procedures for dealing with clients in compliance with the Act and the regulations. Principle 6 replaces this section.

- **Rules, s. 45** ***Underwriter's due diligence procedures***

This section requires an underwriter to establish and apply written prudent business procedures or other safeguards for underwriting distributions of securities made by way of prospectus or offering memorandum. Principle 6 replaces this section.

- **Rules, s. 46** ***Investment dealer's and mutual fund dealer's guidelines***

This section states that an investment dealer will comply with section 44 of the Rules if it follows the bylaws, rules or other regulatory instruments or policies relating to dealing with clients established by a recognized SRO. This section is no longer needed once section 44 is replaced.

- **Rules, s. 49** ***Explanation of relevant terms and conditions***

This section requires a dealer or adviser, on a client's request, to explain the terms and conditions of an exchange contract. This will be covered by the general obligation to inform the client under Principle 6.

- **Rules, s. 47** ***Responsibility for opening new accounts and supervising***
- **Rules, s. 65** ***Designated compliance officer required***
- **Rules, s. 66** ***Branch manager required***

Section 47 states that a registrant must designate a compliance officer and a branch manager. This is replaced by Principle 6, which now provides firms more flexibility in developing compliance systems that work for their particular business.

Section 65 states that a dealer, underwriter or adviser must designate at least one individual as compliance officer, and section 66 requires a dealer or adviser that has a branch office to employ a branch manager who is approved by the executive director and who ensures that the branch complies with the Act and regulations. This is dealt with in the Guidelines about appropriate supervisory systems in Principle 6.

## Principle 7 – Client complaints

***Code and Guidelines***

**Create and use adequate procedures for handling client complaints effectively.**

You must deal directly with all formal and informal complaints or disputes or refer them to the appropriate person or process, in a timely and forthright manner. You should be fully aware of all applicable processes for dealing with complaints and should disclose to all clients the channels available for pursuing different types of complaints (for example, regarding conduct, service, or product performance).

Some registrants are also registered to do business in other sectors, such as insurance. In this case, you must inform clients of the differing complaint resolution mechanisms for each sector in which you do business and how the clients can use those mechanisms.

It is good business practice to provide a written response to any client who complains about you or your firm.

***Discussion***

Principle 7 of the Code does not replace any existing provisions.

## IV. What the Code of Conduct Replaces

This table sets out the current provisions governing registrants that the Code replaces:

| Current provision | Replaced by |
|---|---|
| Act, s. 49 *Calling at or telephoning residence*<br>Act, s. 50(1)(c) *Representations prohibited*<br>Act, s. 54 *Representation or holding out of registration*<br>Act, s. 55 *Approval of commission or executive director not to be represented*<br>Rules, s.11 *False representation prohibited*<br>Rules, s.14 *Fair dealing with clients*<br>Rules, s. 50 Information about registrant available on client's request<br>BCI 33-506 *Exemption from cold calling restrictions for Registered Dealers*<br>BCN 47-701 *Blanket permission under section 50(1)(c) of the Securities Act* | **Principle 1 – Integrity and fairness** |
| NI 33-102 *Regulation of certain registrant activities* (Part 3) | **Principle 2 – Confidentiality** |
| Rules, s. 60 *Designated compliance officer and branch manager*<br>Rules, s. 61 *Salesperson, trading partner, director or officer, advising employee or advising partner, director or officer*<br>Rules, s. 62 *Rewriting industry exams*<br>Rules, s. 63 *Salesperson employed other than full-time*<br>BCI 33-502 *Registration requirements for members of the IDA* | **Principle 3 – Proficiency** |
| Rules, s. 35 *Statement to be provided to prospective client*<br>Rules, s. 48 *Know your client and suitability rules*<br>NI 33-102 *Regulation of certain registrant activities* (Parts 2 and 6) | **Principle 4 – Know your client and suitability** |
| Rules, s. 16 *Registrant's interest in other registrants*<br>Rules, s. 53 *Disclosure of referral fees and commission splitting*<br>Rules, s. 54 *No contingent fees without client's consent*<br>Rules, s. 63 *Salespersons employed other than full time*<br>Rules, s. 75 *Interpretation*<br>Rules, s. 77 *Conflict of interest rules statement*<br>Rules, s. 79 *Limitations on trading*<br>Rules, s. 80 *Confirmation and reporting of transactions*<br>Rules, s. 81 *Limitations on advising*<br>Rules, s. 82 *Limitations on the exercise of discretion*<br>Rules, s. 83 *Limitations on recommendations*<br>Rules, s. 85 *Exceptions*<br>NI 33-102 *Regulation of certain registrant activities* (Section 3.2 and Parts 4 and 5)<br>NI 33-105 *Underwriting Conflicts*<br>BC Form 33-907F *Conflict of interest rules statement*<br>BC Form 33-908F *Statement and undertaking* | **Principle 5 – Conflict of interest** |

| Current provision | Replaced by |
|---|---|
| Act, s. 42 *Notice of change*<br>Act, s. 51 *Registered dealer acting as principal*<br>Rules, s. 36 *Confirmation of purchase or sale*<br>Rules, s. 38 *Statement of account*<br>Rules, s. 44 *Registrant's business procedures*<br>Rules, s. 45 *Underwriter's due diligence procedures*<br>Rules, s. 46 *Investment dealer's and mutual fund dealer's guidelines*<br>Rules, s. 47 *Responsibility for opening new accounts and supervising*<br>Rules, s. 49 *Explanation of relevant terms and conditions*<br>Rules, s. 65 *Designated compliance officer required*<br>Rules, s. 66 *Branch manager required* | **Principle 6 – Compliance systems** |
| Principle 7 does not replace any existing provisions | **Principle 7 – Client complaints** |

## V. What the Code of Conduct Does Not Replace

The Code does not contemplate the following provisions of the Act and Rules:

**Act**

- s. 34 *Persons who must be registered*
- s. 35 *Granting registration*
- s. 36 *Conditions imposed on registration and registrants*
- s. 37 *Subsequent application*
- s. 38 *Further information may be required from applicant*
- s. 39 *Compliance review of registrant*
- s. 40 *Termination or suspension of employment*
- s. 41 *Surrender of registration*

**Rules**

- *Division 2 Categories of Dealers and Advisors and Related Provisions*
  - s. 13 *Refusal to register or to renew registration*

- *Division 3 Registration - General*
  - s. 15 *Jurisdiction of organization or incorporation of registrants*
  - s. 17 *Executive Director's conditions of registration*

- *Division 4 Capital and Bonding (ss. 19-25)*
- *Division 5 Record keeping and reporting (*ss. 26-42, except ss. 35, 36 and 38)

- *Division 6 Client accounts and statements of account and portfolio* (ss. 43-59, except ss. 44 – 50 and 53 – 54)
- *Division 8 Registration and amendments to registration* (ss. 64, 67 and 68)
- *Division 9 Financial statements and financial reports* (ss. 69-72)
- *Division 10 Registrant ownership and diversification requirements* (ss. 73-85, except ss. 75, 77, 79 – 85)

# CHAPTER 2
# REGISTRATION

## Part 2: Registration Exemptions

## I. Summary

We are proposing a streamlined, simplified set of exemptions from the registration requirement. These exemptions reflect the simpler regime possible in a CMA environment (see Chapter 1), as well as changes in the financial services industry and our enforcement experience. The regime preserves registration exemptions that exist today for reporting issuers and that have companion prospectus exemptions.

## II. Background

In the Concept Paper published in February 2002, we noted that the existing registration exemptions are, for the most part, worded identically to the prospectus exemptions, which contain conditions intended to address disclosure and resale issues. These conditions are not relevant to whether registration exemptions should be granted.

We suggested that the registration exemptions could be dramatically simplified. We have identified 88 different exemptions from registration that are currently in effect in BC. Under the Proposal, these are reduced to 24. [2]

## III. Details of the Proposal

### 1. Exemptions from registration as a dealer

In this paper, we refer to exemptions from dealer registration as “trading exemptions”.

Trading exemptions are provided for various reasons:

- The buyer does not need the protection of a registrant, or a registrant is already involved in the trade.
- The public is protected because the seller is regulated under another regime.
- The circumstances of the transaction or the type of security do not require the involvement of a registrant.

[2] See Appendix G, a table of concordance between current registration exemptions and the simplified registration exemptions we are proposing.

The text of each proposed exemption is included below, along with a discussion of how we propose to deal with the existing BC exemptions[3]. All proposed exemptions will be in the Rules.

## *A. Proposed trading exemptions based on the buyer or the involvement of a registrant*

The first set of proposed trading exemptions are available because the buyer does not need the protection a registrant provides, or a registrant is already involved in the trade.

**(1)(a) *Trades to or through a dealer:* A person is not required to register to trade securities or exchange contracts to or through a person registered as a dealer in any province or territory of Canada.**

This exemption is necessary because the definition of "trade" includes any sale of a security. Those persons who sell securities through a registrant or to a registrant do not need to be registered themselves. The proposed exemption consolidates and replaces these existing exemptions (all of which involve trades where a registrant is a party to the trade or an agent facilitating the trade):

- **Act, s. 45(2)(7) *Trade solely through registered dealer***
- **Act, s. 45(2)(16) *Trade to an underwriter or between underwriters***
- **Act, s. 45(2)(26) *Trade to underwriter for services in connection with a distribution of securities***
- **Act, s. 47(a) *Trade of exchange contract solely through a registered dealer***

The proposed exemption also preserves the relief currently contained in BC Instrument 35-501 *Remote access trades on the Canadian Venture Exchange*, which allows for trading by extra-provincial registrants through the facilities of TSX Venture Exchange, formerly the Canadian Venture Exchange. It is not necessary to retain this Instrument.

**(1)(b) *Trades to an exempt purchaser*: A person is not required to register to trade securities to exempt purchasers acting as principal, or for persons referred to in paragraph (i) or (ii) of the definition of *accredited investor*, purchasing for accounts fully managed by those persons.**

Most exempt purchasers have a relationship with the issuer or its principals and do not need the protections of a registrant. The definition of "exempt purchaser" follows.

[3] The bare text of legislative type provisions, including text for the proposed simplified exemptions, is found in Appendix A.

**"exempt purchaser" means:**

**(a) a director, officer, promoter, or control person of the issuer or an affiliate of the issuer,**
**(b) a spouse, parent, grandparent, brother, sister, or child of a director, senior officer or control person of the issuer or an affiliate of the issuer,**
**(c) a close personal friend or close business associate of a director, senior officer or control person of the issuer or affiliate of the issuer,**
**(d) an employee or consultant of the issuer or an affiliate of the issuer or an employee of a company providing management services to the issuer,**
**(e) a vendor of a property or other asset to the issuer or an affiliate of the issuer,**
**(f) an existing securityholder, and**
**(g) an accredited investor, meaning**
- **(i) a Canadian financial institution or its wholly owned subsidiary, or an equivalent entity in another jurisdiction,**
- **(ii) a registered dealer or adviser, an adviser exempt from the registration requirement under section 86 of the Rules,[4] an equivalent entity in another jurisdiction or a representative of the dealer, adviser or entity,**
- **(iii) any government, municipality, government agency, public board or commission,**
- **(iv) a pension fund that is regulated by the Office of the Superintendent of Financial Institutions (Canada) or a provincial pension commission or a similar regulatory authority in any jurisdiction,**
- **(v) a registered charity under the *Income Tax Act* (Canada) or an equivalent entity in another jurisdiction,**
- **(vi) an individual who, either alone or jointly with a spouse, beneficially owns, directly or indirectly, financial assets having an aggregate realizable value that before taxes, but net of any related liabilities, exceeds $1,000,000,**
- **(vii) an individual whose net income before taxes exceeded $200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded $300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year,**
- **(viii) a corporation, limited partnership, limited liability partnership, association, trust or estate, that had net assets of at least $5,000,000 as shown on its most recently prepared financial statements, and any wholly owned subsidiary,**
- **(ix) a mutual fund or non-redeemable investment fund if**
  - **(A) all securityholders of the fund are accredited investors, or**
  - **(B) it files continuous disclosure as a public mutual fund or non-redeemable investment fund,**
- **(x) a person if all of the owners of interests in the person are accredited investors, and**
- **(xi) a person recognized by the commission as an accredited investor.**

[4] This is the current exemption for investment dealers and their directors, officers, partners and advising employees if they follow IDA rules for portfolio managers. We propose, later in this Part of Chapter 2, that this exemption be retained.

The exempt purchaser exemption replaces all of these existing exemptions:

- **Act, s. 45(2)(2)** ***Trades to Business Development Bank, savings institutions, insurers, others***
- **Act, s. 45(2)(4)** ***Trades to exempt purchasers***
- **Act, s. 45(2)(6)** ***Asset acquisition, prescribed amount***
- **Act, s. 45(2)(8)** ***Rights offering***
- **Act, s. 45(2)(10)** ***Trades to directors, officers, employees***
- **Act, s. 45(2)(11)** ***Dividend reinvestment plan***
- **Act, s. 45(2)(12)** ***Stock dividend, dissolution, or winding up, or exercise of right to purchase, convert, or exchange***
- **Act, s. 45(2)(14)** ***Dividend in specie***
- **Act, s. 45(2)(17)** ***Trade to promoter or between promoters***
- **Act, s. 45(2)(18)** ***Trade between control persons***
- **Act, s. 45(2)(21)** ***Trade for acquisition of mining, oil or gas property***
- **Act, s. 45(2)(22)** ***Trade in mutual fund security where net asset value/aggregate acquisition cost not less than prescribed amount***
- **Act, s. 45(2)(25)** ***Securities issued as reinvestment of dividends or distributions of income or capital gains by mutual funds***
- **Rules, s. 89(d)** ***Trade by beneficial owner of escrow securities under terms of escrow agreement***
- **Rules, s. 89(f)** ***Management company employees***
- **Multilateral Instrument 45-103** ***Capital raising exemptions (Parts 3 and 5)***
- **BC Instrument 45-504** ***Trades to trust companies, insurers, and portfolio managers outside BC***
- **BC Instrument 45-507** ***Trades to employees, executives, and consultants***

***Escrow***

The proposed exempt purchaser exemption is slightly narrower than that currently provided in section 89(d) of the Rules (a provision unique to BC). That section provides a registration exemption for trades within escrow. Paragraph (a) of the proposed definition of exempt purchaser covers virtually all potential escrow holders.

**Request for Comment 4: Is the proposed exempt purchaser exemption broad enough to cover all important groups of potential escrow holders?**

***Close personal friend or business associate***

Like MI 45-103, paragraph (c) of the proposed definition of exempt purchaser also refers to "close personal friend" and "close business associate". These terms are discussed in the companion policy to MI 45-103 and in each case there must be a direct relationship between the person and the principals of the issuer. Essentially, these friends and associates must have known, or had sufficient prior business dealings with, the principals of the issuer for a sufficient period of time to be able to assess the capabilities and trustworthiness of the principals.

***Management company employees***

The current exemption in section 89(f) of the Rules for management company employees (a provision unique to BC) is important for many companies in the junior market who need to retain outside management help. Therefore, this exemption is maintained in (d) of the proposed exempt purchaser definition.

***Accredited investors***

Accredited investors do not have a relationship with the issuer or its principals but are considered to have either the capacity to obtain and analyze the information needed to assess a particular investment opportunity without the assistance of a registrant, or the means to withstand significant investment losses. Accredited investors include institutional investors, such as financial institutions, governments, pension plans and mutual funds, as well as large corporations and wealthy individuals.

The proposed definition of accredited investor is similar to that found in MI 45-103 and Ontario Securities Commission Rule 45-501 *Exempt Distributions*. We have simplified the definition to make it easier to use. We will discuss this proposed, simplified definition with our colleagues in other Canadian jurisdictions. Ultimately, a single definition of accredited investor will be included in the Uniform Securities Act.

Under the proposed exemption (specifically, in (g)(xi) of the exempt purchaser definition), the Commission can recognize a person as an accredited investor.

***Portfolio managers outside Canada***

The current exemption in BCI 45-504 has a minimum portfolio requirement to discourage use of the exemption by unregulated persons posing as portfolio managers. We address this concern through the proposed definition of accredited investor, which includes only foreign entities that are equivalent to an exempted Canadian entity.

**(1)(c) *Trades in securities of restricted issuers:* A person is not required to register to trade securities of a restricted issuer.**

This proposed exemption complements the CMA system concept that restricted issuers are completely outside the regulated market, so long as the requirements for offering securities in the exempt market are met (see Chapter 1). It also duplicates the exempt purchaser exemption in proposed exemption (1)(b) so that CMA issuers can also use it.

The proposed exemption replaces the private issuer and offering memorandum registration exemption in MI 45-103 (Parts 2 and 4).

**(1)(d) *Trades in securities back to the issuer*: A person is not required to register to trade securities to the issuer of those securities.**

This proposed exemption allows securityholders to return their securities to the issuer. Because they are already securityholders and, as such, have information about the issuer, the protections of a registrant are not required.

The proposed exemption replaces section 45(2)(29) of the Act (*Trades to issuers as purchases, redemptions, or acquisitions by the issuer*).

## *B. Proposed trading exemptions based on the protections of another regime*

The second set of proposed exemptions are available because the seller is regulated under other financial regulation regimes and, therefore, the protection of a registrant is not necessary.

**(1)(e) *Trades in non-syndicated mortgages under mortgage brokerage legislation*: A person is not required to register to trade mortgages sold under [legislation governing mortgage brokers], provided the mortgages are not syndicated mortgages.**

**"syndicated mortgage" means an investment arrangement in which a person participates, together with others, as a mortgagee through the acquisition of a portion of a debt obligation that is secured by a mortgage.**

This proposed exemption allows mortgage brokers to sell mortgages that are not syndicated mortgages. The use of a registrant is not required because securities registrants do not have knowledge of mortgages that would enhance investor protection. It replaces existing exemptions found in the section 46(e) of the Act (*Mortgages sold by a mortgage broker*) and in BC Instrument 45-501 *Mortgages.*

The syndicated mortgage definition is unchanged from the definition in BCI 45-501. Syndicated mortgages can be sold to accredited investors or with an offering memorandum. The existing exemption in BCI 45-501 for sales of "qualified syndicated mortgages" (syndicated mortgages on residential property with no more than four units and that meet other conditions) is removed under the Proposal.

**(1)(f) *Trades in real estate securities sold by a licensed real estate agent*: A person is not required to register to trade real estate securities if the person is licensed or exempted from licensing under [legislation governing real estate].**

This proposed exemption allows licensed real estate agents to sell real estate securities. The use of a registrant is not required because securities registrants do not have knowledge of real estate securities that would enhance investor protection.

The proposed exemption consolidates and replaces three existing exemptions:

- **Act, s. 46(k)** ***Securities of real estate co-op that evidence right to use part of land owned by co-op***
- **BC Instrument 45-512** ***Real estate securities***
- **BC Instrument 45-513** ***Resale relief for real estate securities***

**(1)(g)** ***Trades in variable insurance contracts issued by an insurer and sold by a licensee under financial institution legislation*****: A person is not required to register to trade variable insurance contracts issued by an insurer and sold by a person licensed or exempted from licensing under [legislation governing financial institutions].**

This proposed exemption allows a person licensed to sell insurance to sell variable insurance contracts (including segregated funds) and replaces the existing exemption found in section 46(l) of the Act.

Unlike section 46(l), the proposed exemption does not limit the kinds of variable insurance contracts that trigger the exemption. The assumption we made is that since insurance products and agents are licensed, investors are adequately protected. We will review the entire range of variable insurance contracts currently available, and the product regulation and agent conduct regulation that applies to them, to confirm that our assumption is valid.

**(1)(h)** ***Trades outside Canada:*** **A person is not required to register to trade to persons or through markets outside Canada in compliance with applicable foreign laws.**

This is a new exemption. It allows Canadians to sell securities to someone outside Canada in compliance with foreign law without the need to hire a registrant. It also allows Canadians to trade securities through markets outside Canada in compliance with applicable foreign law. Generally speaking, the Commission would not be concerned if the foreign market is regulated by a foreign regulator.

Currently, we have two exemptions from the prospectus requirements for trades made on markets outside Canada (BC Instrument 72-501 *Prospectus exemptions for trades in securities of a non-reporting issuer over a market outside Canada* and BC Instrument 72-502 *Trades in securities of US registered issuers*). The prospectus exemptions in these two Instruments are no longer needed in a CMA system (see Chapter 1). The new exemption provides registration relief in similar but broader circumstances.

**(1)(i)** ***Unsolicited trades with foreign dealers*****: A person is not required to register to trade solely through a dealer registered outside Canada if the dealer does not solicit business from residents in Canada.**

The solicitation test in this proposed exemption would apply to the formation of the relationship between the foreign dealer and the client, not on a trade-by-trade basis. Solicitation would include any promotional activity directed specifically at residents in Canada. Solicitation would not include mere exposure of the foreign dealer to Canadians through normal course advertising that Canadians might happen to see (for example, the dealer's website, or advertising on US channels carried on Canadian cable or satellite TV systems).

This proposed exemption replaces two existing exemptions:

- **Act, s. 47(b)** ***Trade resulting from unsolicited order placed with non-resident individual who does not carry on business in BC***
- **National Instrument 35-101** ***Conditional exemption from registration for US broker-dealers and agents***

## *C. Exemptions based on the type of transaction or type of security*

The third set of proposed trading exemptions are available because of the type of transaction or security in question.

**(1)(j)** ***Trades in securities in connection with a corporate reorganization or take over bid:*** **A person is not required to register to trade securities in connection with a reorganization, merger, take over bid, or other business combination.**

This proposed exemption allows securityholders to trade their shares in connection with various business combinations and bids. Given their relationship to one of the issuers that is involved in the transaction and the fact that disclosure about the transaction is available, securityholders can participate in these transactions without going through a registrant. If securityholders want advice in connection with these transactions, they are free to discuss the matter with their brokers or other advisers.

The proposed exemption consolidates and replaces these existing exemptions:

- **Act, s. 45(2)(9)** ***Amalgamation, merger, reorganization or arrangement***
- **Act, s. 45(2)(24)** ***Trade of security of offeree issuer to offeror under take over bid or issuer bid***
- **Act, s. 45(2)(28)** ***Trade in securities of offeror exchanged with securityholders of offeree under take over bid or issuer bid***

**(1)(k)** ***Trades in securities issued to satisfy debt or as consideration for a bonus or finder's fee:*** **A person is not required to register to trade securities issued to satisfy debts or as consideration for a bonus or finder's fee.**

Under this proposed exemption, an issuer can satisfy its debts with shares or use shares to pay a bonus for a loan guarantee or to pay a finder's fee. These exemptions are important for junior market issuers.

A person who previously loaned money to the issuer or has arranged a loan or found buyers for the issuer's securities does not need the protection of a registrant when receiving shares from that issuer.

The proposed exemption consolidates and replaces two existing exemptions:

- **Rules, s. 89(c)** ***Security for debt***
- **Rules, s. 89(e)** ***Bonus or finder's fee***

**(1)(l)** ***Trades by a senior issuer that is in the CMA system in its own securities with mandated disclosure to purchasers:*** **A person is not required to register to trade securities of a senior issuer that is in the CMA System if:**

**(i) no consideration is paid to any person in connection with the trade,**

**(ii) the issuer does not give any advice regarding the merits or suitability of the securities, and**

**(iii) every person who is solicited to purchase the securities from the issuer is notified as required by the Rules.**

This proposed exemption allows a senior CMA issuer to sell securities to investors if the issuer advises the buyer where information about the issuer can be found and that the investor is not receiving any advice. The exemption is described in detail in Chapter 1.

**(1)(m)** ***Trades in senior debt securities*****: A person is not required to register to trade:**

**(i) debt securities or options to acquire those debt securities, issued or guaranteed by, the government of Canada or a province or territory of Canada,**

**(ii) debt securities or commercial paper rated at the level, and by a rating agency, designated by the executive director,**

**(iii) strip bonds or zero interest bonds guaranteed by the Government of Canada or by a province or territory of Canada, or**

**(iv) certificates and receipts for money received for guaranteed investments issued by regulated financial institutions whose deposits are insured by an agency of the government of Canada or a province or territory of Canada.**

These proposed exemptions change current exemptions to reflect the changing nature of the Canadian financial services industry. Debt securities have been divided into two groups: (1) debt of the federal government or a provincial or territorial government, and (2) other rated debt.

The proposed exemption consolidates, replaces, and varies several existing exemptions:

- **Act, s. 46(a)(i)** ***Bonds, etc. of or guaranteed by governments***
- **Act, s. 46(a)(ii)** ***Bonds, etc., of or guaranteed by countries***
- **Act, s. 46(a)(iii)** ***Bonds, etc., of or guaranteed by Canadian municipal corporations***
- **Act, s. 46(a)(iv)** ***Bonds, etc, of or guaranteed by insurers or savings institutions***
- **Act, s. 46(a)(v)** ***Bonds, etc., of or guaranteed by International Bank for Reconstruction and Development***
- **Act, s. 46(a)(vi)** ***Bonds, etc., of or guaranteed by Asian Development Bank or Inter-American Development Bank***
- **Act, s. 46(b)** ***Certificates or receipts of a trust company or credit union for guaranteed investment***
- **Act, s. 46(d)** ***Negotiable promissory notes or commercial paper***

- **BC Instrument 32-501** ***Advising and related trading under an exemption***
- **BC Instrument 45-511** ***Trades of government warrants***
- **BC Instrument 91-504** ***Government strip bonds***

***Government debt***

The exemption in (i) for government debt has been retained because of the taxing authority of those governments.

***Rated debt***

The existing exemptions for debt of financial institutions, municipalities, foreign governments, and many others will be replaced by the proposed exemption in (ii) for rated debt. These exemptions currently exist, and are continued in the simplified exemptions, on the assumption that the risk to investors is low. If the debt is low-rated, or not rated, this assumption no longer holds.

The proposed exemption in (ii) is only available if the debt meets the required debt rating. We expect that all major reputable commercial rating agencies would be recognized.

Most financial institutions covered by the existing exemption (the Asian Development Bank, the Inter-American Development Bank, the International Bank for Reconstruction and Development, and the foreign governments recognized in BC (US and UK)) are all rated at the required level.

Under the proposed exemptions, commercial paper that is not rated to the standard designated by the executive director can be sold to corporate purchasers through the proposed accredited investor exemption (see proposed exemption 1(b) above).

***Strip bonds***

The proposed exemption in (iii) allows trading in government strip bonds, a well-understood form of debt derivative.

***GICs***

The proposed exemption in (iv) replaces an existing exemption, but broadens it to any regulated financial institution. This proposed exemption recognizes that GICs are guaranteed by CDIC or by an equivalent insurance agency for credit unions.

**(1)(n)** ***Trades to realize on legal obligations:*** **A person is not required to register to trade in securities or exchange contracts if the trade is made by a person acting under the authority of a court, administrative body, contract, or statute in the course of enforcing legal obligations or administering the affairs of another person.**

It is not necessary for securities regulators to oversee the activities of persons trading securities or exchange contracts in their roles as legally authorized persons responsible for enforcing legal obligations or administering the affairs of another person. The current registration exemptions recognize that executors, administrators, sheriffs, receivers, persons realizing on securities or

exchange contracts that were pledged as collateral for debt, and many others trade securities and exchange contracts to fulfill their duties, but should not have to register to do so.

These trades often do not qualify for the isolated trade exemption (see proposed exemption (1)(o) below) because there is an element of repetition and continuity to the trades that might even, in some cases, make it appear that trading is a component of the person's "business". However, these legally authorized persons are also either under the supervision of the courts or another authority, or acting within the confines of a very narrowly defined legal authority.

This proposed exemption consolidates, replaces, and expands on these existing exemptions:

- **Act, s. 45(2)(1)** ***Trade by executor, receiver, sheriff, etc.***
- **Act, s. 45(2)(13)** ***Transfer of beneficial ownership to pledgee, mortgagee, etc. under realization on collateral for debt***
- **Act, s. 45(2)(19)** ***Trade by lender, mortgagee, etc. for purpose of liquidating debt by selling security pledged or mortgaged as collateral for debt***

**(1)(o)** ***Trades that are isolated trades*****: A person is not required to register to trade in securities or exchange contracts if the trade is an isolated trade.**

The existing isolated trade exemption has been underutilized, perhaps from lack of clarity about the meaning of "isolated trade". We think it is an appropriate exemption to rely on for trades such as those by individual investors who are rarely in the market.

This proposed exemption preserves the existing exemption in section 45(2)(3) of the Act (*Isolated trade on behalf of owner or issuer*).

## *D. Disposition of remaining trading exemptions*

The following trading exemptions are not continued under the proposed, simplified trading exemptions:

- **Act, s. 45(2)(5)** ***Purchase of prescribed amount***

This is the "$97,000" exemption. Legislation repealing this exemption has been passed, but not yet proclaimed in force. We are monitoring demand for this exemption in light of MI 45-103.

- **Act, s. 45(2)(20)** ***Execution of unsolicited order through registered dealer by bank or trust company***
- **Act, s. 45(2)(27)** ***Trade in bond or debenture by unsolicited order to bank or trust company if bank or trust company acting as principal and dealing with registered dealer to buy and sell bond***

This exemption is no longer necessary. It was originally put in place to facilitate trading of securities in remote areas where the only access to the financial system was through a local bank or trust company. In this age of the Internet, telephone access to brokers, and greater integration of brokerage services within banks and trust companies, the exemption is no longer

required. (Many banks use dual employees or "roving registrants" to provide brokerage service to people in smaller communities.)

In the meantime, some trust companies have used this exemption for another purpose entirely: to facilitate equity trading by clients of mutual fund dealers without any qualified registrant providing suitability advice. Some trust companies have also established a carrying broker relationship relying on this exemption to avoid registering and joining the Mutual Fund Dealers Association. This is an unintended and inappropriate use of the exemption.

- **Act, s. 45(2)(23)** ***Trades through recognized exchange through telephone or other linkages with other exchanges***

This exemption is not currently being used. The Commission has not recognized an exchange for this purpose.

- **Act, s. 46(c)** ***Securities issued by a private mutual fund***

The definition of a "private mutual fund" includes both investment clubs and mutual funds administered by trust companies. Funds administered by registered portfolio managers do not enjoy this relief. The policy basis for providing the exemption when the fund is managed by a trust company is not clear. The investment club exemption is preserved in proposed exemption (1)(c).

- **Act, s. 46(f)** ***Securities that evidence indebtedness under conditional sales contract, provide for acquisition of personal property and are not sold to individuals***

These securities can be sold to corporations or other institutions under the proposed accredited investor exemption (see proposed exemption 1(b) above).

- **Act, s. 46(g)** ***Securities issued for educational, benevolent, fraternal, charitable, religious or recreational purposes and not for profit***

In BC, this exemption can only be used if disclosure is provided to investors in accordance with a required form (BCF 32-901).

Given that affinity fraud is one of our major areas of investor abuse, this exemption is no longer appropriate.

The entities contemplated in section 46(g) can, like other issuers, raise capital as restricted issuers under CMA (see Chapter 1). One of the capital raising options for restricted issuers is offering securities through an offering memorandum. This process provides a number of investor protections. These include an offering memorandum in plain language describing the business and securities, a blunt risk acknowledgement form, a right to withdraw within two days and rights of rescission and damages if the offering memorandum contains a misrepresentation.

- **Act, s. 46(i)** ***Shares or deposits of credit unions***
- **Act, s. 46(h)** ***Securities issued by a co-operative to its members***
- **BC Instrument 45-502** ***Co-operatives***

Membership shares in co-operatives or credit unions are not like other securities. They are designed to allow a person access to the commercial or other efficiencies realized in a co-operative structure. We propose to amend the definition of "security" in the Act to except membership shares in co-operatives or credit unions from the definition.

When co-operatives or credit unions want to raise capital by offering investment shares, they will be treated as any other person raising capital would be treated. There are many exemptions available to facilitate capital raising now – many more than there were when the current provisions were created. Co-operatives and credit unions will not be at a disadvantage because most smaller organizations will be able to take advantage of the capital raising exemptions, and larger organizations should be treated the same as other issuers.

- **Rules, s. 89(a)** ***50 purchasers***
- **Rules, s. 89(b)** ***$25,000 – Sophisticated purchaser***
- **Rules, s. 89(g)** ***By exchange issuer to friends and relatives of principals***
- **Rules, s. 89(h)** ***Trade by securityholder in "quasi private issuer" (under 50 holders)***

These exemptions were deleted when MI 45-103 was adopted in BC. For transitional reasons, they have been continued for a period of six months. They would not be continued under our proposed exemption regime.

- **BC Instrument 31-503** ***Exchange contracts dealers trading in commodity pool securities***

The subject matter of this Instrument will be dealt with by describing what exchange contracts dealers are qualified to do, and the exchange contracts category will include the ability to trade in commodity pool securities.

- **National Instrument 32-101** ***Small securityholder selling and purchase arrangements***

While the sale of odd lots is important, we understand that they are generally carried out through registered firms and individuals. This Instrument, which provides relief for issuers and their agents to establish a facility for odd lot sales, does not appear to be necessary. In any event, the exemptions for trades to the issuer by its securityholders and for direct sales by senior issuers appear to cover off this concern.

- **BC Instrument 45-510** ***Trades in self-directed registered educational savings plans***

This Instrument is currently necessary because the definition of security includes an interest in any scholarship or educational savings plan. This will be addressed by amending the definition of security to remove self-directed registered educational savings plans so they are treated the same as registered retirement savings plans.

- **BC Instrument 91-501 *Over-the-counter derivatives***

Many of the entities specified as "Qualified Parties" in this Instrument are covered by the exemption for accredited investors (see proposed exemption 1(b) above). We will consider the additional exemptions for business users over the next few months.

## 2. Simplified advising exemptions

### *A. Proposed advising exemptions*

The proposed simplified exemptions from the requirement to register as an adviser take into account the definition of adviser and limit the exemptions to those who are truly in the business of advising, but should have the exemptions.

We propose to revise the definition of advising to clarify that a person is only required to register as an adviser if managing an investment portfolio or giving advice based on the particular needs of specific clients.

**(2) A person is not required to register as an adviser**
**(a) if the person is advising others about investing in securities that can be traded by a person exempted from the requirement to register, except when the person is managing investment portfolios of others through exercising discretionary authority.**

This proposed exemption allows a person to give advice about securities traded under exemptions without being registered. As we noted above under our discussion of the proposed trading exemptions, investors in these circumstances are protected by other mechanisms. They are similarly protected when they receive advice.

This exemption does not extend to managing the investment portfolio of others through discretionary authority. Investors who grant others discretionary authority to manage their funds should receive the protections provided by registration.

The proposed exemption replaces the current exemption in BC Instrument 32-501 *Advising and related trading under an exemption.*

**(2) A person is not required to register as an adviser**
**(b) if the person is a member of a self regulatory organization and complies with the rules or other regulatory instruments of that self regulatory organization relating to portfolio management activities.**

This proposed exemption allows portfolio managers working for investment dealers to carry out the same functions as persons that are registered directly with the Commissions as portfolio managers. Assuming the SRO rules require these persons to meet proficiency and other requirements that are substantially similar to those required by the Commission for registration as a portfolio manager, this exemption should be retained.

We are aware that IDA rules permit so-called "discretionary accounts" as well as "managed accounts". The IDA has special proficiency requirements for managed accounts. Many of these "discretionary accounts" are managed by representatives without the representatives having the proficiency that the IDA requires for managed accounts or that the Commission requires for portfolio managers. We will consider further whether this exemption is appropriate after discussions with the IDA.

The proposed exemption essentially preserves the current exemption found in section 86 of the Rules (*Exemption for investment dealer or representative at IDA member firm who follow IDA rules re portfolio management*).

**(2) A person is not required to register as an adviser**
**(c) if the person is registered as an adviser outside Canada and does not solicit business from residents of Canada.**

This proposed exemption is new – it does not replace or consolidate existing exemptions in BC. The exemption provides relief to Canadian investors seeking advice or portfolio management services from foreign advisers where the foreign adviser has not solicited the investor's business. It parallels the trading exemption provided when Canadian investors wish to retain the services of a foreign dealer on an unsolicited basis.

As on the trading side, solicitation will be judged at the formation of the relationship between the foreign adviser and the client, not on a piece-meal basis. Solicitation includes promotional activity directed specifically at Canadian investors, but mere exposure of the foreign adviser through normal course advertising Canadians might happen to see would not, by itself, be solicitation.

## *B. Disposition of remaining advising exemptions*

The following advising exemptions are not continued under the proposed, simplified advising exemptions:

- **Act, s. 44(2)(a)** ***Exemption for insurers or savings institutions if solely incidental and no advertising of services***
- **Act, s. 44(2)(b)** ***Exemption for Business Development Bank of Canada if solely incidental and no advertising of services***
- **Act, s. 44(2)(c)** ***Exemption for lawyers and accountants if solely incidental and no advertising of services***
- **Act, s. 44(2)(d)** ***Exemption for dealer re research reports and analysis***
- **Act, s. 44(2)(f)** ***Exemption for publisher of, or writer for, a newspaper or business or financial publication if solely incidental and no advertising of services***

"Adviser" is defined as a person engaging in the business of advising. No exemption is required for the activities described in these existing sections of the Act because the activities are "incidental" to the person's real business. If these persons are in the business of advising, we expect them to register.

- **Act, s. 44(2)(e)** ***Exemption for registered dealer or representative if reasonably in fulfillment of duty to ensure suitability***

We expect dealers to advise their clients about investing in or buying or selling specific securities or exchange contracts on the basis of their clients' investment needs. Rather than giving an exemption from the requirement to register as an adviser, we will deal with this in our guidance on the duties of a dealer.

# CHAPTER 2
# REGISTRATION

## Part 3: Registration Passport

After our Concept Paper was published in February 2002, CSA decided to develop an interim registration passport system that we expect will be implemented for most individual registrants in a few months. This system will remain in place until a permanent system is established under the Uniform Securities Act and Rules.

This Part of Chapter 2 describes our Proposal for the permanent system.

The Ontario Five Year Review Committee supports the underlying principles behind the registration passport concept (see its Recommendation 2). The Committee recommends that regulators accept compliance by a market participant with the securities laws in another Canadian jurisdiction as compliance with the securities laws in the regulator's own jurisdiction.

## I. Summary

Under the registration passport system we are proposing:

- A registrant can apply for or amend registration in any jurisdiction in Canada by applying to the registrant's "home" jurisdiction.
- Categories and conditions of registration are uniform throughout Canada.
- Application requirements are uniform throughout Canada.
- Registration is "permanent".
- The system applies to both firm and individual registration.

## II. Background

In our Concept Paper, we identified these problems with the current registration system: First, if registrants want to do business in two or more provinces or territories, they must register in each jurisdiction. Second, national firms spend significant time and resources filing applications for registration in multiple jurisdictions, dealing with Commission staff in those jurisdictions, and keeping track of the differences between the rules of the various jurisdictions. Third, this process is costly and time consuming for both applicants and Commissions.

We proposed a registration passport system as a solution. Registration passport will be even more efficient in combination with the proposed National Registration Database, which will allow registrants to register their employees in multiple Canadian jurisdictions with the click of a mouse.

# III. Details of the Proposal

## 1. Applying for registration

Under this Proposal, the Act provides only that registration is required in accordance with the Rules for trading and advising. The Rules set out the following process for applying for registration:

**(1) If British Columbia is the applicant's principal jurisdiction, the applicant must file an application to register in the prescribed form, pay the prescribed fee, and provide any other information the executive director requires.**

**(2) If British Columbia is the applicant's principal jurisdiction, and the applicant wants to apply for registration in a reciprocal jurisdiction, the applicant can do so by indicating, on the prescribed form, that the applicant is applying for registration in the reciprocal jurisdiction and paying the prescribed fee for registration in the reciprocal jurisdiction.**

**(3) If an applicant's principal jurisdiction is a reciprocal jurisdiction, the applicant can apply, under the reciprocal jurisdiction's equivalent of subsection (2), for registration in British Columbia by indicating, on the reciprocal jurisdiction's prescribed form, that it wishes to be registered in British Columbia and by paying the prescribed fee for registration in British Columbia.**

**(4) Applicants that comply with a reciprocal jurisdiction's equivalent of subsection (2) and are registered in that jurisdiction are registered in British Columbia to carry out the same activities they are registered to carry out in their principal jurisdiction.**

The Rules would define principal jurisdiction and reciprocal jurisdiction as follows:

**"principal jurisdiction" means the jurisdiction to which a person has the most significant connection, considering the person's place of residence, office location(s), head office location, revenues in the [province or territory], assets in the [province or territory], number of registered and other employees or independent contractors, place of incorporation or organization, [and any other relevant factors].**

**"reciprocal jurisdiction" means the other provinces and territories that have adopted [the uniform act].**

## 2. Uniformity of registration requirements

Under the Proposal, there is a uniform set of registration categories throughout Canada. The conditions of registration attached to those categories and the information and filing requirements to apply for registration will also be uniform. The CSA USL Committee has adopted these objectives.

## 3. Permanent system

We are proposing that registration be "permanent". In a permanent registration system, it is not necessary to renew registration on an annual basis. Registration remains valid until terminated, suspended or surrendered. Supporters of a renewal system say it provides an automatic point for re-evaluating the registrant's suitability for registration. However, as a practical matter, registration renewals are rarely refused in circumstances where the conduct leading to the refusal would not otherwise have come to the regulators' attention.

Under a permanent registration system, registrants have an ongoing obligation to provide "evergreen" (continuously updated) disclosure to the principal regulator of important changes (see Chapter 2, Part 1).

## 4. Administering a registration passport system

Under this Proposal, the system is administered through a mutual reliance regime. Once the principal jurisdiction registers the firm or employee, it notifies the other jurisdictions of the registration and the registrant is entitled to registration in any other jurisdiction by giving notice and paying the fee through the principal jurisdiction.

Likewise, when a firm or employee decides at any time after initial registration to conduct business in a jurisdiction other than its principal jurisdiction, that firm or individual need only notify its principal jurisdiction and pay the applicable fee.

The principal jurisdiction notifies the other jurisdictions of new registrations and any changes in registration status or disciplinary action. Administration of the system will be conducted through mutual reliance or possibly through delegation of powers. The delegation of powers among jurisdictions is expected to be authorized in the Uniform Securities Act.

***Registration maintenance, reporting, compliance reviews, enforcement activity***

Under the Proposal, local jurisdictions rely on the principal regulator to administer:

- registration applications, amendments and reinstatements,
- "evergreen" disclosure of important changes to registrant information, and
- regular reporting.

The principal regulator notifies local regulators of changes to registrant information relevant in the local jurisdiction.

Local regulators share information and provide all reasonably necessary assistance so the principal regulator can adequately oversee registration maintenance and reporting. For example, principal regulators could arrange for local regulators to conduct compliance reviews of local offices and rely on that work in preparing a comprehensive compliance review of the registrant.

Mutual reliance and delegation arrangements will take into account the resources and expertise of each jurisdiction and the extent to which the resources and expertise of SROs can be used.

Under the passport system, complaints from the public can be dealt with locally, as they are today, or on a multi-jurisdictional basis if the complaint is systemic in nature. Effective enforcement and compliance will depend on efficient and comprehensive information sharing among regulators. It is expected that the appropriate authority for this will be contained in the Uniform Securities Act.

***The role of SROs***

In some jurisdictions, the IDA registers its members and renews, amends, and reinstates registration. In other jurisdictions, the IDA has no role in the registration process. The MFDA may some day do the same. The IDA and MFDA also have enforcement and compliance responsibilities.

If there were a uniform approach to the role of the IDA, the passport concept would perhaps work more efficiently. However, a uniform approach is not essential. The differences in SRO participation among the provinces can be accommodated as part of the passport system.

# CHAPTER 2
# REGISTRATION

## Part 4: Firm-only Registration

## I. Summary

We are proposing a firm-only registration regime. Under this Proposal:

1. Only firms need to register. Individuals can only trade or advise on behalf of a firm. Firms must promptly notify regulators of changes to registration information, including the identities of those representing the firm in advising and trading capacities.

2. Firms are completely responsible for the conduct of their representatives related to trading and advising activity.

3. Information sharing is authorized between regulators and firms and among firms regarding information about representatives.

4. Information about representatives is available to the public. The information includes the firm they represent and any disciplinary history.

This Proposal assumes the adoption of the Code of Conduct for firms (see Chapter 2, Part 1) and the new statutory civil liability for firms (see Chapter 3).

The Code of Conduct and registration passport (see Chapter 2, Part 3) Proposals are written on the basis that both firms and individuals will register. If firm-only registration were adopted, those Proposals would be amended accordingly.

## II. Background

In the Concept Paper published in February 2002, we identified problems with the current system of individual registration. One was that the current system is costly and cumbersome for registered firms. Another was that some firms attempt to use a representative's status as a registrant to cloud their responsibility for the representative's conduct.

We concluded that the benefits of individual registration could be almost entirely preserved in a firm-only registration system. These are the reasons:

1. Individual registration provides the public with information about individuals working in the securities industry. Under this Proposal, essentially the same information will be publicly available.

2. Individual registration gives securities regulators a way to ensure that individuals working in the securities industry have appropriate proficiency. Under this Proposal, securities regulators still set proficiency requirements.

3. Individual registration allows securities regulators to suspend or ban inappropriate or unqualified individuals from participating in the securities industry, or to place terms or conditions on their participation. Under this Proposal, securities regulators still have these powers.

4. Individual registration allows securities regulators to bar individuals from becoming active in the securities industry at the outset. Under this Proposal, securities regulators no longer have that ability, but firms are required to conduct criminal records and credit checks on applicants and have access to all relevant information about applicants that is presently available to regulators. A new statutory right of action against firms for the misconduct of their representatives will encourage firms to thoroughly screen potential representatives.

# III. Details of the Proposal

## 1. Registration requirement

Under this Proposal, all firms that trade securities or exchange contracts, or that advise, must register. As is currently the case in most Canadian jurisdictions, the Proposal requires individuals in the industry to work for a firm. Under the new investor remedies Proposal (see Chapter 3), firms are responsible for the conduct of their representatives.

This is the registration requirement under the Proposal:

**1. A person must not**
**(a) trade in a security or an exchange contract, or**
**(b) act as an adviser**
**unless the person is registered, or exempted from registration, in accordance with the Rules, or is a representative.**

The proposed definition of "representative" reads as follows:

**"representative" means an individual who trades in securities or exchange contracts or acts as an adviser only as a representative of a firm.**

## 2. Hiring and oversight of representatives

***Filing information about representatives***

Under the Proposal, an application for firm registration must disclose the identities of the representatives, the trading and advising activities each representative is authorized to engage in, and any conditions imposed by the firm on any representative's activities. The information must be kept current and is available to the public.

These are the proposed requirements:

**2.(1) On application for registration, an applicant must provide the Commission with this information about each individual trading in securities or exchange contracts or acting as an adviser on the firm's behalf:**
- **(a) full name,**
- **(b) birth date,**
- **(c) trading or advising activities the representative is authorized to engage in, and**
- **(d) the conditions or limitations, if any, on the representative's trading or advising activities.**

**(2) When the employment relationship between a firm and a representative terminates, the firm must file a notice stating:**
- **(a) the name of the representative, and**
- **(b) the date of termination.**

**(3) All information provided to the commission under this section is public information, except that in (1)(b).**

The requirement to file changes with the Commission is in the proposed Code of Conduct (see Chapter 2, Part 1).

Under the firm-only Proposal, there is a database for information about representatives that will be accessible to regulators, firms and the public. The information includes most of the particulars set forth above, as well as the disciplinary history of firms and representatives, and conditions or limitations on a firm's or representative's trading or advising activities.

When representatives are terminated, firms will no longer file Uniform Termination Notices, nor will the Commissions routinely review termination situations. However, under the proposed Code, firms must tell the Commissions about any breaches of the Code by a representative, and this could result in a review. As part of normal compliance reviews, Commissions will review the firms' processes and record keeping relating to hiring and terminations.

***Authority and proficiency of representatives***

Under the Proposal, a firm must ensure that the scope of authority of the representative to trade and advise is specified in writing:

**3.(1) A firm must specify in writing the trading or advising services the representative is authorized to provide on behalf of the firm.**

**(2) A representative is not authorized to provide trading or advising services that are outside the scope of the firm's registration.**

The proposed Code makes firms responsible for ensuring that their representatives are qualified and requires firms to disclose to clients the qualifications of the representative the client is dealing with.

Currently, an individual who does not meet all of the technical requirements for proficiency but is demonstrably proficient seeks an exemption from the proficiency requirements from the Commission or the applicable SRO.

Under the Proposal, the proficiency requirements permit firms to hire individuals who can demonstrate equivalent proficiency based on skills and experience. During compliance reviews, Commissions will test whether the firm is exercising reasonable judgment in determining equivalent proficiency.

***Liability of firms for their representatives***

Under the investor remedies Proposal (see Chapter 3), firms are responsible to investors for the conduct of their representatives.

## 3. Regulatory jurisdiction and powers

Securities regulators do not need to register individuals to have jurisdiction over them. For example, we would draft the Code so that it applied to representatives, even in a firm-only registration environment.

Most current Commission powers are broad enough to apply to representatives in a firm-only environment. However, under a firm-only system, the Commission has no means to suspend, remove or attach conditions to an individual's registration. This would be replaced by a new order power to be added to section 161(1) of the Act:

**161.(1) If the commission or the executive director considers it to be in the public interest, the commission or the executive director, after a hearing, may order one or more of the following:**

**. . .**

**(g) that a person**
**(i) resign as a representative of a firm,**
**(ii) is prohibited from becoming or acting as a representative of a firm,**
**(iii) is prohibited from engaging in trading, advising, or investor relations activities,**

**(h) that a representative be reprimanded or that a representative's trading or advising activities be suspended, cancelled, or restricted, or made subject to any conditions that the Commission may impose.**

The proposed order power also includes the power to make and extend temporary orders before hearings are held, equivalent to the powers set out in sections 161(2) and (3) in the current Act.

Under current legislation, the executive director also has a power to refuse registrations or impose restrictions or conditions on registration after providing the individual concerned with an opportunity to be heard (sections 35 and 36 of the Act and sections 13 and 17 of the Rules). Under the Proposal, these provisions are replaced by similar powers over representatives:

**4.(1) The executive director may restrict or impose conditions on a representative's trading or advising activities, including**

**(a) restricting the duration of the representative's trading or advising activities,**

**(b) restricting the representative's trading activities to trading in specified securities or exchange contracts, or classes of securities or exchange contracts.**

**(2) The executive director acting under (1) must not restrict or impose conditions on a representative's trading or advising activities without giving the representative an opportunity to be heard.**

**(3) A representative must comply with a restriction or condition imposed by the executive director under (1).**

If the Proposal is adopted, other existing provisions of the Act that give the Commission power over firms would need to be amended to ensure they apply to individual representatives and representative corporations. Both section 141(2), which allows the executive director to obtain information from certain listed persons, and section 153, which authorizes the Commission to require certain listed persons to submit to reviews of their financial affairs, would be amended to include "representatives".

## 4. Information sharing

Under the Proposal, it is up to the firm to develop proper hiring procedures, although we propose that criminal records and credit checks be mandatory.

This Proposal requires information sharing among regulators and firms so that firms get all the information they need to make informed hiring decisions. The Proposal contains information-sharing provisions similar to existing freedom of information and protection of privacy (FOIPP) laws but is designed to meet the unique requirements of securities regulation. The proposed regime replaces existing FOIPP laws, including private sector personal information protection legislation. [5]

Some sample legislative language to effect this is in Appendix A. These are the main features of the proposed regime:

- Regulators can share information with firms making decisions about representatives or prospective representatives.

- Firms must share information they have about a former employee at the request of another firm that is considering whether to hire that employee.

- Regulators and firms must keep representatives' personal information secure.

[5] Currently, only Québec, but the federal *Personal Information Protection and Electronic Documents Act* (PIPEDA) requires all provinces to have equivalent private sector privacy legislation in place by January 1, 2004.

- Regulators and firms must appoint a privacy officer to handle inquiries, requests for changes to personal information records, and complaints.

- Firms that share personal information within the structure of the information sharing provisions have a "qualified privilege" defence from defamation actions. This means the firm will be presumed to have acted without malice and will not be liable even if the personal information that was shared was untrue or otherwise defamatory. However, the firm will lose the benefit of the defence if it is proved that the firm did, in fact, act maliciously.

Under the proposed regime, registered firms or firms applying for registration would be able to get from a Commission any information that, at present, the Commission would have confidence relying on in making its decision whether to register an individual or put terms or conditions on the individual's registration. For example, the Commission would not rely on an unproved complaint to decline an individual's registration, but would rely on information that an individual was sanctioned by the SEC.

If a firm declines to hire an individual because the firm thinks the individual does not have adequate proficiency or suitability, the firm must disclose that to the candidate. An individual who has not been hired for these reasons has a limited right of review by the Commission. The Commission's role will be to verify (or not) that the firm had a good public interest reason to decline hiring the individual, not to second-guess the firm's decision.

## 5. Firm-only registration Proposal compared to current system

This table compares the current system to the firm-only registration Proposal:

| **Current system** | **Proposal** |
|---|---|
| Between July 1 and December 31, 2001, four CSA jurisdictions (BC, AB, ON, PQ) processed:<br><br>• 7,492 new individual registrations<br>• 2,402 transfer applications<br>• 9,107 termination notices | Commissions in all CSA jurisdictions process:<br><br>• No new individual registrations<br>• No transfer applications<br>• No termination notices |

| Current system | Proposal |
|---|---|
| Firms fill out extensive forms to register, renew, amend, terminate and provide notice of changes. Here are some examples, for the same six month period appearing in the box above:<br>• 89,904 pages of new application forms[6]<br>• 4,804 pages of transfer applications<br>• 18,214 pages of termination notices | Firms input core information about who works for them, what they do, and the conditions and limitations on the trading or advising services they can provide, if any. |
| Regulators review fitness of individual firms; firms conduct due diligence on potential employees within the limits of privacy and employment laws. | Regulators do not review fitness of potential individual firms; firms conduct due diligence on potential employees using the information sharing regime in securities legislation and are protected from defamation suits if they act in good faith. |
| Investors can get information about an individual's permitted trading and advising activity, the firm employing the individual, and any disciplinary history. | No change. |

# IV. Implications of the Proposal

## 1. Hiring, compliance, and compliance reviews

If this Proposal is adopted, firms may want to review their hiring policies and processes as regulators will no longer be reviewing proficiency and character of individuals working for firms.

The Proposal provides the means for firms to obtain important information to help them in their hiring decisions, but they will also have to conduct criminal records, credit, or other relevant

[6] This is an estimate, based on the numbers of pages in prescribed BC forms. The same is true for other numbers noted in this box.

checks for information that cannot be obtained from securities regulators or other firms that have previously employed such individuals.

Similarly, firms may want to review compliance policies, procedures, and practices so that individuals posing a risk to the firms can be identified and dealt with appropriately – through education, additional supervision, terms and conditions on activity, the exercise of discipline, or termination, if appropriate.

Finally, regulators will include in their examinations of firms the design and operation of hiring, supervision, and compliance systems. As is the case today, compliance reviews will continue to review the conduct of individual representatives.

## 2. SROs

Today, SROs are significantly involved in registering individuals who engage in trading in securities or exchange contracts or act as advisers for registered firms. We will be consulting with SROs to discuss the implications of this Proposal on this aspect of their operations.

## 3. Fees

Fees for individual registration are a major source of revenue for regulators. This revenue will still be required to fund compliance reviews and related regulatory activities, so an alternate fee model would have to be established. This may be as simple as assessing a fee on the firm, based on the number of representatives it has, but we will consult with industry on this issue if the Proposal is adopted.

## 4. National Registration Database (NRD)

If this Proposal is adopted, the current design for NRD would need to be altered to achieve the public disclosure and information sharing features of the Proposal.

# CHAPTER 2
# REGISTRATION

## Part 5: Other Registration Proposals

## I. Foreign Registrant Proposal

In the Concept Paper published in February 2002, we questioned whether it was necessary to require foreign registrants to be registered under Canadian rules in circumstances where a Canadian investor sought out their services on an unsolicited basis.

We have concluded that it is not necessary to do so, so long as the foreign registrant is not soliciting business specifically from Canadians (if it is, then it would be required to register).

We propose this concept be put into effect by exemptions from the requirement to register either as a dealer or as an adviser:

1. **A person is not required to register to trade solely through a dealer registered outside Canada if the dealer does not solicit business from residents of Canada.**

2. **A person is not required to register as an adviser if the person is registered as an adviser outside Canada and does not solicit business from residents of Canada.**

We will publish guidance on what constitutes "solicitation" along these lines:

- The solicitation test is applied to the formation of the relationship, not on a trade-by-trade basis.
- Solicitation includes any promotional activity directed specifically at Canadian residents.
- Solicitation does not include mere exposure of the foreign firm to Canadians through normal-course advertising that Canadians might happen to see (for example, the firm's web site, or advertising on US television channels carried by Canadian cable or satellite companies).

## II. Representative Corporation Proposal

### 1. Definition of "representative corporation"

Under this Proposal, individuals can provide trading or advising services to firms either as individuals or through closely-held, personal corporations, referred to in this paper as "representative corporations". Firms would be free to contract for trading or advising services with individuals as employees or independent contractors, and with representative corporations as independent contractors.

Allowing individuals to provide trading or advising services to firms through representative corporations is a significant departure from the current system.[7] However, it makes sense that individuals employed in the industry should be allowed to organize themselves as they wish, so long as they remain personally responsible to investors and regulators for their conduct.[8]

If this Proposal were adopted, these additional definitions would be required:

**"representative" means a person who trades in securities or exchange contracts or acts as an adviser only as a representative of a firm and includes a representative corporation.**

**"representative corporation" means a corporation**
**(a) that receives commissions and fees from a firm,**
**(b) that is incorporated under the laws of Canada or the laws of a province or territory of Canada, and**
**(c) all of whose directors, officers, and shareholders are representatives of the same firm or family members of those representatives.**

Under the Proposal, the concepts of "salesperson" and "advising employee" are replaced by the concept of "representative" in the Act, so that both individuals and their corporations can apply for registration as representatives.

## 2. Contracts between registered firms and representative corporations

If the Proposal is adopted, we will publish guidance for firms entering into contracts with representative corporations. For example, we recommend that the contract between the firm and the representative corporation cover these points:

- The names of the individuals the firm authorizes to carry out trading or advising activity as employees or directors of the representative corporation
- The scope of authorized activity for each individual
- A requirement for the representative corporation to get prior written consent from the firm before allowing additional individuals to carry out trading or advising activity as employees or directors of the representative corporation
- A requirement that in all agreements between the representative corporation and its clients, the client have recourse to the authorized individuals

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[7] In BC, only mutual fund salespersons can pay their commissions to their personal corporations (BC Instrument 32-503 *Registration exemption for salespersons' corporations*). In Nova Scotia, proposed Rule 34-502 and Companion Policy 34-502CP allow flexibility by permitting the registration of a person as a salesperson of a dealer even though that person is not in an employment relationship with the dealer. In Québec, individuals in some sectors, such as mutual funds and scholarship plans, are not required to be employed by firms.

[8] The Australian firm-only registration system accommodates a variety of relationships between firms and their representatives. See Appendix H.

## 3. Implications for firm-only registration Proposal

If the firm-only registration system were also adopted (see Chapter 2, Part 4), these "firms" would not need to register.

Under the Proposal, an application for firm registration discloses the identities of the representatives, the trading and advising activities each representative is authorized to engage in, and any conditions imposed by the firm on any representative's activities. If the representative is a representative corporation, relevant information about the corporation must also be disclosed. The information must be kept current and is available to the public.

We would amend the requirements for firms to provide information about representatives as follows to accommodate the representative corporation concept (the amendments are indicated in italics below):

**2.(1) On application for registration, an applicant must provide the commission with this information about each individual trading in securities or exchange contracts or acting as an adviser on the firm's behalf, *whether acting as an individual or through a representative corporation:***

- **(a) full name,**
- **(b) birth date,**
- **(c) trading or advising activities the representative is authorized to engage in, and**
- **(d) the conditions or limitations, if any, on the representative's trading or advising activities.**

***(2) On application for registration, an applicant must provide the commission with this information about any representative corporation with which it has a contract:***

- ***(a) name of the representative corporation,***
- ***(b) the jurisdiction in which the representative corporation was incorporated or organized, and***
- ***(c) the representative corporation's address for service.***

***(3)* When the employment relationship or contract between a firm and a representative terminates, the firm must file a notice stating:**

- **(a) the name of the representative, and**
- **(b) the date of termination.**

***(4)* All information provided to the commission under this section is public information, except that in (1)(b).**

If both this Proposal and the firm-only Proposal are adopted, the legislation allowing regulators to share personal information about individuals working in the securities industry with registered firms and firms applying for registration, and for firms to share information with each other, would need to be amended to accommodate representative corporations. The proposed amended legislation is attached in Appendix A.

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# CHAPTER 3
# INVESTOR REMEDIES

## I. Summary

We are proposing a number of new investor remedies. These remedies will provide enhanced redress for some investors and will act as a deterrent against market misconduct.

Under this Proposal:

1. An investor can sue a CMA issuer, its directors and officers and, in some situations, experts and underwriters for misrepresentations in documents, or public oral statements, or for failing to disclose material information on a timely basis.

2. A client of a firm can sue the firm, its directors and officers and the client's representative for failure to comply with the applicable code of conduct.

3. An investor can sue anyone who participated in fraud, market manipulation, misrepresentation, or engaged in unfair practices.

4. There are a number of provisions to protect defendants against abusive litigation.

5. Securities legislation will contain a separate class action regime available to investors using the statutory rights of action in the Act.

## II. Background

***Our Proposals***

In our Concept Paper published in February 2002, we identified problems with the remedies currently available to investors. The limited statutory rights available to investors deal mostly with purchases under a prospectus. Although investors also have some common law rights, there are practical limitations to these rights that make it difficult to succeed in a lawsuit.

We suggested adding a number of investor remedies to provide an effective deterrent to market misconduct. This is consistent with the underlying philosophy of the CSA November 2000 civil remedies proposal, which was based on the recommendations of the Allen Committee on Continuous Disclosure.

The primary focus of the CSA proposal was civil liability for continuous disclosure. Our Proposal deals with that and also includes rights of action against dealers, advisers, portfolio managers and their representatives who breach the Code of Conduct (see Chapter 2, Part 1) and against any persons who engage in fraud or misleading and unfair practices. These remedies are an important complement to a more principles-based system of regulation. This

Proposal is designed to provide investors with meaningful remedies without exposing industry participants to abusive litigation.

The Proposals are discussed below. There is sample legislative-style text reflecting the Proposals in Appendix A.

***Our Proposals compared to the CSA proposal***

The civil remedies ideas in our Concept Paper largely followed the CSA proposal. This Proposal contains changes that adapt the CSA proposal to the CMA context (see Chapter 1). In the course of considering these changes, we identified some areas where we thought the CSA proposal could perhaps be improved. Appendix I is a chart comparing our Proposals to the CSA civil proposal including, in each case, a brief rationale for the proposed change.

The most significant changes are:

- This Proposal does not treat "core" documents differently from other documents. This distinction is less important in this Proposal because we have given all directors a defence if the issuer has an appropriate regime to manage information disclosure and a monitoring system.

- The CSA proposal had many groups of defendants and many standards of proof. This Proposal has a largely common set of defendants and one standard of proof. This flows from the removal of the "core" document concept.

- Directors and experts have broader defences in this Proposal.

- Influential persons, and their directors and officers, are not expressly caught as defendants in this Proposal.

- This Proposal omits the "loser pays" rule. It is silent on costs, which means the usual court rules about costs will apply. We heard in our initial consultations on this issue that a loser pays rule without a government-funded contingency fund similar to that in Ontario is a serious disincentive to class actions. While we want to deter abusive class actions, we view class actions as a necessary means of ensuring the proposed remedies are meaningful.

  Defendants still enjoy significant protection through the requirement for plaintiffs to obtain court approval before commencing an action and the caps on liability. Costs are a less serious issue in these circumstances.

- The Proposal does not require plaintiffs to provide notice to the Commission of these actions and does not give the Commission automatic standing in court. In our view, these provisions are not necessary because counsel on one side or the other, if not both, are likely to argue the policy objectives of the legislation. The Commission will still be entitled to request intervenor status on a case by case basis.

***Ontario Five Year Review Committee***

The Ontario Five Year Review Committee supports civil liability for continuous disclosure (see its Recommendation 35). The Committee does not discuss any other new investor remedies.

## III. Details of the Proposal

### 1. Liability for CMA issuers – misrepresentations and failure to disclose[9]

***Why new rights of action***

The need for a civil liability regime for continuous disclosure has long been established. The issue was debated thoroughly in the Allen Committee process and again as the CSA proposal was developed. The foundation of the idea is that the vast majority of trading occurs in the secondary market yet, under current legislation, only investors who buy securities from the issuer under a prospectus have a statutory right of action.

Under this Proposal, all investors in CMA issuers, whether purchasing under an offering or in the secondary market, have the same rights. All investors can sue for damages in the event of a misrepresentation, but the right of rescission and the two-day withdrawal right currently available to investors who purchase under a prospectus are eliminated.

***Right of action***

Under the Proposal, an investor can sue for misrepresentations in certain documents by a CMA issuer, for misrepresentations in public oral statements by a CMA issuer or its representatives, and for failure of a CMA issuer to disclose material information as soon as practicable.

Multiple misrepresentations or multiple failures to make timely disclosure may, in the discretion of the court, be considered as one event.

The documents that are covered by this action include anything in the issuer's continuous disclosure record and any public written communication that would reasonably be expected to affect the market price or value of the security of a CMA issuer. This last type of document includes information on the issuer's website. It also includes less formal written communications by an issuer (letters, faxes, e-mails, etc.) but only if they become public and the

[9] BC recently enacted rights of action for misrepresentations in an offering memorandum, or the failure to deliver one, under Multilateral Instrument 45-103 *Capital raising exemptions*. In addition to damages, these rights give investors cancellation and rescission rights. These additional rights are available because of the limited market for the securities of exempt issuers and the higher prevalence of high-pressure sales tactics in the marketing of these securities.

Similar rights for investors in restricted issuer will be continued in the final version of the Proposal.

issuer expects them to become public (see "Liability for CMA issuers – misrepresentation and failure to disclose" below).[10]

***Who can be sued***

The investor can sue:

- the CMA issuer[11]
- its directors at the relevant time
- the person who made the misrepresentation in a public oral statement if the person has actual, implied or apparent authority to speak on behalf of the issuer
- any officer of the issuer who authorized, permitted or acquiesced in the release of the document containing the misrepresentation, in the public oral statement, or in the failure to disclose material information
- an auditor or other expert who consented in writing to the use of the expert's opinion or report in the document or public oral statement
- an underwriter or other due diligence provider, if the investor participated in an offering involving the underwriter or other due diligence provider (these defendants are only liable for misrepresentations contained in the issuer's continuous disclosure record as it stood at the date of the offering)

The CSA civil remedies proposal included liability for influential persons and their representatives when they caused issuers to make a misrepresentation or to fail to disclose or if the influential persons made misrepresentations on their own. For non-mutual fund issuers, influential persons were defined to include control persons, promoters and insiders.

We have not included influential persons as specified defendants. The definition of director and officer includes both those appointed to those roles or those who are *de facto* directors or officers. If the relationship between the issuer and the influential person is such that the influential person can cause these events, it is likely that the influential person, or its directors and officers, is a *de facto* director or officer and would be liable on that basis. The definitions of director and officer in the current legislation contemplate only individuals in the role of *de facto* officers and directors, so by eliminating this category of defendant we are eliminating potential actions against corporate influential persons.

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[10] Under this aspect of the Proposal, civil remedies are available for misrepresentations in financial or earnings information provided by way of press release, as discussed in the Ontario Five Year Review Committee's Recommendation 47.

**[11]** The CSA civil remedies proposal included liability for responsible issuers, which includes not just reporting issuers, but any other issuers in a Canadian jurisdiction whose securities trade publicly, such as Canadian issuers that are traded in foreign markets. This Proposal is focused on CMA issuer liability but we expect that the final version of the Proposal will contain a concept similar to the responsible issuer concept in the CSA proposal.

**Request for Comment 5: Should we retain a right of action against influential persons when they influence the issuer?**

When influential persons (corporate or individual) act on their own in making misrepresentations, they would be caught under our new right of action for general misrepresentations (see "Actions for misrepresentation and unfair practices" below).

***What the investor must prove***

An investor must prove:

- **The misrepresentation.** The investor must prove that the misrepresentation was made but is not required to prove that, in making the investment decision, the investor relied on the misrepresentation or the failure to disclose.

- **Knowledge, recklessness, willful blindness.** Directors have a defence if the issuer had a reasonable regime to prevent misrepresentations and a system that monitored compliance with that regime, unless the director acted knowingly or was reckless or willfully blind. Therefore, if the issuer has a reasonable regime and compliance system, the investor will have to prove that the director acted knowingly or was reckless or willfully blind about the misrepresentation or failure to disclose.

- **Damages.** The investor must also prove damages. Defendants are proportionately liable (that is, liable only for their portion of the damages) unless they acted knowingly or were reckless or willfully blind. In that case, liability is joint and several (that is, each defendant is liable for the full amount of the damages).

***Defences***

- **Issuers and directors.** The issuer and the directors have a defence if the issuer had a reasonable regime to prevent misrepresentations and a system that monitors compliance with that regime. This defence is not available to a director who knew or was reckless or willfully blind about the misrepresentation.

- **Other defendants.** All other defendants have a due diligence defence, which means they conducted a reasonable investigation and had no reasonable grounds either to believe that the document or public oral statement contained a misrepresentation or to believe that the failure to make timely disclosure would occur.

- **Experts and those relying on experts.** In addition to the due diligence defence, an expert has a defence if the misrepresentation came from information provided by the issuer or a third party, if the issuer did not fairly represent the expert's report, or if the expert withdrew previously given consent.

  Directors, officers and the issuer have a defence if the misrepresentation is based on the expert's opinion, if their actions did not lead to the misrepresentation being made by the expert, and if they had no reason to believe there had been a misrepresentation or that the disclosure did not fairly represent the expert's opinion.

- **Timely disclosure defences.** CMA issuers and their directors and officers will not be liable for failure to disclose unduly detrimental events if they are disclosed in a confidential filing (see Chapter 1). This defence is available only if:

  - the CMA issuer has a reasonable regime in place to keep undisclosed material information confidential and a system that monitors compliance with that regime,
  - there is a reasonable basis for determining that disclosure of the event would be unduly detrimental to the issuer and a reasonable basis for maintaining confidentiality,
  - the information remains confidential until disclosed by the issuer,
  - in circumstances that would lead a reasonable person in the position of the issuer to conclude that the information may no longer be confidential, the issuer discloses the information as required by the Act, and
  - there is no "tipping" or trading in the issuer's securities by the issuer or its insiders.

  CMA issuers and their directors and officers will not be liable for failure to disclose material information if the issuer discloses the information within 24 hours of a circumstance arising that would lead a reasonable person in the position of the issuer to conclude that the information may no longer be confidential. This defence is not available to anyone who was engaged in tipping, insider trading, fraud, or market manipulation.

- **Forward looking information.** Any person has a defence for forward looking information if there is a reasonable basis for stating the forward looking information, the information is clearly identified as forward looking and certain cautionary language is included.

- **Investor's knowledge.** All defendants have a defence if the investor had knowledge of the misrepresentation or undisclosed material information at the relevant time.

- **Expectation of confidentiality; reliance.** All defendants have a defence if the defendant reasonably expected the document to remain confidential or if the misrepresentation is based on publicly released documents of another issuer that contained a misrepresentation. Most defendants also have a defence if a person who makes a misrepresentation in a public oral statement has apparent but not actual or implied authority.

## 2. Actions against firms and their directors and officers

Our Concept Paper identified problems with proving vicarious liability of firms and their directors and officers at common law. We suggested a new remedy permitting investors to sue firms and their directors and officers for actions of their representatives.

***Right of action***

Under the Proposal, clients can sue firms registered as dealers, advisers and portfolio managers, their directors and officers, and the client's individual representative for failure to comply with the applicable Code of Conduct (see Chapter 2, Part 1 for the Code we are proposing for investment dealers).

This statutory right increases the accountability of firms and their directors and officers for the actions of their representatives. It requires the firm to stand behind its representatives.

***Who can be sued***

A client can sue:

- the firm,
- the firm's directors at the relevant time,
- any officer at the relevant time who authorized, permitted or acquiesced in matters that led to a breach of the Code, and
- the client's individual representative at the relevant time, including any representative corporation.

***What the client must prove***

Clients must prove:

- **Contravention of the Code.** The client must prove that the Code was contravened.
- **Knowledge, recklessness, willful blindness.** Directors have a defence if the firm had a reasonable regime to ensure compliance with the Code at the time of the breach and a system that monitored compliance with the regime, unless the director knew of the contravention or was reckless or willfully blind.
- **Damages.** The client must also prove that the contravention of the Code caused damages. The firm itself and the representative are jointly and severally liable. Directors and officers of the firm are proportionately liable unless they acted knowingly or were reckless or willfully blind. In that case, they are also jointly and severally liable.

***Defences***

- **Directors.** The directors have a defence if the firm had a reasonable regime to ensure compliance with the Code and a system that monitors compliance with that regime. This defence is not available to a director who knew or was reckless or willfully blind about the contravention of the Code.
- **Officers.** Officers have a defence if they conducted a reasonable investigation and had no reasonable grounds to believe that the Code had been breached.

- **Individual Representatives.** The Proposal provides no defences for individual representatives beyond those available at common law and removes any common law due diligence defence the representative may have had.

- **Firms.** In the Concept Paper, we described the liability of the firm and individual representative as "absolute". We learned during consultations that this gave the impression that contributory negligence on the part of the client would not be considered and that investors would have no duty to mitigate their damages. That is not our intention. In fact, we have included a provision in draft legislative-type text (see Appendix A) requiring the court to consider actions of investors that contribute to their loss when determining the damages that the investor is entitled to recover.

Our objective is to ensure that, as between an innocent client and a firm whose representative breached the Code, the firm will be the one to incur the costs of the breach. This can be accomplished so long as the legislation makes clear that the firm stands in the shoes of the individual representative. If the representative has a defence against the client, that defence is also available to the firm but the firm has no defences of its own, such as due diligence.

By contrast, in a regulatory action against a firm for breaches of the Code, the firm can raise its own defences.

We recognize this Proposal for enhanced dealer liability may impact on the capital and insurance requirements that currently apply to firms. We will consider this issue as part of our cost benefit study on these Proposals. Consultations with the insurance industry and market participants will form part of the research for that study.

## 3. Actions for insider trading

In our Concept Paper, we contemplated enhanced investor remedies for insider trading. This was to expand the class of investors who could sue beyond the person who traded with the insider. We will publish the details of this action at a future date when we publish the trade disclosure proposal.

## 4. Actions for fraud or market manipulation

In our Concept Paper, we identified the problems with the existing common law action for fraud: only the person who traded with the perpetrator can sue, and the perpetrator must be shown to have had a fraudulent intent.

***Right of action***

Under the Proposal, an investor can sue anyone who knew or ought to have known they were participating in a fraud or market manipulation, if the investor traded while the fraud or manipulation was taking place.

Anyone can sue if they are in the market during the relevant period, whether or not they dealt directly with the person committing the fraud or market manipulation.

Liability would be linked to a provision, already present in BC and some other provinces, that prohibits a person from participating in a transaction if the person knew or ought to have known that the transaction perpetrated a fraud. This means an investor suing under this provision does not need to show fraudulent intent – only that the defendant knew facts from which he or she ought reasonably to have known that the transaction perpetrated a fraud.

***Defences***

There are no defences in the Proposal for these defendants beyond those available at common law.

## 5. Actions for misrepresentation and unfair practices

In our Concept Paper, we suggested a statutory right of action against those who engage in unfair practices. We have expanded on the Concept Paper by adding a right of action for misrepresentation. This action parallels the Commission's current prohibition against misrepresentations in section 50 of the Act.

This will provide a remedy to investors victimized by these behaviours.

***Rights of action***

Under the Proposal, investors can sue anyone who:

- makes a misrepresentation not covered in the right of action for misrepresentations by CMA issuers and restricted issuers (see "Liability for CMA issuers – misrepresentations and failure to disclose" above), or
- engages in unfair practices.

Under the Proposal, an action can be brought against a person who makes a misrepresentation while engaging in investor relations activities or with the intention of effecting a trade in a security.

An unfair practice includes high-pressure sales tactics, taking advantage of physical or mental infirmity and imposing terms that make the transaction inequitable.

An investor can sue for damages or can cancel a transaction and get money returned.

The potential for liability, combined with the Commission's ability to take action when misrepresentations or unfair practices have been used (see Chapter 4), would deter those who might otherwise be tempted to take advantage of investors in these ways. We find they often direct these unfair practices at those investors least able to look after themselves.

***Defences***

There are no defences in the Proposal for these defendants beyond those available at common law.

## 6. Protections for defendants

In our Concept Paper, we discussed why protections for defendants were needed. Specifically, we raised concerns that without safeguards, the additional rights could increase costs and could discourage qualified people from serving as directors, officers and advisers for fear of potential liability. We also indicated we were aware of the concern about "strike suits" (cases where plaintiffs without a legitimate claim bring an action to try and coerce the defendant into settling).

This Proposal contains protections for defendants as a balance to the proposed new investor remedies. These protections are:

- Court permission to commence an action
- Court approval of proposed settlements
- Caps on liability, unless the defendant acted knowingly or was reckless or willfully blind

***Court approval to proceed***

Investors must obtain the court's permission to start an action. This means that, for a case to proceed, the court has to be satisfied that the action was brought in good faith and has a reasonable possibility of success. The CSA proposal (see "Liability for CMA issuers – misrepresentations and failure to disclose" above) also included this protection. Other issues, such as the identity of the class, must also be dealt with under class proceedings legislation.

***Court approval of settlements***

Under our Proposal, any proposed settlement of an action, whether or not it is a class action, requires the approval of the court. To approve a settlement, the court must be satisfied that there is evidence establishing a reasonable likelihood of wrongdoing.

This was also a recommendation in the CSA proposal. It is intended to act as a deterrent to frivolous or vexatious lawsuits.

***Caps on liability***

The Proposal adopts the caps on liability contained in the CSA proposal. The maximum liability for each class of defendant is as follows:

- Issuers: the greater of $1 million or 5% of market capitalization.
- Directors and officers of issuers and registered firms: the greater of $25,000 or 50% of the total annual compensation, including stock or deferred compensation, they receive from the issuer or registered firm and their respective affiliates.
- Experts: the greater of $1 million or the amount the expert received from the issuer during the prior 12 months.
- Each person who made a public oral statement, other than anyone liable in another capacity: the greater of $25,000 or 50% of the total annual compensation, including stock or deferred compensation, they receive from the issuer and its affiliates.

Under the Proposal, liability is not capped in circumstances where an individual defendant acts knowingly or was reckless or willfully blind.

We have not extended the liability cap to firms registered as dealers or advisers. The caps exist for the issuer to avoid an inappropriate transfer of wealth among different groups of shareholders. This is not an issue when clients are suing dealers and advisers. We do not anticipate that class actions would be brought against firms for breach of the Code, except in the most egregious circumstances.

We heard two criticisms related to the level at which the caps have been set:

- For many junior issuers, a $1 million liability would be catastrophic.
- For an expert who is an individual or a small professional practice, a $1 million liability would be similarly damaging.

We are considering whether the caps could be adjusted for these groups so that they are large enough to cause them to take their responsibilities seriously but not so large as to jeopardize their continued existence.

**Request for Comment 6: Should the caps for junior issuers and small professional firms be revised?**

## 7. Securities class action regime

Our Concept Paper included the idea of developing a completely new regime for securities class actions. In our initial consultations, we heard that the BC *Class Proceedings Act* works reasonably well and that legislation similar to that would be appropriate. As a result, we will be considering whether to build provisions similar to those in that Act into the *Securities Act*, with three exceptions:

- The *Class Proceedings Act* contains certain limitations on participating plaintiffs from outside British Columbia. These are not appropriate for a regime designed for securities litigation (Ontario's legislation does not contain these restrictions).
- The particular cost rules would be omitted as well as an express "loser pays" rule. Costs would be left to the Court. This is discussed above under "Our Proposals compared to the CSA proposal".
- The requirement to prove that a cause of action exists during the certification hearing would be omitted since the Proposal requires court approval to start a proceeding (discussed above under "Protections for defendants").

**Request for Comment 7: Should the class action provisions in the *Securities Act* duplicate existing provincial class action regimes or are there enhancements that should be made?**

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# CHAPTER 4
# ENFORCEMENT AND PUBLIC INTEREST POWERS

## I. Summary

We are proposing four new enforcement and public interest powers. Under this Proposal:

1. The Commission can order that people who breach the securities legislation give up their ill-gotten gains.

2. The Commission can prohibit a professional from practicing before the Commission if the professional has intentionally contravened the securities legislation, or has intentionally assisted others to do so.

3. Anyone can apply to the Commission for a compliance or restraining order if there is a breach of the securities legislation.

4. The securities legislation prohibits unfair practices.

## II. Background

In the Concept Paper published in February 2002, we said that effective enforcement is essential to a credible regime of securities regulation. The existing enforcement powers in the BC legislation are reasonably comprehensive, but we noted in the Concept Paper that some market misconduct requires more effective tools.

## III. Details of the Proposal

### 1. Disgorgement orders

We propose that the Commission have the power to order disgorgement and that investors be entitled to claim the disgorged monies.

Market participants who have benefited from contravening the securities legislation should not keep their ill-gotten gains. When they do, it shakes the public's confidence in our markets.

A few years ago, a provision allowing the Commission to apply to court for disgorgement and restitution was added to the *Securities Act*, but no applications have been made since this provision has been in force. During that period, we devoted Commission staff resources to bringing public interest matters to a settlement or to hearings before the Commission.

We propose that the disgorgement power be made more effective by allowing the Commission to order disgorgement in its enforcement hearings and by providing for the repayment of the disgorged monies to investors who have proved their claims.

This is the proposed draft legislation for our new disgorgement power:

> **If the Commission, after a hearing,**
> **(a) determines that a person has contravened or is contravening a provision of this Act or of the regulations, or has failed to comply or is not complying with a decision, and**
> **(b) considers it in the public interest to do so,**
> **the Commission may order the person to pay to the Commission one or both of the following:**
> **(c) any money obtained by the person directly or indirectly as a result of the contravention or failure to comply,**
> **(d) the amount of any payments or losses avoided by the person directly or indirectly as a result of the contravention or failure to comply.**

The Commission will act as custodian of the disgorged monies pending their disposition. However, the legislation will also have to include the procedures the custodian must follow in dealing with the money (including giving notice to investors, procedures that would be outside the Commission's usual expertise). We will consider whether there are other entities that would be more appropriate custodians of the funds.

**Request for Comment 8: Who should hold disgorged funds pending the disposition of investor claims?**

Under this proposed power, investors would have to prove their claims. In the Concept Paper, we suggested a streamlined court process for investors to use to claim disgorged monies, but we are now proposing that investors use existing court processes. This is because determining rights between parties is often complex, and existing court procedures deal with these complexities. However, where there is agreement, alternate dispute resolution processes may work in appropriate cases.

The new legislation will also have to deal with unclaimed monies. Under the Proposal, unclaimed monies are paid to the Commission's Industry Education Fund.

**Request for Comment 9: Is there another more appropriate use for unclaimed monies?**

The Concept Paper included the idea of allowing the Commission to make restitution orders. We have reconsidered this concept and, at this time, we are no longer proposing that the Commission have this power.

Making restitution orders would take the Commission into the area of determining rights between parties, traditionally the purview of the courts. Our effectiveness in dealing with

matters of public interest is due in part to the high level of judicial deference we enjoy on matters of securities regulation policy, and to some extent to our less formal hearing procedures. We believe that if we were to exercise the power to order restitution we risk losing some judicial deference and having courts impose more formal procedures on our hearings.

Weighed against this risk is the potential benefit to investors. Restitution orders would have been made only in cases that would have come to a hearing in any event, based on their public interest impact. Of those, only cases in which there was no doubt as to both the amount owed and the parties concerned would likely have resulted in restitution orders. On balance, the potential benefit to investors of Commission-ordered restitution seems small, especially with an improved disgorgement power in place.

We are aware that the Manitoba Government has introduced legislation that would give the Manitoba Securities Commission the power to order restitution. In addition, the Financial Services Authority in the UK has this power. We will monitor their experiences. We note the Ontario Five Year Review Committee, in its Recommendation 65, recommends the same approach.

## 2. Orders against professionals

We propose that the Commission have the power to prohibit professionals from practicing before the Commission if the professional has intentionally contravened the securities legislation, or has intentionally assisted others to do so. (Intention includes conduct that is reckless or willfully blind.)

The Commission may determine that a professional has acted contrary to the public interest. While, in some cases, the Commission can issue enforcement orders that deal effectively with the professional, this is not always the case. For example, issuing a cease trade order is not effective in stopping a lawyer whose advice facilitates a client's breach of securities laws. In those circumstances, professionals whose conduct has harmed our capital markets may continue to appear and practise before the Commission and continue to harm our markets.

In overseeing our capital markets, the Commission must act in the public interest to ensure market integrity and investor protection. Therefore, if the Commission finds conduct is prejudicial to the public interest, it must be able to deal effectively with that conduct. Our Proposal does that by saying to the professional, where your conduct is prejudicial to the public interest, you can practice, but not in our capital markets.

The SEC has the power to deny professionals the right to appear and practice before the Commission. We are proposing legislation to accomplish the same thing. We say an intentional contravention of the securities legislation can be a basis for finding a professional has engaged in conduct that is prejudicial to investor protection and market integrity.

Some commenters say that professional conduct should be a matter for the professionals, not the Commission. We agree that determining matters of competence and professional conduct is the responsibility of the bodies that regulate the professions. This Proposal is not an attempt to regulate the professions. However, we do have a responsibility to deal effectively with conduct that is prejudicial to the public interest in our capital markets. The power to deal

effectively with market misconduct of professionals by ordering them not to appear or practice before the Commission is founded on that responsibility.

This is the proposed draft legislation for our new power to make orders against professionals:

**1. If the Commission, after a hearing,**
**(a) determines that a person has intentionally contravened, or intentionally aided or abetted the contravention of, the Act or the regulations, and**
**(b) considers it to be in the public interest,**
**the Commission may order the person not to appear or practice before the Commission.**

**2. "Appear or practice before the Commission" includes, but is not limited to:**
**(a) preparing, or giving advice about preparing, documents filed with the Commission, and**
**(b) representing a person on a matter that falls within the Commission's jurisdiction.**

## 3. Compliance and restraining orders

Currently, if the Commission considers that a person has not complied or is not complying with the provisions relating to take over bids and issuer bids, the Commission may issue a compliance and restraining order (see section 114 of the Act).

We propose that anyone be entitled to apply to the Commission for a compliance or restraining order where there is any breach of the securities legislation.

The Commission could deal with these matters under section 161(1) of the Act (through an enforcement hearing) and under section 164 of the Act (by issuing a cease trade order for failure to file a record required to be filed under the legislation). However, we believe the Commission should also be able to do so without an enforcement hearing or a cease trade order.

The proposed provisions replace the existing provisions relating to take over and issuer bids. They are similar to the current section 114 of the Act, except that, under our Proposal, a person seeking to apply for an order must first get leave of a commissioner.

The Concept Paper stated the Commission would award costs and could ask for security for costs. We have not included these ideas in our Proposal. They were intended to discourage frivolous applications and this issue can be adequately dealt with through the leave procedure.

This is the proposed draft legislation for our new compliance and restraining orders power:

**1. If the Commission determines that a person has not complied or is not complying with the Act or the regulations, the Commission may make an order,**
**(a) restraining the distribution of any record,**
**(b) requiring an amendment to or variation of any record, and**

**(c) directing any person to comply with the Act or the regulations or restraining any person from contravening the Act or the regulations and directing the directors and senior officers of the person to cause the person to comply or to cease contravening the Act or the regulations.**

**2. An order may be made on application by an interested person or on the Commission's motion.**

**3.**

**(a) An interested person must obtain leave from a single commissioner to make an application.**
**(b) The commissioner may only grant leave if the commissioner considers it to be in the public interest.**
**(c) The commissioner's decision whether to grant leave is final and cannot be appealed.**

## 4. Prohibition of unfair practices

We propose that the Uniform Securities Act prohibit unfair practices.

A prohibition against unfair practices has already become law in BC. In May, the Government amended the *Securities Act* to prohibit unfair practices and to make it an offence to contravene the prohibition. The unfair practices now prohibited include high-pressure sales tactics, taking advantage of physical or mental infirmity and imposing harsh terms. The amendment answers our concern that some market participants engage in unfair practices. We find that these market participants direct their unfair practices to those investors least able to look after themselves.

This is the legislation as it appears in BC (the amendment also covers persons engaged in investor relations activities and exchange contracts):

**50.(1) A person . . . with the intention of effecting a trade in a security, must not**
**. . .**
**(e) engage in an unfair practice.**
**. . .**

**(4) For the purpose of this section, an "unfair practice" includes any of the following:**
**(a) putting unreasonable pressure on a person to purchase, hold or sell a security;**
**(b) taking advantage of the person's inability or incapacity to reasonably protect his or her own interest because of physical or mental infirmity, ignorance, illiteracy, age or inability to understand the character, nature or language of any matter relating to a decision to purchase, hold or sell a security;**
**(c) imposing terms or conditions that make a transaction inequitable.**

The amendment was made in connection with the implementation of the new capital raising exemptions, a joint initiative of the Commission and the Alberta Securities Commission (see MI 45-103). We understand that several other securities Commissions are considering adopting the exemptions, including the prohibition of unfair practices.

**Request for Comment 10: Should the prohibition be more broadly worded to catch a failure to deal properly with conflicts of interest or to manage the business and affairs of an issuer?**

# APPENDIX A

# Draft Legislation

Legislative-style provisions are summarized or included in the paper for all the Proposals. These have been drafted merely to illustrate how the Proposals might be implemented from a legal standpoint. Formal legislative drafting principles have not been applied and there has been no attempt to include all of the technical drafting that will ultimately have to be addressed at the formal legislation stage. We have also not yet turned our minds to the anti-avoidance language that might be necessary for some of the Proposals.

# Chapter 1
# Continuous Market Access

## Act provisions

### Definitions

1. In this Act,

**"AIF"** means an annual information form in the required form, or in a form that is acceptable to the executive director,

**"approved foreign-regulated issuer"** means an issuer or class of issuers prescribed in the Rules,

"**CMA issuer**" means an issuer, other than a mutual fund, that:
(a) has filed an initial AIF that has been accepted by the executive director,
(b) was a reporting issuer under the *Securities Act*, R.S.B.C. 1996, c. 418 immediately before the effective date of this Act, or
(c) is an approved foreign-regulated issuer,

**"exempt security"** means a security of an issuer that can be traded under one of the exemptions prescribed in the Rules,

**"material information"** means information relating to the business or affairs of an issuer that would reasonably be expected to result in a significant change in the market price or value of any of the issuer's securities,

**"restricted issuer"** means an issuer or class of issuers prescribed in the Rules.

### Issuance of securities

2. An issuer cannot issue a security unless
(a) the issuer is a CMA issuer,

(b) the issuer is a restricted issuer and the securities being issued are traded to persons prescribed in the Rules, or
(c) the securities are exempt securities.

### CMA Issuer Disclosure

3. A CMA issuer must disclose all material information in accordance with the Rules.

## Rule provisions

### Definitions

1. In these Rules,

**"1934 Act"** means the *Securities and Exchange Act of 1934* of the United States of America, as amended from time to time,

**"accredited investor"** means. . . **[Note to Reader: This will list accredited investors described in Chapter 2, Part 2 of the Proposal Paper]**

"**due diligence provider**" means an underwriter or any other person or class of persons that is acceptable to the executive director **[Note to Reader: The rules will include provisions setting financial adequacy and proficiency criteria for due diligence providers that are not underwriters],**

**"foreign market requirements"** means the disclosure requirements that apply to an approved foreign-regulated issuer,

**"general offering"** means an offering of securities other than one made using the registration exemptions in section 1 of the Registration Exemptions, **[Note to Reader: See Chapter 2, Part 2 of the Proposal Paper]**

**"misrepresentation"** means . . . **[Note to Reader: This will have the same definition as in the legislation for Chapter 3 of the Proposal Paper]**

"**private issuer**" means an issuer
(a) that is not a CMA issuer, a mutual fund or a non-redeemable investment fund,
(b) whose designated securities:
  (i) are subject to restrictions on transfer that are contained in the issuer's constating documents or security holders agreements; and
  (ii) are beneficially owned, directly or indirectly, by not more than 50 persons, counting any 2 or more joint registered owners as one beneficial owner, and not counting employees and former employees of the issuer or its affiliates, and
(c) that has distributed designated securities only to a person described in sections 2(a) to 2(h) or a person that is wholly-owned by any combination of persons described in sections 2(a) to 2(h) , or to a person that is not the public.

**"restricted issuer"** means an issuer whose securities

(a) are not listed, quoted or traded on any marketplace, and
(b) have been issued only to persons described in section 2.

**"senior issuer"** means an issuer or class of issuers that are acceptable to the executive director. **[Note to Reader: the executive director will accept issuers that meet the requirements to be exempt from the Toronto Stock Exchanges' acceptance requirement for proposed material changes]**

## Permitted sales by restricted issuers

2. A restricted issuer can only issue a security to a person if the person is
   (a) A person who invested in the issuer when it was a private issuer,
   (b) a director, officer, employee or control person of the issuer or an affiliate of the issuer,
   (c) a spouse, parent, grandparent, brother, sister or child of a director, senior officer or control person of the issuer,
   (d) a close personal friend of a director, senior officer or control person of the issuer,
   (e) a close business associate of a director, senior officer or control person of the issuer,
   (f) a current holder of securities of the issuer,
   (g) a vendor of property or other assets to the issuer,
   (h) an accredited investor,
   (i) a person who invested under the offering memorandum exemption described in MI 45-103 **[Note to Reader: See Chapter 1 of the Proposal Paper]**,
   (j) a person resident outside Canada if the person acquired the securities in compliance with the laws of the jurisdiction where the person is resident, or
   (k) a person who is wholly-owned by any combination of persons or companies described in paragraphs (a) to (j).

3. A holder of a security of a restricted issuer can only trade the security to a person referred to in section 2.

## Use of a due diligence provider

4.(1) An issuer must retain a due diligence provider in connection with its initial AIF and any general offering to
   (a) conduct a reasonable investigation of the business and affairs of the issuer and any securities that the issuer is offering,
   (b) provide a written opinion to the issuer that there are no reasonable grounds to believe that the issuer's continuous disclosure record contains a misrepresentation, and
   (c) file the opinion.

(2) Subsection (1) does not apply to a senior issuer for general offerings other than under an initial AIF.

## Acceptance of initial AIF

5.(1) An issuer must file an initial AIF with the executive director to become a CMA issuer.

(2) The executive director must accept an initial AIF unless the executive director considers that
- (a) the initial AIF fails to comply substantially with the requirements of the form,
- (b) the issuer has failed to retain a due diligence provider as required by section 4,
- (c) the past conduct of the issuer or its officers, directors, promoters or control persons would lead a reasonable person to doubt whether the business of the issuer would be conducted with integrity and in the best interests of its securityholders,
- (d) the issuer's officers and directors lack the knowledge and expertise necessary to comply with the law applying to the issuer and to act in the best interests of its securityholders,
- (e) the financial condition of the issuer or its officers, directors, promoters or control persons is such that the issuer cannot reasonably be expected to conduct its business in a financially responsible way, or
- (f) it is contrary to the public interest to do so.

(3) The executive director must notify the issuer in writing:
(a) that it accepts an initial AIF or
(b) that it does not accept an initial AIF with reasons for non-acceptance.

(4) The executive director must not refuse to accept an initial AIF without giving the issuer an opportunity to be heard.

## Timely disclosure

7.(1) A CMA issuer must disclose all material information regarding the issuer as soon as practicable by issuing and filing a press release.

(2) Despite subsection (1), a CMA issuer may disclose material information in confidence to the Commission by filing a confidential material information report in the required form together with written reasons why there should not be a press release, if in the opinion of the reporting issuer, acting reasonably, the disclosure required by subsection (1) would be unduly detrimental to its interests.

(3) If the executive director is of the view that the public interest in disclosure outweighs the detriment to the issuer, the executive director may require disclosure.

(4) The executive director must not require disclosure without giving the issuer an opportunity to be heard.

(5) If a report is filed under subsection (2), the issuer must advise the Commission in writing every 10 days that it believes the report should continue to remain confidential until the material information is disclosed in accordance with subsection (1) or the information is not material .

(6) Once the reason for confidentiality no longer applies, the issuer must disclose the material information in accordance with subsection (1).

(7) If a report is filed under subsection (2), the issuer must as soon as practicable disclose the material information in circumstances that would lead a reasonable person in the position of the issuer to conclude that the information may no longer be confidential.

8. A CMA issuer may file a supplementary information form to disclose information in addition to the material information in section 7.

## Prescribed exemptions

4. For the purpose of the definition of exempt securities, the securities are those referred to in sections 1(e), (f), (g) or (m) of the Registration Exemptions. **[Note to Reader: See Chapter 2, Part 2 of the Proposal Paper]**

## Approved foreign-regulated issuer

2. An issuer is an approved foreign-regulated issuer if
   (a) its securities are principally traded on a market or markets outside Canada,
   (b)
      (i) it has a class of securities registered under section 12 of the 1934 Act, or it files reports under section 15(d) of the 1934 Act, or

      (ii) it is subject to a system of securities regulation of a foreign jurisdiction that is designated by the executive director, and
   (c) it files a notice of intention to become a CMA issuer in the required form **[Note to Reader: in addition to indicating an intention to join CMA, the required form will also include an agreement to attorn to the jurisdiction of Canadian regulators and courts]**.

## Exemptions for approved foreign-regulated issuers

12.(1) An approved foreign-regulated issuer is not required to file an AIF or any documents required to be filed by a CMA issuer under • **[Note to Reader: we will refer to the National Instrument that sets out the filing requirements including an ongoing AIF, annual and quarterly financial statements and MD&A, director and audit committee review, etc.]** if:
   (a)
      (i) it files the documents required under the applicable foreign market requirements, or
      (ii) the documents it files under the applicable foreign requirements have been filed on a publicly accessible electronic system, it files a notice containing a statement to that effect and instructions for finding the documents under that system, and
   (b) it files a notice in the required form **[Note to Reader: The required form will require the issuer to state that the issuer is subject to a foreign regime of securities regulation and that securityholders resident in Canada do not have the same rights and remedies available to them in Canada, and may not have the same rights and remedies as securityholders who are resident in the foreign jurisdiction].**

(2) An approved foreign issuer is not required to comply with [•] **[Note to Reader – we will refer to Canadian requirements for insider bids, issuer bids, going private transactions, insider reporting, early warning, mining disclosure, oil & gas disclosure and restricted share disclosure]**, if

(a) it complies with the equivalent provisions, if any, of the foreign market requirements,

(b) if the foreign market requirements require the filing of documents,

(i) it files those documents, or

(ii) if the documents it files under the applicable foreign requirements have been filed on a publicly accessible electronic system, it files a notice containing a statement to that effect and instructions for finding the documents under that system, and

(c) if it is required to deliver documents to securityholders under the foreign market requirements, it delivers those documents to its securityholders resident in Canada.

# Chapter 2
# Registration Part 1: Code of Conduct

## Act provision

1. A registrant and its representatives must comply with the Code of Conduct prescribed in the Rules. **[Note to Reader: The provisions of the Code that will appear in the Rules are in bold face type. The paragraphs that follow each Code provision will appear in policy guidelines.]**

## Rule provisions (with guidance)

### Principle 1 – Integrity and fairness

**1. Meet appropriate standards of professional ethics, including honesty, integrity and fair dealing. Inform your client of all facts about your background that a reasonable client would consider important to the client-adviser relationship.**

The client-adviser relationship is based on trust. The client therefore needs to know everything about you, good and bad, that a reasonable client would want to know before entering that relationship.

You must act honestly and fairly in keeping with the highest professional and ethical standards. Conduct involving dishonesty, fraud, deceit or misrepresentation will violate this standard. Examples of this conduct are churning accounts or failing to be forthright with your client about your commissions or any limitation on your ability to service your client's investment needs. You should keep each client informed about your relevant employment and regulatory history.

Soliciting clients at their homes must be done within the bounds of fair dealing. You should do so only during reasonable times and you should respect an individual's request not to be contacted again. You should also make sure that the person making the call is not making statements that could be viewed as soliciting a trade in a security unless the person is registered. Firms may want to define employee policies for unsolicited communications with prospective clients to avoid infractions under the communication abuse sections of the *Competition Act* (Canada).

**2. Comply with all relevant laws and regulations that govern your profession and report infractions.**

You must keep yourself informed of the laws that govern your profession and you must abide by them. Apart from securities laws, this could include, for example, federal proceeds of crime and anti-terrorist legislation and some aspects of federal competition law. If you breach any relevant laws, report them to your firm; firms must report those infractions to the regulator.

## Principle 2 – Confidentiality

**Hold in strict confidence all confidential information acquired in the course of the professional relationship with your clients, unless the client consents or the disclosure is required by law.**

In the course of your employment, you will receive information about the personal financial affairs of clients and prospective clients. You must keep that information in confidence. Receiving such information places you in a position of trust and responsibility and it is unethical to betray this trust in any way.

If personal information is disclosed, the damage to the client is the same whether the disclosure was willful or negligent.

You may disclose your client's confidential information in two, and only two, situations. First, you may disclose if you get the client's consent, preferably in writing. Second, you may disclose if you are required to do so by law. This includes legally enforceable requests for information from the Commission or your SRO, or the requirements of Canadian money laundering and anti-terrorist legislation.

## Principle 3 – Proficiency

**Maintain the proficiency, skill and diligence necessary to properly advise and serve your clients.**

Your SRO or the Commission will continue to set the minimum proficiency standards for entering the securities industry, as well as mandating continuing educational requirements. However, in a rapidly changing financial marketplace, you must keep abreast of changes in products, regulations and other factors that will affect your ability to provide high standards of service to clients. Education, including continuing education, is a necessary component of professional skill.

Firms have several additional factors to consider in establishing rules or guidelines for representatives, including:

- The criteria for requiring re-qualification when a representative has been out of the securities industry for a period of time.
- The training requirements applicable before a representative is permitted to sell new products.
- Policies regarding part-time employment by its representatives in occupations outside of the securities industry.
- The special training and skills requirements of representatives engaged in underwriting activity.

## Principle 4 – Know your client and suitability

**1. Learn the essential facts about each client, including the client's identity, credit worthiness and reputation.**

**2. Determine the general investment needs and objectives of the client, the appropriateness of the recommendations you make to that client and the suitability of a proposed trade for that client (unless the client is entitled to decline suitability advice).**

Principle 4 combines what have traditionally been referred to as the "know your client" and "suitability" rules.

The first part of the Principle, "know your client", requires you to understand the client's identity, background, financial position and character so you can fulfill your role as a "gatekeeper" to the market. If your client is not an individual, knowing your client means knowing the individuals that control the client, its business and its financial circumstances.

The second part of the Principle, "suitability", means understanding the client's financial circumstances, risk tolerance and investment objectives so you will be able to determine what is suitable when recommending or selling products and services.

You should make every effort to give your clients objective and impartial information about their financial needs, and advise them of their various options. You should identify and explain to the client all negative aspects, including risks, of your recommendations. You should have a reasonable basis for the recommendations you make to your client.

In addition to clearly describing the product or service for the client and the ways in which the transaction will fulfill the needs of the client, product information includes disclosure of important assumptions underlying any illustrations or examples that have been provided to the client, as well as the fact that actual results may differ significantly from those shown. You should avoid using examples or illustrations that you know, or ought to know, are based on unusual results or a period that generated much better that normally anticipated performance.

The suitability obligation requires you to advise your client on factors other than the features of the investment itself. For example, if your client intends to invest using borrowed money, a discussion of the risks of leveraged investing would be appropriate.

Currently, clients may refuse suitability only when dealing with IDA member firms, and then only in the limited circumstances prescribed by the IDA.

3. **Your conduct and the conduct of your clients must not bring the reputation of the securities market into disrepute.**

You and your clients must not engage in any activity that will lower the public's confidence in the integrity of the securities industry such as engaging in wash trading, high closing or other types of market manipulation. The Code does not allow you to turn a blind eye to the actions of your clients. You must take all reasonable steps to determine if your client's actions are bringing the integrity of the securities markets into disrepute.

4. **If your client refuses to comply with regulatory requirements, you must cease to act on behalf of that client.**

You should use all reasonable efforts to ensure that your client understands the relevant regulatory requirements and their implications at all stages of a transaction. If you become aware that your client is not complying with regulatory requirements, you should inform your compliance officer and advise your client to bring the matter into compliance. If your client refuses or fails to do so, you must not continue to act on behalf of that client, and you should consider whether you should bring the client's activities to the attention of the regulators.

## Principle 5 – Conflict of interest

1. **Take all reasonable steps to avoid situations that are likely to involve a conflict of interest.**

2. **Resolve all significant conflicts of interest in favour of the client, using fair, objective and transparent criteria. If there is a conflict of interest between clients, use fair, objective and transparent criteria to resolve those conflicts. In both cases, apply the criteria consistently.**

Conflicts of interest arise frequently in the securities industry. This Principle makes it clear that the client's interests always come first. The best way to ensure this happens is to have appropriate procedures in place to ensure that all conflicts of interest between the firm or sales representative and the client are resolved in favour of the client and to have a system that effectively monitors and enforces compliance with those procedures. These procedures should cover conflicts of interest arising in the context of trading, advising, making recommendations, and exercising your discretion in managed accounts.

Sometimes the conflict of interest is not between registrant and client, but between clients. For example, a registrant sometimes has to decide how to allocate investment opportunities among clients when an issue is oversold. This is best resolved if the registrant has appropriate procedures in place to deal with these situations, and a system to monitor and enforce compliance with those procedures. For example, this does not mean that all clients must have equal access to an offering of securities; it is open to a registrant to vary the allocation according to the degree of business the firm does with a given client. The guidelines for making these determinations must be transparent to all clients.

The onus of showing that the registrant has acted in the best interests of the client is on the registrant. This onus would be difficult to meet in some situations, such as arrangements to which you are a party where clients are required or expected to deal with a particular financial

institution in connection with a trade in a security or to purchase particular securities to obtain other financial goods or services.

**3. Develop conflict of interest avoidance procedures and describe them to the client.**

You must develop conflict of interest procedures that address the conflict situations that arise in your business specifically. Disclosure of potential conflicts of interest must take place before the conflicts arise. This may be before taking on a new client, or before making any recommendation to, or accepting any instructions from, the client.

Conflict procedures should be communicated to each client at the beginning of the business relationship and in a way that is understandable and useful to that client.

"Blanket" disclosure about routine compensation arrangements in general is appropriate so long as you disclose changes to those arrangements promptly. However, in other cases (for example, referral fees), disclosure should be made on a case-by-case basis so that the client can consider the information in the context of any decision the client needs to make in the circumstances giving rise to the compensation.

**4. Disclose promptly to the client any information that a reasonable client would consider important in determining your ability to provide objective service or advice.**

Conflicts that you cannot avoid should be managed appropriately. You must fully disclose to your clients all conflicts of interest and all potential conflicts of interest that you know, or ought to know about. Certain conflicts are inherent in the relationship between you and your clients, such as the remuneration of any sort paid to you for the distribution of units of a mutual fund to a client and recommendations you make in selling proprietary products or services of your firm or an affiliated company.

You have an obligation to ensure that your clients are aware of and understand these conflicts. Even when you believe that your actions are not affected by the conflict, you must ensure that even an appearance of a conflict is adequately addressed.

One of the most important areas for full disclosure is anything to do with compensation you receive that is related to the work you do for the client or to your relationship with the client. You must disclose fees received or paid for client referrals, sharing compensation with someone else (commission splitting), contingency fees and any compensation incentives you receive in connection with the client or the client's business (for example, trailer fees). The disclosure must be made before the client is required to make a decision about the transaction in question.

For example, sometimes several products would be suitable for a client but one product pays you significantly higher commissions or fees. This should be disclosed, because a reasonable client would likely consider that this difference in your compensation could affect your objectivity.

**5. When acting as an underwriter, act in the best interests of the investors. Disclose to investors any direct or indirect relationships between you and the issuer or seller that would lead a reasonable investor to question whether you and the issuer or seller are in fact independent from each other.**

The role of the underwriter includes performing due diligence and negotiating the price and terms of the offering. In performing these functions, the underwriter is acting on behalf of the public investors. Even when the underwriter is unrelated to the issuer or seller of the securities being underwritten, there are conflicts of interest involved, such as the underwriter's desire to earn the commission and underwriting fee and to be considered by the issuer for future underwriting and advising work.

When the underwriter and the issuer are not independent, the potential for conflicts of interest increases. This section requires that underwriters act in the best interests of the investors. Underwriters will have to be particularly vigilant in situations where there is less than complete independence. The obvious situation is cross-ownership of the underwriter and the issuer, either directly or through a parent entity. However, there can be other relationships between an underwriter and the issuer, or parties affiliated with them, that would lead a reasonable investor to question whether the underwriter and issuer were in fact independent of each other.

The best way to ensure that these conflicts are resolved in favour of the investor is to have appropriate procedures to ensure that outcome and to have a system that effectively monitors and enforces compliance with those procedures.

This section requires you to disclose to the investor the circumstances of any relationship that could reasonably be perceived as less than completely independent. The disclosure should be sufficient so that the investor fully understands the nature of the conflict and its relevance to the underwriting transaction.

In some cases, the conflict may be so direct that you may conclude that following your ordinary procedures and making disclosure to investors may not be sufficient to remove the potential for real conflict, or at least the apprehension of conflict in the mind of the reasonable investor. An example would be your underwriting an issue of your own securities. In those cases, you may conclude that an independent underwriter should be involved in the transaction in a meaningful role to alleviate any concerns over the potential for real conflict.

**6. When providing security analyst services you must develop, establish and enforce conflict of interest policies that adequately address the conflicts of interest faced by analysts within their firms.**

Analysts are exposed to increasing pressures from internal and external sources as well as conflicts of interest. As a result, their reports and recommendations are not always as objective, candid, or independent as they might be. In attempting to remedy this situation, you must develop conflict of interest policies that address conflicts for analysts specifically. Some policies you may want to consider would be the required disclosure by the analyst of specific conflicts of interest in each research report and recommendation issued on a company (for example, if the advisor holds a long or short position in the company's shares). We also recommend that the disclosure be readable and displayed prominently, whether printed or disseminated electronically. You may also want to consider preventing any analyst employed by you from issuing research on a company when the analyst serves as an officer, director or employee of, or serves in any advisory capacity to, the company.

## Principle 6 – Compliance systems

**1. Maintain an effective system to ensure compliance with this Code, all applicable regulatory and other legal requirements and your own internal policies and procedures.**

You are required to develop, implement and monitor a written compliance system that satisfies the requirements of the Code. The system you develop should be effective for your firm and its business procedures.

**2. Ensure that your compliance function possesses the technical competence, adequate resources and experience necessary for the performance of its functions.**

An effective system will provide for monitoring compliance with the system. This usually requires:

- staff, sufficient in number, independence and authority to effectively operate and enforce the system, and
- regular audits of the system's effectiveness.

If you have multiple branches you should consider the need for a compliance person in some or all of those branches. Perhaps the best way to achieve effective compliance is to have the compliance function in your firm independent from other functions and have the compliance reporting relationship reflect this. In small firms with few employees, senior management should assume compliance responsibilities.

**3. Ensure that all of your staff members who engage in trading or advising activities are appropriately qualified and supervised.**

You are responsible for all trading and advising activities by your representatives and therefore you must not only hire people with the appropriate qualifications but also supervise them. Those in supervisory positions should have sufficient experience to do so and should also be fully familiar with the firm's compliance system.

**4. Provide clients with all the information that a reasonable client would consider important respecting all transactions that you conduct on the client's behalf at the time of the transaction and on an ongoing basis.**

You should promptly send the client all relevant information relating to a trade, having regard to the type of security being traded. This includes the particulars of the trade, any consideration paid by the client in connection with the trade and any information about conflicts of interest that apply to the trade (see Principle 5). Relevant information would also include anything the client will need to know to prepare and file income tax returns.

You should send your clients statements that keep them informed about the status of their accounts and about the activity in the account since the last statement. The objective is to ensure the client has information on a current basis that is reasonable in the circumstances. This would normally mean monthly, however, less frequent reporting may be reasonable in some circumstances (for example, if the volume and frequency of trading in the account is low, or if the client requests less frequent reporting).

**5. Separate underwriting functions from the firm's trading and advising functions.**

If you carry out both underwriting activities and trading or advising activities, you need to be particularly careful about information about upcoming offerings being generally accessible. You will need to ensure there is an effective system of functional barriers (known as "Chinese walls") to prevent the flow of information that may be confidential or price sensitive between the corporate finance group and the trading and advising groups. Lapses in this area may lead to allegations of tipping or trading on inside information.

**6. Notify the Commission immediately of any significant change in the information relating to the registration, and of the hiring or termination (including reasons), of any trading or advising representative.**

The information you provided when you registered as a firm or an individual is important to the Commission's assessment of your fitness as a registrant and to the Commission's ability to maintain contact with you. Therefore, any change in this information is significant and you must disclose it to the Commission.

You should fully disclose the circumstances of any termination, especially if your representative breached any provisions of the Code and this played any part in the termination. When asked by the regulators about a possible breach of a relevant regulation (whether committed by you or by your client), you should respond cooperatively and truthfully.

In the case of dually licenced individuals, it is the firm's obligation to inform the Commission of breaches by those individuals of other regulatory requirements because this goes to the person's character and suitability to be employed in the securities industry. For example, if the individual is an employee of a bank-owned investment dealer and is terminated for breaching a bank-related rule, you must inform the Commission of the reasons for that termination.

## Principle 7 – Client complaints

**Create and use adequate procedures for handling client complaints effectively.**

You must deal directly with all formal and informal complaints or disputes or refer them to the appropriate person or process, in a timely and forthright manner. You should be fully aware of all applicable processes for dealing with complaints and should disclose to all clients the channels available for pursuing different types of complaints (for example, regarding conduct, service, or product performance).

Some registrants are also registered to do business in other sectors, such as insurance. In this case, you must inform clients of the differing complaint resolution mechanisms for each sector in which you do business and how the clients can use those mechanisms.

It is good business practice to provide a written response to any client who complains about you or your firm.

# CHAPTER 2
# Registration Part 2: Exemptions

## Rule provisions

### Exemptions from registration as a dealer

(1)(a) *Trades to or through a dealer:* A person is not required to register to trade securities or exchange contracts to or through a person registered as a dealer in any province or territory of Canada.

(1)(b) *Trades to an exempt purchaser*: A person is not required to register to trade securities to exempt purchasers acting as principal, or for persons referred to in paragraph (i) or (ii) of the definition of *accredited investor*, purchasing for accounts fully managed by those persons.

**"exempt purchaser"** means:

(a) a director, officer, promoter, or control person of the issuer or an affiliate of the issuer,
(b) a spouse, parent, grandparent, brother, sister, or child of a director, senior officer or control person of the issuer or an affiliate of the issuer,
(c) a close personal friend or close business associate of a director, senior officer or control person of the issuer or affiliate of the issuer,
(d) an employee or consultant of the issuer or an affiliate of the issuer or an employee of a company providing management services to the issuer,
(e) a vendor of a property or other asset to the issuer or an affiliate of the issuer,
(f) an existing securityholder, and
(g) an accredited investor, meaning
    (i) a Canadian financial institution or its wholly owned subsidiary, or an equivalent entity in another jurisdiction,
    (ii) a registered dealer or adviser, an adviser exempt from the registration requirement under section 86 of the Rules,[12] an equivalent entity in another jurisdiction or a representative of the dealer, adviser or entity,
    (iii) any government, municipality, government agency, public board or commission,
    (iv) a pension fund that is regulated by the Office of the Superintendent of Financial Institutions (Canada) or a provincial pension commission or a similar regulatory authority in any jurisdiction,
    (v) a registered charity under the *Income Tax Act* (Canada) or an equivalent entity in another jurisdiction,
    (vi) an individual who, either alone or jointly with a spouse, beneficially owns, directly or indirectly, financial assets having an aggregate realizable value that before taxes, but net of any related liabilities, exceeds $1,000,000,
    (vii) an individual whose net income before taxes exceeded $200,000 in each of the two most recent years or whose net income before taxes combined with that of a

[12] This is the current exemption for investment dealers and their directors, officers, partners and advising employees if they follow IDA rules for portfolio managers. We propose, later in this Part of Chapter 2, that this exemption be retained.

spouse exceeded $300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year,

(viii) a corporation, limited partnership, limited liability partnership, association, trust or estate, that had net assets of at least $5,000,000 as shown on its most recently prepared financial statements, and any wholly owned subsidiary,

(ix) a mutual fund or non-redeemable investment fund if

(A) all securityholders of the fund are accredited investors, or

(B) it files continuous disclosure as a public mutual fund or non-redeemable investment fund,

(x) a person if all of the owners of interests in the person are accredited investors, and

(xi) a person recognized by the commission as an accredited investor.

(1)(c) *Trades in securities of restricted issuers:* A person is not required to register to trade securities of a restricted issuer.

(1)(d) *Trades in securities back to the issuer*: A person is not required to register to trade securities to the issuer of those securities.

(1)(e) *Trades in non-syndicated mortgages under mortgage brokerage legislation*: A person is not required to register to trade mortgages sold under [legislation governing mortgage brokers], provided the mortgages are not syndicated mortgages.

"**syndicated mortgage**" means an investment arrangement in which a person participates, together with others, as a mortgagee through the acquisition of a portion of a debt obligation that is secured by a mortgage.

(1)(f) *Trades in real estate securities sold by a licensed real estate agent*: A person is not required to register to trade real estate securities if the person is licensed or exempted from licensing under [legislation governing real estate].

(1)(g) *Trades in variable insurance contracts issued by an insurer and sold by a licensee under financial institution legislation*: A person is not required to register to trade variable insurance contracts issued by an insurer and sold by a person licensed or exempted from licensing under [legislation governing financial institutions].

(1)(h) *Trades outside Canada:* A person is not required to register to trade to persons or through markets outside Canada in compliance with applicable foreign laws.

(1)(i) *Unsolicited trades with foreign dealers*: A person is not required to register to trade solely through a dealer registered outside Canada if the dealer does not solicit business from residents in Canada.

(1)(j) *Trades in securities in connection with a corporate reorganization or take over bid:* A person is not required to register to trade securities in connection with a reorganization, merger, take over bid, or other business combination.

(1)(k) *Trades in securities issued to satisfy debt or as consideration for a bonus or finder's fee:* A person is not required to register to trade securities issued to satisfy debts or as consideration for a bonus or finder's fee.

(1)(l) *Trades by a senior issuer that is in the CMA system in its own securities with mandated disclosure to purchasers:* A person is not required to register to trade securities of a senior issuer that is in the CMA System if:

(i) no consideration is paid to any person in connection with the trade,

(ii) the issuer does not give any advice regarding the merits or suitability of the securities, and

(iii) every person who is solicited to purchase the securities from the issuer is notified as required by the Rules.

(1)(m) *Trades in senior debt securities*: A person is not required to register to trade:

(i) debt securities or options to acquire those debt securities, issued or guaranteed by, the government of Canada or a province or territory of Canada,

(ii) debt securities or commercial paper rated at the level, and by a rating agency, designated by the executive director,

(iii) strip bonds or zero interest bonds guaranteed by the Government of Canada or by a province or territory of Canada, or

(iv) certificates and receipts for money received for guaranteed investments issued by regulated financial institutions whose deposits are insured by an agency of the government of Canada or a province or territory of Canada.

(1)(n) *Trades to realize on legal obligations:* A person is not required to register to trade in securities or exchange contracts if the trade is made by a person acting under the authority of a court, administrative body, contract, or statute in the course of enforcing legal obligations or administering the affairs of another person.

(1)(o) *Trades that are isolated trades*: A person is not required to register to trade in securities or exchange contracts if the trade is an isolated trade.

## Exemptions from registration as an adviser

(2) A person is not required to register as an adviser

(a) if the person is advising others about investing in securities that can be traded by a person exempted from the requirement to register, except when the person is managing investment portfolios of others through exercising discretionary authority,

(b) if the person is a member of a self regulatory organization and complies with the rules or other regulatory instruments of that self regulatory organization relating to portfolio management activities,

(c) if the person is registered as an adviser outside Canada and does not solicit business from residents of Canada.

# Chapter 2
# Registration Part 3: Registration Passport

## Rule provisions

### Applying for registration

(1) If British Columbia is the applicant's principal jurisdiction, the applicant must file an application to register in the prescribed form, pay the prescribed fee, and provide any other information the executive director requires.

(2) If British Columbia is the applicant's principal jurisdiction, and the applicant wants to apply for registration in a reciprocal jurisdiction, the applicant can do so by indicating, on the prescribed form, that the applicant is applying for registration in the reciprocal jurisdiction and paying the prescribed fee for registration in the reciprocal jurisdiction.

(3) If an applicant's principal jurisdiction is a reciprocal jurisdiction, the applicant can apply, under the reciprocal jurisdiction's equivalent of subsection (2), for registration in British Columbia by indicating, on the reciprocal jurisdiction's prescribed form, that it wishes to be registered in British Columbia and by paying the prescribed fee for registration in British Columbia.

(4) Applicants that comply with a reciprocal jurisdiction's equivalent of subsection (2) and are registered in that jurisdiction are registered in British Columbia to carry out the same activities they are registered to carry out in their principal jurisdiction.

"**principal jurisdiction**" means the jurisdiction to which a person has the most significant connection, considering the person's place of residence, office location(s), head office location, revenues in the [province or territory], assets in the [province or territory], number of registered and other employees or independent contractors, place of incorporation or organization, **[and any other relevant factors].**

"**reciprocal jurisdiction**" means the other provinces and territories that have adopted **[the uniform act].**

# Chapter 2
# Registration Part 4: Firm-only Registration

## Act provisions

### Registration requirement

1. A person must not
   (a) trade in a security or an exchange contract, or
   (b) act as an adviser

unless the person is registered, or exempted from registration, in accordance with the Rules, or is a representative.

"**representative**" means an individual who trades in securities or exchange contracts or acts as an adviser only as a representative of a firm.

## Information sharing

2.(1) Notwithstanding the *Freedom of Information and Protection of Privacy Act, t*he commission, SROs, marketplaces, regulation services providers, clearing and settlement agencies, and other securities regulators (in this section, called regulators) can disclose personal information of individuals engaged in, formerly engaged in, or proposing to be engaged in, trading in securities or exchange contracts or acting as advisers to a registered firm or a firm applying for registration to enable it to make any decision regarding hiring such an individual.

(2) Notwithstanding [citation for private sector personal information protection], and notwithstanding the *Personal Information Protection and Electronic Documents Act (Canada),* registered firms can collect, use, and disclose to other registered firms, or firms applying for registration, personal information of individuals engaged in, formerly engaged in, or proposing to be engaged in, trading in securities or exchange contracts or acting as advisers for a registrant to enable the registrant to make any decision regarding hiring such an individual.

(3) Regulators that receive a request to share information under (1), and firms that receive a request to share information under (2), must provide all relevant personal information about the individual specified in the request if the regulator or firm knows or believes the information is important to the recipient's decision.

(4) A registered firm or a firm applying for registration that collects information under the authority of this section can only use the information to make decisions about hiring representatives.

(5) A registered firm or firm applying for registration that collects and uses information under the authority of this section can only disclose it:
- (a) to regulators exercising their authority over any persons under their jurisdiction,
- (b) to other registered firms or firms applying for registration that make a request under (2), or
- (c) if required by law.

(6) If a regulator or registered firm collects, uses, or discloses personal information under this section, that regulator or registered firm must take all necessary steps to protect the individual's personal information that is not otherwise identified in this Act as public information from unauthorized collection, use, and disclosure.

(7) A regulator, registered firm, or firm applying for registration that collects personal information of an individual under the authority of this section must disclose to the individual what the personal information will be used for and what disclosure can be made to others under the authority of this section.

(8)

(a) An individual whose personal information has been collected, used, or disclosed under this section may get a copy of any information used to make hiring decisions.

(b) If an individual thinks any personal information used or disclosed under this section is inaccurate or incomplete, that individual can request the registered firm or firm applying for registration to amend its personal information about the individual.

(c) The privacy officer for the registered firm or firm applying for registration must consider all requests for amendment to personal information about individuals and can amend any personal information, as necessary, after considering the individual's request for amendment or decline to amend the personal information.

(9) A registered firm or firm applying for registration that collects, uses, or discloses personal information of individuals under the authority of this section must appoint a privacy officer, who must ensure:

(a) all personal information is handled in accordance with the protections of this section,

(b) individuals whose personal information is collected, used, or disclosed under the authority of this section get disclosure from the firm about the uses and disclosure permitted,

(c) the firm's personal information handling policy, including policies relating to this section, is readily available to the public, including:

(i) the name and contact information for the privacy officer,

(ii) the process for reviewing and requesting amendments to the personal information a firm has about an individual, and

(iii) the process for appealing a decision made by the privacy officer declining to amend, in whole or in part, the personal information the firm has about an individual.

(10) A registered firm or firm applying for registration that collects, uses, or discloses information about a representative in accordance with the requirements of this section has a defence of qualified privilege to an action for defamation.

161.(1)If the commission or the executive director considers it to be in the public interest, the commission or the executive director, after a hearing, may order one or more of the following:

. . .

(g) that a person

(i) resign as a representative of a firm,

(ii) is prohibited from becoming or acting as a representative of a firm,

(iii) is prohibited from engaging in trading, advising, or investor relations activities,

(h) that a representative be reprimanded or that a representative's trading or advising activities be suspended, cancelled, or restricted, or made subject to any conditions that the Commission may impose **[Note to Reader: These provisions would be added to s. 161(1) of the Act]**

# Rule provisons

## Filing information about representatives

(1) On application for registration, an applicant must provide the Commission with this information about each individual trading in securities or exchange contracts or acting as an adviser on the firm's behalf:
- (a) full name,
- (b) birth date,
- (c) trading or advising activities the representative is authorized to engage in, and
- (d) the conditions or limitations, if any, on the representative's trading or advising activities.

(2) When the employment relationship between a firm and a representative terminates, the firm must file a notice stating:
- (a) the name of the representative, and
- (b) the date of termination.

(3) All information provided to the commission under this section is public information, except that in (1)(b).

## Authority and proficiency of representatives

2.(1) A firm must specify in writing the trading or advising services the representative is authorized to provide on behalf of the firm.

(2) A representative is not authorized to provide trading or advising services that are outside the scope of the firm's registration.

## Commission powers

3.(1) The executive director may restrict or impose conditions on a representative's trading or advising activities, including
- (a) restricting the duration of the representative's trading or advising activities,
- (b) restricting the representative's trading activities to trading in specified securities or exchange contracts, or classes of securities or exchange contracts.

(2) The executive director acting under (1) must not restrict or impose conditions on a representative's trading or advising activities without giving the representative an opportunity to be heard.

(3) A representative must comply with a restriction or condition imposed by the executive director under (1).

# Chapter 2
# Registration Part 5: Other Registration Proposals

## Act provisions

### Representative corporation

"**representative**" means a person who trades in securities or exchange contracts or acts as an adviser only as a representative of a firm and includes a representative corporation.

"**representative corporation**" means a corporation
(a) that receives commissions and fees from a firm,
(b) that is incorporated under the laws of Canada or the laws of a province or territory of Canada, and
(c) all of whose directors, officers, and shareholders are representatives of the same firm or family members of those representatives.

## Rule provisions

### Foreign Registrants

1. A person is not required to register to trade solely through a dealer registered outside Canada if the dealer does not solicit business from residents of Canada.

2. A person is not required to register as an adviser if the person is registered as an adviser outside Canada and does not solicit business from residents of Canada.

### Filing information about representatives

2.(1) On application for registration, an applicant must provide the commission with this information about each individual trading in securities or exchange contracts or acting as an adviser on the firm's behalf, *whether acting as an individual or through a representative corporation:*
   (a) full name,
   (b) birth date,
   (c) trading or advising activities the representative is authorized to engage in, and
   (d) the conditions or limitations, if any, on the representative's trading or advising activities.

*(2) On application for registration, an applicant must provide the commission with this information about any representative corporation with which it has a contract:*
   *(a) name of the representative corporation,*
   *(b) the jurisdiction in which the representative corporation was incorporated or organized, and*
   (c) *the representative corporation's address for service.*

*(3)* When the employment relationship or contract between a firm and a representative terminates, the firm must file a notice stating:
(a) the name of the representative, and
(b) the date of termination.

*(4)* All information provided to the commission under this section is public information, except that in (1)(b).

# Chapter 3
# Investor Remedies Part 1: CMA issuer liability for misrepresentation or failure to disclose

## Act provisions

**Definitions**
**1.** In this part,

**"CMA issuer"** means . . . **[Note to Reader – see legislation under Chapter 1]**

**"derivative security"** means a security whose market price or value or payment obligations are derived from or based on a security of a CMA issuer and that is created by a person on behalf of the CMA issuer or is guaranteed by the CMA issuer,

**"document"** means any written communication, including electronic communication,
(a) that is filed or required to be filed with the Commission or a market on which the issuer's securities trade, or
(b) the content of which would reasonably be expected to affect the market price or value of the security,

**"due diligence provider"** means an underwriter or any other person or class of persons acceptable to the executive director,

**"expert"** means a person whose profession gives authority to a statement made in a professional capacity, including an accountant, actuary, appraiser, auditor, engineer, financial analyst, geoscientist and lawyer,

**"material information"** means information relating to the business and affairs of an issuer that would reasonably be expected to result in a significant change in the market price or value of any of the issuer's securities,

"**misrepresentation"** means
(a) an untrue statement of material information, or
(b) an omission to state material information that is necessary to prevent a statement that is made from being false and misleading,

**"public oral statement"** means an oral statement made in circumstances in which a reasonable person in the position of the speaker would believe the information contained in the statement will become generally disclosed,

**"release"** means
(a) file with the commission or any other securities commission in Canada or an exchange, or
(b) to otherwise make available to the public,

"**representative**" means a person with actual, implied or apparent authority to act or speak on behalf of a CMA issuer.

## Rights of Action

2(1) If a CMA issuer or a representative of the issuer releases a document that contains a misrepresentation and a person purchases or sells a security of the CMA issuer or a derivative security between the time when the document was released and the time when the misrepresentation is publicly corrected, the person has a right of action for damages against:
(a) the CMA issuer,
(b) every director of the CMA issuer at the time that the document was released,
(c) every officer of the CMA issuer who authorized, permitted or acquiesced in the release of the document,
(d) an expert if the expert provided written consent to the use of the expert's opinion or report in any document and the expert's opinion or report also contained the misrepresentation, and
(e) if the person with the right of action participated in an offering, any due diligence provider for the offering.

2(2) If a CMA issuer or a representative of the issuer makes a misrepresentation in any public oral statement about the issuer and a person purchases or sells a security of the CMA issuer or a derivative security between the time when the public oral statement was made and the time when the misrepresentation is publicly corrected, the person has a right of action for damages against:
(a) the CMA issuer,
(b) the person who made the public oral statement,
(c) every director of the CMA issuer on the date of the public oral statement, and
(d) every officer of the CMA issuer who authorized, permitted or acquiesced in the making of the public oral statement.

2(3) If a CMA issuer fails to disclose all material information as required under the Act, a person who purchases or sells a security of the CMA issuer or a derivative security between the time when the material information was required to be disclosed and the time when it was disclosed as required under the Act has a right of action for damages against:
(a) the CMA issuer,
(b) every director of the CMA issuer at the time when the material information was required to be disclosed, and
(c) every officer of the CMA issuer who authorized, permitted or acquiesced in the failure to disclose material information.

2(4) In an action under this section,
- (a) multiple misrepresentations having common subject matter may, in the discretion of the court, be treated as a single misrepresentation, and
- (b) multiple instances of failure to disclose material information concerning common subject matter may, in the discretion of the court, be treated as a single failure to disclose material information.

2(5) In an action under subsection (2), if the person that made the public oral statement had apparent, but not implied or actual, authority to speak on behalf of the issuer, no other person is liable for purchases or sales of a security of the CMA issuer or a derivative security before the other person became, or should reasonably have become, aware of the misrepresentation.

## What investor proves

3(1) A person has a right of action under section 2 without regard to whether the person relied on the misrepresentation or on the issuer having failed to disclose material information as required under the Act.

3(2) If a person has a right of action against a directors of an issuer under section 2 and the issuer had a system described in section 4(1), the person must prove that the director knowingly made the misrepresentation or failure to disclose material information or was reckless or willfully blind.

## Defences

4(1) Subject to subsection 3(2), a CMA issuer and its directors are not liable under section 2 if, at the relevant time, the issuer had a reasonable regime to prevent misrepresentations or failure to disclose material information as required under the Act and a reasonable process for monitoring compliance with the regime.

4(2) A person, other than the CMA issuer and its directors, is not liable under section 2(1) or (2) if the person conducted or caused to be conducted a reasonable investigation before the release of the document or the making of the public oral statement containing the misrepresentation and, at the time of the release of the document or the making of the public oral statement, the person had no reasonable grounds to believe that the document or public oral statement contained a misrepresentation.

4(3) A person, other than the CMA issuer and its directors, is not liable under subsection 2(3) if the person conducted or caused to be conducted a reasonable investigation before the failure to disclose material information first occurred, and the person had no reasonable grounds to believe that the failure to disclose material information would occur.

4(4) An expert is not liable under section 2(1) or (2) if:
- (a) the misrepresentation derives from the expert's report and resulted from a misrepresentation that the issuer or a third party made to the expert,
- (b) the issuer did not fairly represent the expert's report, or
- (c) the expert withdrew previously given written consent to the use of the report.

4(5) No person, other than an expert, is liable under sections 2(1) or (2) for the part of the document or public oral statement that uses an expert's opinion or report if the misrepresentation is based on the expert's opinion or report, the expert provided written consent to the use of the expert's opinion or report and the person did not know and had no reasonable grounds to believe that there had been a misrepresentation in the part of the document or public oral statement made on the authority of the expert unless

(a) the person made a misrepresentation to the expert,
(b) the person did not fairly represent the expert's opinion or report, or
(c) the expert withdrew in writing the consent that had previously been given to the use of the opinion or report.

4(6) A person is not liable under section 2(3) if:

(a) the material information is disclosed in a confidential material information report,
(b) the CMA issuer has a reasonable regime to keep undisclosed material information confidential and a reasonable process for monitoring compliance with the regime,
(c) there is a reasonable basis for determining that disclosure of the information would be unduly detrimental to the issuer and a reasonable basis for maintaining confidentiality,
(d) the information remains confidential until disclosed by the issuer,
(e) the issuer discloses the information as required by the Act in circumstances that would lead a reasonable person in the position of the issuer to conclude that the information may no longer be confidential, and
(f) there is no tipping or trading in the issuer's securities by the issuer or its insiders.

4(7) A person is not liable under section 2(3) if material information is disclosed as required under the Act within 24 hours of circumstances arising that would lead a reasonable person in the position of the issuer to conclude that the information may no longer be confidential.

4(8) Subsection (7) does not apply to a person who

(a) traded on undisclosed material information,
(b) informed another person of the undisclosed material information, unless necessary in the ordinary course of business, or
(c) engaged in fraud or market manipulation. **[Note to Reader: see definition of "fraud or market manipulation" in Chapter 3, Part 4]**

4(9) A person is not liable for forward looking information if:

(a) the public disclosure contains, close to the forward looking information,
    (i) cautionary language identifying the information as forward looking information and identifying material factors that could cause actual results to differ materially from the forecast or projection in the forward looking information, and
    (ii) a statement of material factors or assumptions relied on in making the forward looking statement, and
(b) the person making the statement had a reasonable basis for making it.

4(10) A person is not liable under section 2 if the person proves that the plaintiff purchased or sold the CMA issuer's security or a derivative security with knowledge of the misrepresentation or the material information.

4(11) A person is not liable under section 2(1) or (2) if the person proves that:
- (a) the misrepresentation is also contained in a document filed by a person other than the CMA issuer with the commission or another securities commission in Canada or an exchange and not corrected in another document filed by that other person with the commission or another securities commission in Canada or an exchange before the release of the document or the public oral statement by the CMA issuer,
- (b) the document or public oral statement contained a reference identifying the document that was the source of the misrepresentation, and
- (c) at the time of the release of the document or the making of the public oral statement, the person did not know and had no reasonable grounds to believe that the document or public oral statement contained a misrepresentation.

4(12) Other than a document required to be filed with the commission, a person is not liable under section 2(1) if the person proves that, at the time of the release of the document, the person did not know and had no reasonable grounds to believe that the document would be released.

## Factors to be considered

5. In determining whether an investigation was reasonable in section 4(2) or (3), the court must consider all relevant circumstances, including:
- (a) the nature of the issuer,
- (b) the knowledge, experience and function of the defendant,
- (c) the office held if the defendant was an officer,
- (d) the existence, if any, and the nature of any system to ensure that the issuer meets its disclosure obligations,
- (e) the reasonableness of reliance by the defendant on the issuer's disclosure compliance system and on the issuer's officers, employees and others who would be expected to have knowledge of the relevant facts,
- (f) the time period within which disclosure was required to be made under applicable law,
- (g) any professional standards that apply to an expert who gave an opinion or report,
- (h) the extent to which the defendant knew or should have known the content and medium of dissemination of the document or public oral statement, and
- (i) the role and responsibility of the person in
  - (i) the preparation and release of the document or the making of the public oral statement,
  - (ii) ascertaining facts contained in the document or public oral statement, or
  - (iii) the decision not to disclose the material information.

## Damages

6. Damages must not include any amount that the defendant proves is attributable to a change in market price of the securities or derivative securities unrelated to the misrepresentation or the failure to disclose material information.

### Proportionate liability

7 Each defendant who is found liable in an action under this Part is liable, subject to the liability limits in the Act, for the portion of the damages that correspond to the defendant's responsibility for the damages unless the defendant acted knowingly or was reckless or willfully blind in which case the defendant is liable for the full amount of the damages.

8. A defendant who is found liable for the full amount of the damages is entitled to claim contribution from any other defendant in the same action who is also found liable for the full amount of the damages.

### Derogation from other rights

9. The rights of action under this Part are in addition to and not in derogation from any other right the person may have.

# Chapter 3
# Investor Remedies Part 2: Firm liability for breach of Code

## Act provisions

### Definitions

1. In this part,

"**code**" means the code of conduct in the *Securities Rules* that applies to a firm in that firm's category of registration,

"**firm**" means a dealer, adviser, or portfolio manager,

"**representative**" means a person who trades in securities or exchange contracts or acts as an adviser only as a representative of a firm and includes a representative corporation,

"**representative corporation**" means . . . **[see legislation under Chapter 2, Part 5]**

### Liability for breaches of code

2. If a firm or its representative breaches a principle in the code that causes damage to a person that is a client or former client of the firm, the client or former client of the firm has a right of action for damages against
   (a) the firm,
   (b) every director of the firm at the relevant time,
   (c) every officer of the firm at the relevant time who authorized, permitted or acquiesced in the breach of the code, and
   (d) the representative that the client or former client dealt with at the relevant time.

### What client proves

3. If a person has a right of action against a director of a firm under section 2 and the firm had a system described in section 4(1), the person must prove that the director knew of the breach or was reckless or willfully blind.

### Defences

4(1) Subject to section 3, a director of a firm is not liable under section 2 if, at the time of the breach, the firm had a reasonable regime to ensure compliance with the code and a reasonable process for monitoring compliance with that regime.

4(2) Except where an officer is found to have personally breached the code, an officer is not liable under section 2 if the officer conducted a reasonable investigation and had no reasonable grounds to believe that the code was being breached by a representative.

4(3) A firm and its representative may not invoke a due diligence defence in an action under section 2.

4(4) The firm may not invoke a defence that the representative was acting outside of the scope of authority in an action under section 2.

### Factors to be considered

3. In determining whether an investigation was reasonable in section 4(2), the court must consider all relevant circumstances, including:
   (a) the nature of the firm,
   (b) the knowledge, experience and function of the defendant,
   (c) the office held,
   (d) the existence, if any, and the nature of any system to ensure that the firm meets its obligations under the code,
   (e) the reasonableness of reliance by the defendant on the firm's compliance system and on the firm's officers, employees and others who would be expected to have knowledge of the relevant facts, and
   (f) the role and responsibility of the person at the firm.

### Damages

4. In assessing damages, the court must consider any actions of a plaintiff that contribute to the plaintiff's loss.

### Liability

5. Each director and officer of a firm who is found liable in an action under this Part is liable, subject to the liability limits in the Act, for the portion of the damages that correspond to the director's or officer's responsibility for the damages unless the director or officer acted knowingly or was reckless or willfully blind in which case the director or officer is liable for the full amount of the damages.

6. A firm or its representative who is found liable in an action under this Part is liable for the full amount of the damages.

7. A defendant who is found liable for the full amount of the damages is entitled to claim contribution from any other defendant in same action who is also found liable for the full amount of the damages.

### Derogation from other rights

8. The rights of action under this Part are in addition to and not in derogation from any other right the person may have.

# Chapter 3
# Investor Remedies Part 3: Actions for insider trading

To be published at a later date.

# Chapter 3
# Investor Remedies Part 4: Liability for fraud or market manipulation

## Act provisions

### Definitions

1. In this part,

"**fraud or market manipulation**" means a transaction or series of transactions relating to a trade in or acquisition of a security or an exchange contract if the person knows, or ought reasonably to know, that the transaction or series of transactions

(a) perpetrates a fraud, or
(b) results in or contributes to a misleading appearance of trading activity in, or an artificial price for, any security or exchange contract.

### Liability for fraud and market manipulation

2. If a person participates in a fraud or market manipulation, a person who purchased or sold securities while the fraud or market manipulation was occurring has a right of action for damages against any person who participated in the fraud or market manipulation.

### Derogation from other rights

3. The rights of action under this Part are in addition to and not in derogation from any other right the person may have.

# Chapter 3
# Investor Remedies Part 5: Liability for unfair practices and misrepresentations

## Act provisions

### Definitions

1. In this part,

**"investor"** means a person who purchased or sold securities or exchange contracts,

"**unfair practice**" includes any of the following:
(a) putting unreasonable pressure on a person to purchase, hold or sell a security,
(b) taking advantage of a person's inability or incapacity to reasonably protect his or her own interest because of physical or mental infirmity, ignorance, illiteracy, age or inability to understand the character, nature or language of any matter relating to a decision to purchase, hold or sell a security or exchange contact,
(c) imposing terms or conditions that make a transaction inequitable.

### Liability for Unfair Practices and Misrepresentation

2(1) If a person engages in unfair practices in connection with a trade in or acquisition of a security or exchange contract that causes an investor to trade or acquire the security or exchange contract, the investor has a right of action for damages or rescission against the person who engaged in unfair practices.

2(2) If a person, while engaging in investor relations activities or with the intention of effecting a trade in a security, makes a misrepresentation to an investor who subsequently purchases or sells the security, the investor has a right of action for damages or rescission against the person who made the misrepresentation.

2(3) An action under subsection 2(2) is not available against a person who can be sued under Part 1.

3. An investor has a right of action under section 2(2) without regard to whether the person relied on the misrepresentation.

### Derogation from other rights

4. The rights of action under this Part are in addition to and not in derogation from any other right the person may have.

# Chapter 3
# Investor Remedies Part 6: Protections for defendants

## Act provisions

### Definitions

1. "**code**" means … **[Note to Reader: see legislation under Chapter 2, Part 1]**,

"**firm**" means . . . **[Note to Reader: see legislation under Chapter 2, Part 1]**,

"**market capitalization**" for an issuer means the aggregate of the following:

(a) for each class of equity securities for which there is a published market, the amount calculated by multiplying
  (i) the average number of outstanding securities of the class at the close of trading on each of the 10 trading days immediately before the day on which the misconduct occurred by
  (ii) the trading price of the securities of the class on the principal market on which the securities traded for the 10 trading days before the day on which the misconduct occurred, and

(b) for each class of equity securities not traded on a published market, the fair market value of the outstanding securities of that class as of the day on which the misconduct occurred.

### Court approval to proceed

2(1) Subject to subsection 2(2), no action may be commenced for a remedy under the Act without leave of the court.

2(2) Leave of the court is not required to commence an action for fraud or market manipulation or unfair practices under the Act.

2(3) The court may approve an application under subsection (1) if the court is satisfied that the action was commenced in good faith and there is a reasonable possibility that the action will be resolved in favour of the plaintiff.

### Court approval to settle

3(1) A proceeding for a remedy under the Act may only be settled, discontinued or abandoned with the approval of the court and on the terms the court considers appropriate.

3(2) In an application under subsection 3(1) for approval, the court must consider if any other actions have been brought under the Act or under comparable provisions in other jurisdictions in Canada regarding the same activity.

### Limits on damages

4(1) Subject to subsection 4(2), in an action for damages for misrepresentation, failure to disclose material information or breach of the code under the Act, a person shall not recover more than:
- (a) from an issuer, the greater of $1 million or 5% of market capitalization,
- (b) from directors and officers of an issuer or a firm, the greater of $25,000 or 50% of the total annual compensation, including stock or deferred compensation, they receive from the issuer or firm or their respective affiliates,
- (c) from an expert, the greater of $1 million and the amount the expert and its affiliates received from the issuer and its affiliates during the prior 12 months, or
- (d) from each person who made a public oral statement, other than an individual under paragraphs (a), (b) or (c), the greater of $25,000 or 50% of the total annual compensation, including stock or deferred compensation, they receive from the issuer and its affiliates.

4(2) The limits on liability set out in subsection 4(1) do not apply to a person, other than an issuer, if the plaintiff proves that the person knew about the misrepresentation, failure to disclose material information or breach of the code or was reckless or willfully blind.

# Chapter 3
# Enforcement and Public Interest Powers

## Act provisions

### Disgorgement

1. If the Commission, after a hearing,
(a) determines that a person has contravened or is contravening a provision of this Act or of the regulations, or has failed to comply or is not complying with a decision, and
(b) considers it in the public interest to do so,

the Commission may order the person to pay to the Commission one or both of the following:

(c) any money obtained by the person directly or indirectly as a result of the contravention or failure to comply,
(d) the amount of any payments or losses avoided by the person directly or indirectly as a result of the contravention or failure to comply.

### Orders against professionals

1. If the Commission, after a hearing,
- (a) determines that a person has intentionally contravened, or intentionally aided or abetted the contravention of, the Act or the regulations, and
- (b) considers it to be in the public interest,

the Commission may order the person not to appear or practice before the Commission.

2. "Appear or practice before the Commission" includes, but is not limited to:
   (a) preparing, or giving advice about preparing, documents filed with the Commission, and
   (b) representing a person on a matter that falls within the Commission's jurisdiction.

## Compliance and restraining orders

1. If the Commission determines that a person has not complied or is not complying with the Act or the regulations, the Commission may make an order,
   (a) restraining the distribution of any record,
   (b) requiring an amendment to or variation of any record, and
   (c) directing any person to comply with the Act or the regulations or restraining any person from contravening the Act or the regulations and directing the directors and senior officers of the person to cause the person to comply or to cease contravening the Act or the regulations.

2. An order may be made on application by an interested person or on the Commission's motion.

3. (a) An interested person must obtain leave from a single commissioner to make an application.
   (b) The commissioner may only grant leave if the commissioner considers it to be in the public interest.
   (c) The commissioner's decision whether to grant leave is final and cannot be appealed.

## Prohibition of unfair practices

**[Note to reader: This is the legislation as it appears in BC (the amendment also covers persons engaged in investor relations activities and exchange contracts]:**

50.(1) A person . . . with the intention of effecting a trade in a security, must not
. . .
   (e) engage in an unfair practice.
. . .

(4) For the purpose of this section, an "unfair practice" includes any of the following:
   (a) putting unreasonable pressure on a person to purchase, hold or sell a security;
   (b) taking advantage of the person's inability or incapacity to reasonably protect his or her own interest because of physical or mental infirmity, ignorance, illiteracy, age or inability to understand the character, nature or language of any matter relating to a decision to purchase, hold or sell a security;
   (c) imposing terms or conditions that make a transaction inequitable.

# APPENDIX B

## Form of AIF

**Chapter I of the Continuous Market Access Guidelines will help you prepare this form. The Guidelines are available on the BC Securities Commission website at www.bcsc.bc.ca.**

**[Form ·]**
***Annual Information Form***

Date:

*If this is your initial AIF, indicate that. Complete all unshaded portions of this form for all your AIFs, including your initial AIF. The shaded portions of this form are relevant only if this is your initial AIF and you are filing it in connection with a transaction.*

*Include all applicable information listed on this page on the cover page.*

_____
*(Name of issuer as set out in incorporation or organization documents)*

*State in bold type:*

**This is the [initial] AIF of** _____*[insert name of issuer]* **issued in connection with** _____ *[specify initial public offering, reverse take-over or other transaction]* **(the transaction). Information about the issuer is available on the SEDAR website at www.sedar.com.**

Name of underwriter(s):

*Include the following statements in bold type:*

**There are risks associated with investing in the company. See page ·.**

**If the company's continuous disclosure record, when taken as a whole, contains a misrepresentation, investors have the right to sue for damages. See page ·.**

**No securities regulatory authority is recommending these securities or has determined that this document is accurate or adequate. Any representation to the contrary is an offence under Canadian securities legislation.**

## Part 1 The business

### 1.1 The business

Describe the issuer's business, including its products or services, operations, marketing plan, competitive position and objectives.

### 1.2 Our history and development

(1) Describe how the issuer's business has developed generally over the last three financial years and any subsequent period and disclose the major events and conditions that affected that development.

(2) Discuss any changes in the issuer's business that you expect will occur during the current financial year.

### 1.3 Trend information

Describe any trend, contingency or uncertainty that would reasonably be expected to have a material effect on the issuer.

### 1.4 Other material information about the business

Disclose any other material information about the issuer's business that you have not disclosed elsewhere in this Part.

## Part 2 Risk factors

### 2.1 Risk factors

Describe in order of importance the risk factors that are material to the issuer.

## Part 3 Management and others involved with the issuer

### 3.1 Our management

Provide a resume for each of the issuer's directors and senior officers.

### 3.2 Board committees

(1) Disclose the board committees of the issuer and the members and mandate of each committee.

(2) If the issuer does not have an audit committee, state that.

### 3.3 Arrangements with senior management and key persons

Describe any arrangements intended to ensure that senior management and any key persons will remain with the issuer for a period of time and will not compete with the issuer if they leave.

### 3.4 Interest of management and others

Describe the following for each director, senior officer and significant shareholder, and any of their associates or affiliates, of the issuer and its subsidiaries:

(a) any existing or potential conflicts of interest between the person and the issuer or any of its subsidiaries, and

(b) any interest in any transaction involving the issuer or any of its subsidiaries within the last three financial years.

### 3.5 Legal, administrative and bankruptcy proceedings

Disclose the following for each of the issuer's directors, senior officers and, if this is the issuer's initial AIF, promoters and control persons, and for any issuer that they were a director, senior officer, promoter or control person of at the time:

(a) the circumstances and outcome of any court, securities regulatory, financial regulatory, or bankruptcy or similar proceedings, within the last 10 years,

(b) any cease trade or similar order issued within the last 10 years, and

(c) any pending securities or financial regulatory proceedings.

### 3.6 Compensation

(1) Using the following table, disclose the compensation that the issuer has paid in the last financial year and will pay in the current financial year to:

    (a) its chief executive officer (specifying name and municipality of residence),

    (b) its senior management, excluding the chief executive officer, as a group,

    (c) its independent directors (in that capacity), as a group, and

    (d) each of its significant shareholders and promoters, individually (specifying name, position with the issuer and municipality of residence).

| | **Compensation received in last financial year** | **Compensation to be received in current financial year** |
|---|---|---|
| Chief executive officer (name and municipality of residence) | Cash $_____ | Cash $_____ |
| | Other *[if constitutes 10% or more of total compensation, specify]* $_____ | Other *[if constitutes 10% or more of total compensation, specify]* $_____ |
| Senior management (as a group) | Cash $_____ | Cash $_____ |
| | Other *[if constitutes 10% or more of total compensation, specify]* $_____ | Other *[if constitutes 10% or more of total compensation, specify]* $_____ |
| Independent directors (as a group) | Cash $_____ | Cash $_____ |
| | Other *[if constitutes 10% or more of total compensation, specify]* $_____ | Other *[if constitutes 10% or more of total compensation, specify]* $_____ |
| Promoters and significant shareholders (for each, name, position and municipality of residence) | Cash $_____ | Cash $_____ |
| | Other *[if constitutes 10% or more of total compensation, specify]* $_____ | Other *[if constitutes 10% or more of total compensation, specify]* $_____ |

(2) Disclose in notes to the table:

(a) for both senior management and independent directors, how many persons are in each group and the name and title of each person,

(b) in general terms, the relationship between the compensation and the issuer's performance, and

(c) how any compensation is expected to change during the next year.

**3.7 Securities held**

(1) Using the following table, disclose the securities held by:

(a) the issuer's senior management, as a group,

(b) the issuer's independent directors, as a group, and

(c) each of the issuer's significant shareholders and promoters, individually (specifying name, position with the issuer and municipality of residence).

| | **Number, type and percentage of issuer's securities held before completion of transaction** | **Number, type and percentage of issuer's securities held on completion of transaction** |
|---|---|---|
| Senior management (as a group) | | |
| Independent directors (as a group) | | |
| Promoters and significant shareholders (for each, name, position and municipality of residence) | | |

(2) Disclose in notes to the table, for both senior management and independent directors, how many persons are in each group and the name and title of each person.

(3) If appropriate, include separate columns for the number of securities that will be held assuming completion of a minimum and maximum offering.

### 3.8 Other material information about management and others involved with the issuer

Disclose any other material information about the issuer's senior officers, directors, significant shareholders, control persons, promoters or key persons that you have not disclosed elsewhere in this Part.

## Part 4 General corporate information

### 4.1 Business and corporate structure

(1) State the issuer's business structure (for example, partnership, corporation or trust).

(2) State the statute, jurisdiction and date of the issuer's incorporation, continuance or organization.

(3) Provide an organizational chart showing all of the issuer's corporate relationships. Include significant shareholders, subsidiaries and affiliates, and indicate the percentage ownership of voting shares for each entity and its jurisdiction of incorporation or organization.

### 4.2 Outstanding securities and consolidated capitalization

(1) Disclose any material change in the equity or loan capital of the issuer on a consolidated basis, since the date of the comparative financial statements for the issuer's last financial year.

(2) Describe the material terms of each class of the issuer's outstanding securities (for convertible securities, include the exercise price).

(3) If the issuer sold within the last 12 months, or will sell, securities of the same class as those offered in the transaction, disclose the prices and number of the securities sold or to be sold.

### 4.3 Escrowed securities

(1) Using the following table, describe any securities of the issuer that are, or after the transaction will be, held in escrow or subject to a pooling or lock-up agreement.

(2) Provide details about the escrow or other arrangements.

| **Class of security** | **Number of securities to be held in escrow or subject to pooling / lock-up agreement** | **Percentage of outstanding securities of the class on completion of transaction** |
|---|---|---|
| | | |
| | | |

(3) If appropriate, include separate columns for the number of securities that will be held assuming completion of a minimum and maximum offering.

### 4.4 Head office

Disclose the following about the issuer:

- Head office address
- Phone and facsimile numbers
- E-mail address
- Exchange, quotation system or other trading facility where issuer's securities trade and name of market regulator *[e.g. Market Regulation Services Inc.]*

### 4.5 Transfer agents and registrars

Identify the transfer agent and registrar for all classes of the issuer's securities.

### 4.6 Interest of expert

Disclose whether any expert involved in preparing the AIF or any report or valuation relating to the issuer's business has an interest in any property, or owns any securities, of the issuer or any of its associates or affiliates, or is likely to become a director, senior officer, employee or consultant of the issuer or any of its associates or affiliates.

### 4.7 Financial statements and MD&A

**[Note to Reader: We have not yet determined what financial statement and MD&A requirements we will impose under CMA. The Proposal Paper contains a request for comment on this issue.]**

### 4.8 Other material information about the issuer or its securities

Disclose any other material information about the issuer or its outstanding securities that you have not disclosed elsewhere in this Part.

### 4.9 Investors' rights

State:

"If there is a misrepresentation in this AIF or in another document contained in this issuer's continuous disclosure record, investors have a statutory right to sue for damages against the issuer, every person who was a director or officer at the date of the document, and every underwriter or other due diligence provider involved in the transaction.

This right is available regardless of whether the investor relied on the misrepresentation. There are defences available to the persons that investors have a right to sue.

If an investor intends to rely on this right, the investor must start an action for damages within

(a) three years of the date the document containing the misrepresentation was first released, or

(b) six months of the date of a news release disclosing that leave has been granted to start an action relating to the representation,

whichever comes first.

Investors should consult a lawyer about these rights and any other rights they may have."

## Part 5 The transaction

### 5.1 Due diligence

State the name of the due diligence provider and give details of the provider's arrangements with the issuer, including the compensation paid to the provider and whether the provider and the issuer have a relationship that could affect the provider's independence.

### 5.2 The transaction

(1) Describe the transaction and the securities being offered.

(2) State the name of the underwriter or other registrant involved in the transaction and give details of its arrangements with the issuer in connection with the sale of the securities.

(3) If the issuer has a relationship with any underwriter that could affect the underwriter's independence, provide details.

### 5.3 Net proceeds and other available funds

(1) Using the following table, disclose the net proceeds of the transaction. If the issuer is a development stage issuer, also disclose the current working capital (or working capital deficiency) and the total funds available to be used with the net proceeds to achieve the objectives set out in section 1.1.

(2) If there is no minimum offering, state "$0" as the minimum.

| | | Assuming min. offering | Assuming max. offering |
|---|---|---|---|
| A | Amount to be raised by the transaction | $_____ | $_____ |
| B | Estimated transaction costs:<br><br>Underwriter compensation<br>Other | <br><br>$_____<br>$_____ | <br><br>$_____<br>$_____ |
| C | Net proceeds: C = A – B | $_____ | $_____ |
| D | *[For development stage issuers only]*<br>Current working capital (or working capital deficiency) | $_____ | $_____ |
| E | *[For development stage issuers only]*<br>Available funds E = C + D | $_____ | $_____ |

### 5.4 Use of proceeds and other available funds

Disclose how the issuer will use the net proceeds of the transaction and, if the issuer is a development stage issuer, the other available funds.

**5.5 Project financing and limited partnership offering**

(1) If the transaction is a project financing, limited partnership offering or other transaction where the investor will be a party to the transaction agreement, summarize the key terms of the co-tenancy, unitholders', limited partnership or other agreement.

(2) You must give investors a copy of the agreement to review if they request it. Tell investors that they have this right.

**5.6 Income tax consequences**

(1) If income tax consequences are a material aspect of the securities being offered (for example, flow-through shares),

(a) summarize the significant income tax consequences to Canadian residents, and

(b) name the person providing the tax disclosure in (a), and the person providing the opinion on which that disclosure is based and the professional designation, if any, of that person.

(2) Suggest to investors that they consult a professional adviser to get advice on any possible tax consequences of the transaction.

**5.7 Other material information about the transaction**

Disclose any other material information about the transaction that you have not disclosed elsewhere in this Part.

# APPENDIX C

# Continuous Market Access System Guidelines

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## Introduction

These are Guidelines to the Continuous Market Access System (CMA).

Chapter I deals with the Annual Information Form (AIF). Chapter II summarizes a CMA issuer's continuous disclosure obligations. Chapter III describes the offering process under CMA.

The purpose of an initial AIF (the AIF that an issuer files to enter CMA) is to ensure that all material information about an issuer and any transaction the issuer is doing in connection with its entry into CMA is publicly disclosed when the issuer carries out the transaction.

Throughout the year, the issuer will keep its public record current by filing annual and quarterly financial statements and MD&A, press releases, required experts reports and, if it wishes, supplemental information forms, as well as offering and other documents that it may issue throughout the year that are part of its public record.

The purpose of a subsequent AIF is to update, in one convenient form, material information about the issuer's business and affairs on the issuer's public record. As with the initial AIF, all material information about the issuer's business and affairs must be disclosed.

Attached as a schedule to these Guidelines is a list of defined terms that are used throughout the Guidelines and also in the AIF. While many of these terms are defined in the Act or the Rules, some are not.

# Chapter I
# Completing Form · *Annual Information Form*

This Chapter will help you complete Form • *Annual Information Form*.

The first section of this Chapter sets out some general points to keep in mind when preparing your AIF.

The second section is divided into Parts 1 to 5, which provide more specific instructions on how to complete the various sections of the form. The section numbers in those five Parts correspond to those in the form.

Parts of Form • and these Guidelines are shaded. The shaded portions are relevant only to initial AIFs filed in connection with a transaction.

## General instructions

---

**Disclose all material information**

You must disclose all material information about the business and affairs of the issuer and the transaction. Information is material if it would reasonably be expected to result in a significant change in the market price or value of the issuer's securities.

The information required in the form is not specific to any particular industry or type of business. To disclose all material information about the issuer, you may need to include in your AIF information in addition to the information specifically called for in the form.

We have provided some examples in these Guidelines of the type of information that may be relevant to some issuers. However, these examples are not exhaustive. You must consider the issuer's specific circumstances carefully and conclude whether the examples are relevant to the issuer's business, and whether there is other information that is material but is not caught by one of the examples. We expect issuers to use their judgment about what is material information rather than follow a "checklist" of disclosure requirements or adopt a "boilerplate" approach by simply copying language from the AIFs of others without tailoring the content to the issuer's own circumstances.

The AIF requires you to disclose other information that may not be material, but is important for investors to know. There may be additional information that you wish to disclose because you believe the information will be meaningful to investors and analysts.

You should disclose both positive and negative material information. If you are unsure whether negative information is material and therefore should be disclosed, one approach is to consider whether you would disclose that information if the situation were reversed and it would have a positive effect on the issuer's business. Consider the example of a pharmaceutical company that manufactures one principal drug: the two main markets for that drug are BC and Alberta, but the company learns that in BC the drug may soon not be covered by medicare. Is this information material? The answer is clearer if you imagine the reverse situation – a company, whose sole market is Alberta, learns that in BC medicare may soon begin to cover the drug. Would not the company likely consider this material?

Liability for misrepresentation is based on misstatements and omissions of material information. Therefore you must take care in deciding what information is material and present the information in a fair and balanced manner to ensure that the statements you make in the AIF are not false or misleading.

If an issuer's continuous disclosure record as a whole contains a misrepresentation, the issuer may be subject to civil liability, enforcement action, and criminal liability under Canadian securities legislation.

**Plain language**

Draft the AIF so that it is easy to read and understand. Be concise and use clear, plain language.

Here are some plain language principles for you to consider when preparing your AIF:

- Use short sentences
- Use definite, unambiguous, everyday language
- Use the active voice
- Avoid superfluous words
- Organize the document in clear, concise sections, paragraphs and sentences
- Avoid jargon
- Do not rely on glossaries and defined terms unless it helps the reader understand the information
- Avoid boilerplate wording
- Avoid multiple negatives
- Avoid technical terms where possible (if you use them, include definitions or explain them)
- Use charts and tables where it makes information easer to understand

**Presentation of information**

The AIF is designed to be flexible, both as to the level of detail presented and to the presentation itself.

You should present the information required in a way that you think will help investors make their investment decision. You may wish to include a table of contents as well as an executive summary of some of the key information in the document, since these can help readers find the information that most interests them.

You do not need to discuss the items required in exactly the order they appear in the form if you think a different presentation will be easier for investors to follow. However, we encourage you to organize the information into the following main Parts to help market participants compare your information with that of other issuers:

- The business
- Risk factors
- Management and others involved with the issuer
- General corporate information
- The transaction

You do not need to provide disclosure about, or refer to, any item that does not apply.

**Financial information**

The information in your responses to the form must be consistent with the information in the issuer's financial statements, including the accompanying notes.

**Duplicate information**

If more than one section of the form requires disclosure of the same information, you may disclose the information in one section only, and refer the reader to that section in the other sections that require the same disclosure.

**Cross references**

Where one section of your AIF refers to another, you may want to include a "hyperlink" in the electronic version of your document to allow readers to go directly to the cross-referenced section.

**Initial AIFs**

If your AIF is an initial AIF, you must indicate this where appropriate.

The unshaded portions of the form apply to all AIFs. The shaded portions apply only to an initial AIF that is prepared in connection with a transaction.

**Filing, review and delivery of initial AIFs**

Issuers do not have to deliver the initial AIF to investors, although they can if they wish. However, the issuer must file it with the Commission. The issuer cannot complete the transaction until the executive director has accepted the initial AIF for filing.

Commission staff will vet the initial AIF. In most cases, our review will be focused on identifying whether there are:

- unsuitable directors and officers
- significant non-compliance with the disclosure requirements of the form, or
- public interest concerns

Public interest concerns include:

- the past conduct of the issuer or its officers, directors, promoters or control persons
- the knowledge and expertise of the issuer's officers and directors
- the financial condition of the issuer or its officers, directors, promoters or control persons

If the issuer cannot satisfy concerns raised by staff, the executive director may refuse to accept the issuer's initial AIF. The executive director must not refuse to accept an initial AIF without giving you an opportunity to be heard.

## Specific instructions

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### Part 1 The business

#### 1.1 The business

***Products and services***

You should describe the products or services the issuer sells or will be selling. Generally, a description of the activities the issuer engages in and will engage in over the next 12 months will be sufficient. You should include enough information to allow a person who knows nothing about the issuer's business to understand what the issuer does and will do.

In describing the issuer's products and services, consider:

- if the issuer is a development stage issuer, how the products or services are produced or provided – for example, does the issuer make the final product or does it manufacture components and sell them to others who produce the final product?
- if this is the issuer's initial AIF, how the products or services are distributed – for example, is the business retail or wholesale?
- the principal markets – who is the issuer selling to?
- the stage of development – for example, if the issuer plans to offer a new product, what amount of resources will it need to complete development of the product?
- any research and development – how will the issuer benefit from the knowledge gained through R&D?

If the issuer is a development stage issuer, you should discuss how production or any services will change when the issuer has access to the transaction proceeds. This disclosure should be consistent with your discussion under section 5.4 *Use of proceeds and other available funds*.

***Operations***

In describing the issuer's operations, you should discuss things like the issuer's properties, suppliers, customers, sales and employees. Of course, other factors may be material, depending on the nature of the issuer's business.

In preparing your description, you should consider questions like:

- If the issuer has any mineral projects, what are the issuer's material properties and who are its experts? Normally, this information will be incomplete without a summary of any technical report prepared and filed under National Instrument 43-101 *Standards of Disclosure for Mineral Projects.*
- If the issuer has any oil and gas operations, what are those operations and who are the issuer's experts? Normally, this information will be incomplete without a summary of any report under National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities*. **[Note to Reader: This Instrument is not in force as of the date of the Proposal Paper.]**
- Does the issuer have any significant intangible assets?
- Who are the issuer's suppliers? What are the terms of their arrangements? Does the issuer depend on a limited number of suppliers for essential raw materials or other supplies? What impact will renegotiation of any supply contracts have on the issuer's business?
- What are the cost and availability of any raw materials, component parts or finished products?
- Who are the issuer's customers? Do any account for a major portion of the issuer's sales? What will the issuer do if it loses any of those customers?
- Does the issuer have any major sales contracts? If so, what are their material terms? What impact will renegotiation of these contracts have on the issuer's business?
- Is the business cyclical or seasonal?
- How many people work for the issuer currently? Does the issuer expect this to change significantly over the next 12 months?
- Is the issuer dependent on the specialized skill or knowledge of any individual or firm?

***Marketing plan***

If the issuer is a development stage issuer, you should describe how it intends to make its products or services known to potential customers (a description of major target markets is likely material; tactical details are likely not).

You should also disclose how the issuer intends to fund its marketing activities.

If you intend to use transaction proceeds to fund these activities, your disclosure here should be consistent with section 5.4 *Use of proceeds and other available funds*.

***Competition***

In describing the issuer's competitive position, you should describe the market area that the issuer competes in or will compete in. An issuer's market area may be larger than its geographic area (if, for example, it does business mainly over the internet). You should also discuss the issuer's main competitors (including their relative size and financial and market strengths) and how the issuer competes or expects to compete with them (including, in general terms, its strategy for doing so).

***Objectives***

*Short term*

A discussion of short term objectives should be the major focus for development stage issuers when disclosing their objectives, although other issuers will also want to discuss them when they are material.

You should consider these questions:

- What do you intend to accomplish in the next 12 months?
- What steps must you undertake to complete these goals?
- How much will it cost to meet each goal?
- When will each task begin and be completed?

For example, if you have listed a production target as an objective, to achieve that objective, you might have to hire skilled employees, expand your plant or buy new equipment. There may also be regulatory approvals involved.

You may want to organize the information in a table. We also suggest that you discuss the issuer's objectives in chronological order, since some steps in the issuer's business plan may be dependent on others.

You should give sufficient information so that an investor can assess whether the issuer's resources will be adequate to meet its goals. Indicate whether completing any or all of the issuer's objectives will exhaust the transaction proceeds and, if so, discuss whether the issuer has access to other sources of funds.

You should also discuss the consequences if there are delays in achieving any of the issuer's objectives. For example, how would a delay affect the issuer's available funds?

An issuer's objectives will differ depending on the nature of its business and its resources. We have provided below some examples of short term objectives, but you should keep in mind that these are examples only:

- Registering a trademark
- Acquiring a specific contract
- Achieving a level of net sales
- Reaching a specific number of new markets
- Reaching a specific level of production

***Long term***

A discussion of long term objectives will likely be the focus for more developed issuers when discussing their objectives, although other issuers will also want to discuss them when they are material.

Disclosure of these types of objectives will likely be less detailed than disclosure about short term objectives. Specific dates and costs for long term objectives may not be relevant, or even known. Here are some examples of long term objectives that an issuer might have:

- Change the issuer's business focus
- Reach another market
- Develop a different product line
- Adopt a different business strategy

***Material agreements***

You should disclose all material agreements relating to the issuer's business and affairs. For example, if the issuer has only one supplier, the supply agreement is likely crucial to the business and you should disclose it.

Usually, discussion of the issuer's material contracts will be most appropriate in the description of the issuer's business under section 1.1 or in other Parts of the form (for example, agency agreements under Part 5). You can disclose material agreements that do not fall neatly into those sections in a separate disclosure section.

When disclosing the issuer's material agreements, you should discuss their key terms.

***Use of available funds***

If the issuer is a development stage issuer, you should discuss the issuer's working capital and available funds (including the net proceeds of the transaction) and how it will use those funds.

You may want to disclose this information in a table, similar to the one required under section 5.4. Or, as with your discussion of the issuer's material contracts, it may be more appropriate to include your use of funds discussion under the other headings set out above. For example, what portion of the issuer's available funds will you use to satisfy the issuer's short term objectives? However, if you intend to use any of the issuer's available funds in a manner not contemplated by any of the categories discussed earlier, you should still disclose this use in section 1.1.

Your discussion here should be consistent with section 5.4 *Use of proceeds and other available funds*.

### 1.2 Our history and development

You should summarize the material events relating to the issuer and its business that have occurred over the last three financial years and any subsequent period. If the issuer's history includes a merger, acquisition, spin-off, recapitalization, or other similar corporate transaction, you should disclose that event. You should also disclose any significant acquisition or disposition, and any bankruptcy, receivership or similar proceedings involving the issuer or any of its subsidiaries. You can disclose the issuer's history and development in section 1.1 if it is more convenient to do so.

**[Note to Reader: The Proposal Paper contains a discussion of and a request for comment on the issue of significant acquisition disclosure.]**

### 1.3 Trend information

***Trends, contingencies and uncertainties***

You should disclose both positive and negative trend information.

***Forward-looking information***

Preparing your AIF necessarily involves some degree of prediction or projection. For example, section 1.3 requires a discussion of known trends, contingencies or uncertainties that would reasonably be expected to have a favourable or unfavourable material effect on the issuer. Whether you need to disclose a trend event will depend on how likely it is to occur and the impact the event will have on the issuer if it does. (If the potential impact is significant enough, it may warrant disclosure even if the likelihood of occurrence is fairly low.)

Section 1.3 does not require you to meet the requirements that apply to "FOFI" (future oriented financial information) as defined in National Policy 48.

You may also include less significant trend information that you think will be helpful to investors. Even if this information is not FOFI as defined by NP 48, you should have a reasonable basis for making the statements, disclose that basis, and include appropriate statements of risks and cautionary language. Your warnings should be substantive and tailored to the specific statements made. You should also identify and quantify the risks.

The presentation of forward-looking information may be misleading unless it contains:

- a statement that the information is forward-looking
- a description of the factors that could cause actual results to differ significantly from the information
- a statement of the factors or assumptions that were used to arrive at the information

## Part 2 Risk factors

### 2.1 Risk factors

Every AIF should contain risk factor disclosure. Every business and investment has risks. The risk factors should appear in order of importance with the most important factors appearing first. You may find it helpful to write your risk factors and determine their priority after you have completed the rest of your AIF.

***Specific, sufficient and non-boilerplate***

You should avoid generalized statements and include risk factors that are specific to the issuer and the transaction. You should not use language that tends to trivialize the risks you are disclosing.

We list below some examples of risk factors. Not all of these risks will exist for all issuers. The list is not intended to be exhaustive as risks vary according to the nature of an issuer's business and the type of security offered. Therefore, there may be risks relating to the issuer or its securities that are not listed. There is no specific number of risk factors that you should identify.

***Categories of risk factors***

There are three general categories of risk factors.

**Issuer risks –** risks that are specific to the issuer, such as:

- Commodity prices
- Sensitivity to interest rate fluctuations
- Exposure to foreign currency fluctuations
- Labour relations
- Regulatory actions and approvals
- Legal or administrative proceedings
- Political risk factors
- For development stage issuers,
    - Insufficient funds to accomplish the issuer's business objectives
    - No history or a limited history of sales or profits
    - Lack of specific management or technical expertise
    - Management's regulatory and business track record
    - Dependence on key employees, suppliers or agreements

**Industry risks –** risks that the issuer faces because of the industry it operates in, such as:

- Environmental and industry regulation
- Product obsolescence
- Industry-wide product pricing
- Industry-wide collective bargaining

**Investment risks –** risks relating to the securities being offered, such as:

- Arbitrary determination of price
- No market or an illiquid market for the securities
- Public investors in a minority position
- Subordination of debt securities
- The absence of any guarantee or other credit support for the payments to be made under the securities
- If the issuer is a foreign issuer, the potential difficulty investors may face when attempting to enforce judgments of Canadian courts in foreign jurisdictions

## Part 3 Management and others involved with the issuer

### 3.1 Our management

When providing the resumes required under section 3.1, remember that “director” and “senior officer” include persons who perform these functions, regardless of their titles. (See Schedule 1 to these Guidelines for the definitions of “director” and “senior officer”.)

The resumes should include all information that is relevant to the particular director or senior officer’s ability to manage the issuer. You should disclose sufficient information to help investors understand the value of the directors’ and senior officers' skills and experience to the issuer and its business.

### 3.3 Arrangements with senior management and key persons

Most development stage issuers and some other issuers make arrangements to ensure that their senior management and key persons stay with them for a certain period of time to help carry out the issuer’s business plan. These arrangements are often made in connection with an issuer’s initial public offering but can also be made in other contexts. Here are some examples of these types of arrangements:

- Escrowing of securities
- Employment, non-competition or non-disclosure agreements
- Vesting periods for options
- Bonus systems

### 3.4 Interest of management and others

***Conflicts of interest***

Consider whether there are any situations in which any of the persons listed in section 3.4 could benefit at the issuer’s expense.

Here is an example of a conflict of interest situation you should disclose under section 3.4: A senior officer owns a product and has granted distribution rights over that product to the issuer, on condition that the issuer achieve specified performance levels. If the issuer does not perform

as contemplated under its agreement with the senior officer, the issuer's rights to distribute the product terminate and the officer can exploit the rights personally or grant them to another party.

The conflict arises because the senior officer is directly responsible for how the issuer will perform. The officer has competing interests because he or she wants the issuer to succeed but may also want to regain the distribution rights to the product to make other arrangements that might be more profitable.

***Transactions***

When deciding whether to disclose a particular transaction, you should consider questions like:

- How important is it to the person with the interest?
- How important is it to the issuer?
- What is the relationship between the parties to the transaction?

When describing the transaction, you should include the name of each person whose interest you are disclosing and that person's relationship to the issuer. You should also disclose the business purpose of the arrangement, any ongoing commitments resulting from the arrangement, and the transaction price and how it was determined. If you are representing that the transaction was evaluated for fairness, disclose how the evaluation was made and by whom.

An example of the type of transaction you should disclose is one in which the issuer (or any of its subsidiaries) bought or sold assets of any significance from the person.

### 3.5 Legal, administrative and bankruptcy proceedings

You should disclose under section 3.5 any penalty, sanction, settlement agreement, cease trade or similar order, or order denying access to a statutory exemption (including the reason for it and whether it is currently in effect) imposed by a court, securities regulatory authority (including self-regulatory organizations), or any other financial regulatory body (such as the BC Financial Institutions Commission).

If there is a securities or financial regulatory proceeding pending and the relevant regulatory body has issued a notice of hearing for that proceeding, you should also disclose that.

### 3.6 Compensation

We expect you to disclose all compensation the issuer paid in the issuer's last financial year (and will pay in the current year) to senior management, independent directors, significant shareholders and promoters. You should include both cash and non-cash items. When deciding whether something constitutes compensation, ask yourself whether the item directly or indirectly benefits the person in any way.

Compensation includes stock options and loans granted by the issuer. You may wish to disclose stock options in a table that is separate from the one required in section 3.6. Information about any repricing of options may also be material.

When disclosing any bonuses, you should include bonuses that accrued in the last financial year that have not been paid.

In addition to the usual forms of compensation, you should disclose things like personal benefits, including club memberships, company cars and insurance benefits if they are not generally available to employees.

## Part 4 General corporate information

### 4.2 Outstanding securities and consolidated capitalization

***Material changes***

When discussing material changes under 4.2(1), you should discuss any stock split, stock dividend, recapitalization, merger, acquisition, spin-off, reorganization or other similar corporate transaction.

If several material changes have occurred, you should disclose each change, and not just the net effect of all changes. For example, if an issuer repurchased securities, then issued additional securities of the same class, and both the repurchase and issuance are material, you should report both transactions and not just the total number of securities outstanding after the issuance.

***Material terms***

When you are describing the material terms of the issuer's outstanding securities, you may want to present the information in the form of a capitalization table, similar to the one set out in item 4.1 of the offering memorandum form (Form 45-103F1) under Multilateral Instrument 45-103 *Capital Raising Exemptions*.

Material terms of the issuer's outstanding securities could include:

- Shares or other equity interests that are subject to rights, options or warrants
- Constraints on ownership of the issuer's securities to ensure a certain percentage of Canadian securityholders and the issuer's plans for monitoring and maintaining that percentage

### 4.3 Escrowed securities

In an escrow arrangement, an issuer's principals (typically directors, senior officers, promoters and founding shareholders) place their securities in escrow with an escrow agent. The principals are then restricted from selling or dealing in other ways with the escrowed securities until they are released from escrow, usually according to an agreement.

The purpose of escrow is to tie an issuer's management and certain shareholders to the issuer by restricting their ability to sell their securities for a period of time. This gives them an incentive to devote their time and attention to the issuer's business while they are shareholders.

When providing details of any escrow arrangement under 4.3(2), you might wish to include the name of the escrow agent.

### 4.7 Financial statements and MD&A

**[Note to Reader: We have not yet determined what financial statement and MD&A requirements we will impose under CMA. The Proposal Paper contains a request for comment on this issue.]**

## Part 5 The transaction

### 5.2 The transaction

***All transactions***

What you disclose in section 5.2 will differ depending on the type of securities you are offering. However, there is some information you should disclose regardless of the type of transaction. For example:

- The type of securities offered
- The price per security and how the price was determined
- The maximum and minimum number of securities offered
- The material terms of any transaction agreement
- Any restrictions on resale of the securities
- The exchange or other market where securities of the class being offered trade or are expected to trade (and whether the issuer has received conditional listing approval)
- Any intention to stabilize the market
- Arrangements to deal with funds received if there is a minimum amount of funds to be raised
- Whether the securities are underwritten, under option or to be sold on a best efforts basis, including details
- Any finder's fees

***Underwriters and agents***

Here are some example of the types of things you should disclose when you describe the arrangements between the underwriter or other registrant and the issuer in connection with the sale of the securities:

- The underwriter's obligations and any conditions on those obligations
- The underwriter's right, if any, to decrease the price per security
- The underwriter's compensation (discounts, commissions or other)
- Any over-allotment option

For guidance on whether the relationship between the issuer and its underwriter could affect the underwriter's independence, see •. **[Note to Reader: This cross reference will be to the relevant provisions of the Code of Conduct proposed in Chapter 2, Part 1 of the Proposal Paper.]**

***Shares***

State if the issuer is offering common shares.

For shares other than common shares, here are the types of things you should disclose:

- Voting rights or restrictions
- Dividend rights, restrictions and policies
- Rights on dissolution or winding-up
- Pre-emptive rights
- Conversion or exchange rights
- Redemption, retraction or similar rights
- Sinking or purchase fund provisions
- Material restrictions
- Provisions requiring a shareholder to contribute capital
- Provisions as to modification, amendment or variation of any rights
- Information about any other securities of the issuer that limit or qualify the rights of the shares or that rank ahead of or equally with them
- Role of any guarantor

***Debt securities***

If the issuer is offering debt securities, here are the types of things you should disclose:

- Interest rates
- Maturity date
- Effective yield if securities held to maturity (if applicable)
- Conversion or exchange rights
- Redemption, retraction or similar rights
- Sinking or purchase fund provisions
- Any security for the securities
- The issuer's financial arrangements that could affect any security for the securities
- Role of any guarantor
- Earnings coverage ratios
- Any ratings from an approved rating organization
- Material restrictions
- Provisions as to modification, amendment or variation of any rights
- The identity of and any arrangements with a trustee

***Derivatives***

If the issuer is offering derivatives, here are the types of things you should disclose:

- Calculation of the value or payment obligations
- Exercise
- Settlement of exercises
- Underlying interest
- Role of a calculation expert
- Related risk factors

- Role of any guarantor or other person providing support for any payments the issuer must make in connection with the securities

***Other securities***

If the issuer is offering any other type of securities, you should disclose the material terms and conditions of those securities.

**5.3 Net proceeds and other available funds**

You should include in row B of the table under "Other" all direct, indirect and miscellaneous costs of the transaction. Some examples of these costs are:

- Compensation paid to sellers or finders (for example, commissions, corporate finance fees, finder's fees)
- Legal and accounting fees
- Consulting fees
- Advertising and filing costs

**5.4 Use of proceeds and other available funds**

Disclose the principal purposes for the use of the net proceeds of the transaction (and, for development stage issuers, of other available funds) and the amount to be used for each purpose. You may want to disclose this information in a table.

You should be specific about how the issuer will use the proceeds (or total available funds) and how the cost of each item was determined. If the issuer is a development stage issuer, stating that the issuer will use the funds for "general corporate purposes" will not help investors make their investment decision.

You may want to use categories like the following: leases, rent, payroll, purchase or lease of equipment or inventory, repayment of debt. Of course, the categories you use will depend on the nature of the issuer's business and its business plan. Therefore, these categories are examples only and are not exhaustive.

For development stage issuers, your disclosure here should be consistent with section 1.1 *The business*.

***Insufficient funds***

You should disclose what you will do if the issuer does not raise enough money in the transaction to carry out its business plan. For example, does the issuer have access to alternate sources of funding? Are these sources firm or contingent?

***Reallocation***

You should also consider how you will reallocate the proceeds (funds) if the issuer's circumstances change and the originally intended use of proceeds (funds) no longer applies. For example, if the issuer intends to use the proceeds (funds) from the transaction to fund a

new business, you should discuss how it will use the proceeds (funds) if it is unable to obtain the necessary approvals for that business.

# Chapter II
# Continuous disclosure obligations

There are two types of continuous disclosure: periodic disclosure and timely disclosure. Periodic disclosure requires the issuer to update its disclosure record at regular intervals, for example, by issuing quarterly and annual financial statements. Timely disclosure refers to public dissemination of information from time to time that could reasonably be expected to affect the market price of the issuer's securities.

The issuer's AIF, together with any other documents included in the issuer's continuous disclosure record, must present all material information about the issuer's business and affairs. After the issuer files an AIF, it must keep its public record current and up to date by filing the documents required under the rules governing continuous disclosure and by making timely disclosure of all other material information.

## Part A – Other Periodic Disclosure Obligations

**[Note to Reader: This will refer specifically to the continuous disclosure rule.]**

## Part B – Timely Disclosure Obligations

### General Obligation

An issuer must disclose material information as soon as practicable after management learns of it, or in the case of information that is previously known to management, as soon as practicable after management determines that the information is material. The issuer must make disclosure by issuing and filing a press release. The press release must contain all material information about the matter being disclosed. If it wishes, the issuer may also file supplemental information.

Complete, accurate and timely disclosure is the foundation of the CMA system. It is the issuer's most important obligation under the system.

### What is "material information"?

Material information is information relating to the business or affairs of an issuer that would reasonably be expected to result in a significant change in the market price or value of any of the issuer's securities.

This is the information that investors need to know, and this is the information on which issuer and management liability is based. The issuer may disclose other information that is important to investors, and the issuer should present that information with care, but the issuer and its management will not be liable to investors for errors or mistakes in information that is not "material information", unless fraud or unfair practices are involved.

### Materiality depends on the issuer's circumstances

The materiality of information varies from one issuer to another according to the size of its profits, assets and capitalization, the nature of its operations and many other factors. Information that is "material" in the context of a smaller issuer's business or affairs is often not

material to a larger issuer. The issuer, itself, is in the best position to determine the materiality of particular information in the context of its own affairs.

**Examples of information that may be material**

Examples of information that may be material include:

- Capital reorganizations, mergers or amalgamations
- Significant acquisitions or dispositions of assets, property or joint venture interests
- The borrowing or lending of a significant amount of funds or any mortgaging or encumbering of the issuer's assets
- The development of a new product or a development that affects the issuer's resources, technology, products or markets
- The entering into or loss of a significant contract or other developments relating to a major customer or supplier
- A significant increase or decrease in near-term earnings prospects
- A significant change in capital investment plans or corporate objectives
- Significant changes in management
- Significant litigation
- Events regarding the issuer's securities, such as an event of default under a financing, a call of securities for redemption, a declaration or omission of dividends, or a stock split, share consolidation, stock dividend, exchange, redemption or other change in the issuer's capital structure.

Exchange policies also contain examples of the types of information that may be material. These lists are not exhaustive and are not substitutes for issuers exercising their own judgment in making materiality determinations.

**Disclosure of external events**

Issuers are generally not required to interpret the impact of external political, economic and social developments on their business and affairs. However, if an external development has had or will have a direct effect on the business and affairs of an issuer that is both material and uncharacteristic of the effect generally experienced by other issuers engaged in the same business or industry, the issuer must disclose the development and its impact or potential impact on the issuer.

**When must disclosure be made?**

Issuers must disclose material information as soon as practicable. This is intended to give the issuer's management time to review the information so that it can become reasonably comfortable with its accuracy and put it into context prior to disclosing the information. Under CMA, we call this establishing the material information.

Under CMA, an issuer may defer making disclosure in three circumstances:

1. *While it is establishing the material information.* For example, when an issuer is conducting a drilling program and is receiving results as the program proceeds, the issuer need not release the results piece-meal as it receives them. Management should

review the results for reasonableness and consider them in the context of known exploration information, prior to making disclosure.

2. *If it is uncertain whether an event will occur.* When it uncertain whether an event will occur, management must balance the likelihood that the event will occur and the anticipated impact of the event on the market price or value of the issuer's securities if it were to occur, to determine whether the materiality threshold has been crossed, and if so, when.

   For example, if an issuer begins merger discussions and it is reasonable to expect that the merger would result in a significant change in the price or value of the issuer's securities, we expect that management would defer any announcement at least until negotiations had begun in earnest, to prevent undue speculation in the issuer's securities and negative impact on the transaction. However, once certainty increases to the point where management believes the information is material, release of the material information may be unduly detrimental to the issuer's interests. At this point, management may consider making the confidential filing (see 3 below).

3. *If disclosure would cause undue detriment.* If in the issuer's reasonable opinion disclosure of material information would be unduly detrimental to the issuer's interests, the issuer will fulfill its timely disclosure obligations if it files a confidential report with the Commission detailing the material information and the reasons why the issuer should not make a press release at that time.

   For example, if an issuer goes into technical default on a material loan transaction, entitling the lender to call the loan, disclosure of the lender's entitlement to call the loan could lead to a general loss in confidence in the issuer. If management reasonably believes that arrangements will be made with the lender to correct the default, management may fulfill its timely disclosure obligation by filing with the Commission a confidential report of the material information, together with its reasons why public disclosure should not be made at that time. (The executive director may require the issuer to disclose the material information if the public interest outweighs the issuer's interest in confidentiality.)

   Once the basis for the deferral of disclosure of material information has ended, if the information is still material information, the issuer must disclose it. In no event can disclosure of material information about a CMA issuer be permanently deferred.

**What are management's responsibilities?**

Management decisions on disclosure will be reviewed on the basis of the business judgment rule. That is, "Did management exercise reasonable business judgment in determining whether the information was material, based on the information available to them at the time the decision was made?" Management must make reasonable inquiry to ascertain relevant information. The actual market impact of the disclosure when it is ultimately made will not be considered in determining liability, although it may be relevant to determine damages.

Issuers are responsible for having systems in place:

- to bring important information to management's attention,

- for management to review information, to determine its materiality, and to disclose material information, and
- to prevent trading in the issuer's securities by the issuer, its directors, senior officers and anyone with knowledge of the material information until the information is disclosed, and to monitor market activity during these periods.

Management is responsible for seeing that these systems are in place and for complying with them.

If it appears that the information has leaked or if selective disclosure was unintentionally made, the issuer must issue a press release clarifying the situation within 24 hours. If it does so, neither the issuer, nor management will be liable for failure to disclose material information. This defence will not be available to anyone who has engaged in tipping, insider trading, fraud or market manipulation.

The issuer has no general duty to correct or update third party statements or rumours unless:

- The issuer or its management is responsible for the rumour
- The issuer or its management are closely associated with the statements (such as analyst reports where the issuer has provided the information to the analyst or encouraged the report)
- There is undisclosed material information that appears to have leaked

# Chapter III
# Offerings under CMA

This Chapter describes the offering process once an issuer has entered CMA.

**Continuous and immediate market access**

Once an issuer enters the CMA system, it can access the public market immediately to sell its securities.

**Press release**

The only document a CMA issuer must prepare before offering securities is a press release, where the offering is material. (This requirement flows from an issuer's general obligation to disclose all material information by press release.) Like all press releases, this release will be filed on SEDAR and become part of the issuer's continuous disclosure record.

It is up to the issuer to decide whether the offering is material. However, a general offering of securities, and most private placements, are likely to be material in almost all circumstances. When we refer to a general or "public" offering of securities, we mean an offering that is not limited to a specific group of investors but is made to an unlimited number of potential investors.

Material information about a public offering would usually include:

- The fact that the offering is being made.
- The terms of the offering (for example, the number of securities being offered, the price, whether there is a minimum or maximum offering and the duration of the offering).
- A description of the securities.
- How the issuer intends to use the proceeds of the offering.
- The significant features of the issuer's arrangements with the underwriter and/or due diligence provider.

Completion of a public offering is also likely to be material information. If so, the issuer must issue and file another press release stating that fact.

**No mandated offering document**

A CMA issuer does not have to prepare and file a formal offering document before it can go to market, unless it is entering the CMA system in connection with an initial public offering (see Chapter I).

Of course, an issuer may prepare an offering document if it wishes. We expect most issuers (and their underwriters or selling agents) will want to produce an offering document as part of their sales effort. Issuers may also want to prepare their offering documents with analysts and other market participants in mind.

Since CMA does not mandate an offering document, there is no prescribed information an issuer must include if it chooses to prepare one. Issuers can present information about the offering in a form that best suits the market for their securities.

However, an issuer must ensure that the information in an offering document is balanced. If the document contains a misrepresentation, the issuer will be subject to enforcement action and, along with any underwriter, civil liability.

The issuer should not use an offering document to disclose material information for the first time. This is because the issuer's continuous disclosure record must contain all material information about the business and affairs of the issuer at the time it offers securities. If there is material information that should be disclosed before an offering, the issuer must disclose it by press release.

If an issuer uses an offering document to make a general offering of its securities, it must file the offering document and it becomes part of the issuer's continuous disclosure record. There is no vetting, approval or receipt process for offering documents after the initial AIF prior to the offering. (An offering document may be reviewed at a later time as part of a continuous disclosure review by the regulator.)

**Due diligence providers**

Due diligence providers may be either registrants or other competent third parties, such as venture capital companies, law firms, accounting firms, or financial institutions.

Due diligence providers are liable to investors if there is a misrepresentation in the offering document (if any) or the issuer's continuous disclosure record at the time of the offering, subject to a due diligence defence. (In an IPO, the issuer's continuous disclosure record would generally consist of the issuer's initial AIF and any other document the issuer or its agent used to market the offering.)

Due diligence providers must meet proficiency and financial adequacy criteria.

- *Junior issuers.* An issuer that is not a senior issuer must retain a due diligence provider for all offerings.

- *Senior issuers.* A senior issuer must use a due diligence provider for an IPO, but not for subsequent offerings.

**Use of registrants; direct selling**

- *Junior issuers.* An issuer that is not a senior issuer must use registrants to sell its securities to investors, unless there is an exemption from the registration requirement.

- *Senior issuers.* Senior issuers will be permitted to sell directly to investors if:
  - No consideration is paid to any person in connection with the trade
  - The issuer does not give any advice regarding the merits or suitability of the securities
  - Every person who is solicited to purchase the securities is notified that the securities are being sold without the involvement of a registrant and the investor will not receive any suitability or other investment advice, and if the investor wants investment advice, the investor must contact his or her own investment dealer.

# Schedule 1

## Definitions and interpretation

There are a number of terms used in the AIF and these Guidelines that have particular meanings. These meanings, or definitions, are set out in the Act or the Rules. For your convenience, we have listed below all terms used in the AIF or Guidelines and defined in the Act or the Rules, together with their definitions. We have also set out those terms that are not defined in the Act or the Rules, but that have a specific meaning when used in the AIF or Guidelines.

**affiliate –** An issuer is an affiliate of another issuer if

(a) one of them is the subsidiary of the other, or

(b) each of them is controlled* by the same person.

*An issuer is controlled by a person if

(a) voting securities of the issuer are held, other than by way of security only, by or for the benefit of that person, and

(b) the voting rights attached to those voting securities are entitled, if exercised, to elect a majority of the directors of the issuer.

**associate –** An associate, if used to indicate a relationship with any person, is

(a) a partner, other than a limited partner, of that person,

(b) a trust or estate in which that person has a substantial beneficial interest or for which that person serves as trustee or in a similar capacity,

(c) an issuer in respect of which that person beneficially owns or controls, directly or indirectly, voting securities carrying more than 10% of the voting rights attached to all outstanding voting securities of the issuer, or

(d) a relative, including the spouse**, of that person or a relative of that person's spouse, if the relative has the same home as that person.

**A “spouse” is a person who

(a) is married to another person and is not living separate and apart, within the meaning of the *Divorce Act* (Canada), from the other person, or

(b) is living and cohabiting with another person in a marriage-like relationship, including a marriage-like relationship between persons of the same gender.

**control person –** A control person is

(a) a person who holds a sufficient number of the voting rights attached to all outstanding voting securities of an issuer to affect materially the control of the issuer, or

(b) each person in a combination of persons, acting in concert by virtue of an agreement, arrangement, commitment or understanding, that holds in total a sufficient number of the voting rights attached to all outstanding voting securities of an issuer to affect materially the control of the issuer,

and, if a person or combination of persons holds more than 20% of the voting rights attached to all outstanding voting securities of an issuer, the person or combination of persons is deemed, in the absence of evidence to the contrary, to hold a sufficient number of the voting rights to affect materially the control of the issuer.

**development stage issuer –** A development stage issuer*** is an issuer that is devoting substantially all of its efforts to establishing a new business and planned principal operations have not commenced.

***In assessing whether an issuer is in the development stage, you should apply the principles in the Canadian Institute of Chartered Accountants Handbook Accounting Guideline AcG-11, which read, in part:

2. An enterprise in the development stage typically will be devoting most of its efforts to activities such as financial planning, raising capital, exploring for natural resources, developing natural resources, research and development, establishing sources of supply, acquiring property, plant and equipment or other operating assets, such as mineral rights, recruiting and training personnel, developing markets and starting up production.

3. For purposes of this Guideline, an enterprise is in the development stage when it is devoting substantially all of its efforts to establishing a new business and planned principal operations have not commenced. Various factors indicate that planned principal operations have commenced. These would include, for example, one or more of the following:

    (a) significant revenue has been earned;

    (b) a significant portion of available funding is directed towards operating activities;

    (c) a significant percentage of employees is involved in operating activities;

    (d) a pre-determined, specified level of activity has been achieved;

    (e) a pre-determined, reasonable period of time has passed; or

    (f) a development project significant to the primary business objective of the enterprise has been completed.

The determination of whether any of these factors is present is made in light of characteristics of the enterprise and its industry.

4. The following factors would not necessarily indicate that an enterprise is in the development stage:

   (a) lack of profitability;

   (b) uncertainty of cost recovery; or

   (c) difficulty in valuing the consideration received in exchange for share capital.

   These factors may be experienced by any enterprise regardless of whether it is an enterprise in the development stage.

5 Professional judgment is required in assessing whether an enterprise is in the development stage. It is not possible to classify an enterprise as being in the development stage solely by reference to the nature of activities undertaken by the enterprise. For example, the principal operations of some enterprises are the development of products, services or technologies.

6 The length of the development stage will vary significantly from enterprise to enterprise, depending on the nature of its business and the industry in which it operates. Some enterprises may become operational within weeks or months of inception, for example, an enterprise established to open a single retail store. Other enterprises may require several years of development activity before becoming operational, for example, an enterprise established to produce new and commercial applications of a bio-medical process.

**director –** A director is a director of a corporation or an individual occupying or performing, with respect to a corporation or any other person, a similar position or similar functions. Where the issuer is a limited partnership or trust, this includes both the general partner(s) and trustee(s) and any director of the general partner or trustee.

**key person –** A key person is any person who performs a function that is of material importance to the issuer. Key persons could include the original inventors of the issuer's product, members of the issuer's research and development team and the issuer's sales personnel.

**material information –** Material information is information relating to the business or affairs of an issuer that would reasonably be expected to result in a significant change in the market price or value of the issuer's securities.

**MD&A –** MD&A means •. **[Note to Reader: To be determined.]**

**misrepresentation –** A misrepresentation is

(a) an untrue statement of material information, or

(b) an omission to state material information that is necessary to prevent a statement that is made from being false or misleading.

**independent director –** An independent director is a director who is not an officer or employee of the issuer.

**SEDAR –** SEDAR is the System for Electronic Document Analysis and Retrieval.

**securities regulatory authority –** A securities regulatory authority is any one of:

- Alberta Securities Commission
- British Columbia Securities Commission
- The Manitoba Securities Commission
- Office of the Administrator, New Brunswick
- Securities Commission of Newfoundland
- Registrar of Securities, Northwest Territories
- Nova Scotia Securities Commission
- Registrar of Securities, Nunavut
- Ontario Securities Commission
- Registrar of Securities, Prince Edward Island
- Commission des valeurs mobilières du Québec
- Saskatchewan Securities Commission
- Registrar of Securities, Government of the Yukon Territory

**senior issuer –** A senior issuer is an issuer that satisfies the requirements for senior issuers established by the executive director or set out in the regulations. **[Note to reader: We are currently considering the criteria an issuer would have to satisfy to be a "senior issuer". Specifically, we are considering whether to mirror the criteria the Toronto Stock Exchange uses to exempt an issuer from section 502 of the TSX Company Manual, which requires listed companies to obtain prior Exchange acceptance for filing of all proposed material changes. For industrial companies, the criteria for exemption are $7,500,000 in net tangible assets, $300,000 in earnings from operations in the previous year, pre-tax cash flow of $700,000 in the previous year and pre-tax average cash flow of $500,000 for that year and previous year.]**

**senior management –** Senior management are the issuer's senior officers and directors that are not independent directors.

**senior officer –** A senior officer is any of the president, chief executive officer, chief operating officer and chief financial officer and anyone who works for the issuer in an executive capacity and regularly participates in material decision-making activity in connection with the issuer's business and affairs.

**significant shareholder –** A significant shareholder is a shareholder that directly or indirectly beneficially owns or controls 10% or more of any class of the issuer's voting securities.

# APPENDIX D

## Sample Initial AIF

**Note to Reader:**

**This Appendix, containing a sample initial AIF, can be found on our website at *www.bcsc.bc.ca***

# APPENDIX E

## Table of Concordance
### BC Form 41-601F *Information required in a prospectus* and AIF / Guidelines under CMA

**Note to Reader: This table indicates where the general subject matter of each item in the long form prospectus form (BCF 41-601F) is covered in the CMA AIF or Guidelines.**

| **Subject matter under BCF 41-601F** | **Item in BCF 41-601F** | **Section of AIF / Guidelines under CMA** |
|---|---|---|
| **Cover page disclosure** | **Item 1** | |
| Required language | 1.1 | AIF cover page |
| Preliminary prospectus disclosure | 1.2 | N/A – no preliminary prospectus under CMA |
| Basic disclosure about the distribution | 1.3 | AIF cover page, 5.2 |
| Distribution | 1.4 | 5.2 |
| Non-fixed price distributions | 1.5 | 5.2 |
| Reduced price distributions | 1.6 | 5.2 |
| Market for securities | 1.7 | 4.4, 5.2, 2.1 |
| Risk factors | 1.8 | 2.1 |
| Underwriter(s) | 1.9 | AIF cover page, 5.2 |
| International issuers | 1.10 | 2.1 |
| **Table of contents** | **Item 2** | |
| Table of contents | 2.1 | Guidelines – general instructions |

| **Subject matter under BCF 41-601F** | **Item in BCF 41-601F** | **Section of AIF / Guidelines under CMA** |
|---|---|---|
| **Summary of prospectus** | **Item 3** | |
| General | 3.1 | Guidelines – general instructions |
| Cautionary language | 3.2 | N/A – summary not mandatory |
| **Corporate structure** | **Item 4** | |
| Name and incorporation | 4.1 | AIF cover page, 4.1 |
| Intercorporate relationships | 4.2 | 4.1 |
| **General development of the business** | **Item 5** | |
| Three year history | 5.1 | 1.2 |
| Significant acquisitions and significant dispositions | 5.2 | 1.2 |
| Trends | 5.3 | 1.3 |
| **Narrative description of the business** | **Item 6** | |
| General | 6.1 | 1.1, 1.2 |
| Issuers with asset-backed securities outstanding | 6.2 | 1.1, 1.2 |
| Issuers with mineral projects | 6.3 | 1.1 |
| Issuers with oil and gas operations | 6.4 | 1.1 |
| **Use of proceeds** | **Item 7** | |
| Proceeds | 7.1 | 5.3, 5.4 |
| Funds available | 7.2 | 1.1, 5.3 |

| **Subject matter under BCF 41-601F** | **Item in BCF 41-601F** | **Section of AIF / Guidelines under CMA** |
|---|---|---|
| Principal purposes | 7.3 | 1.1, 5.4 |
| Escrowed proceeds | 7.4 | 5.4 |
| Other sources of funding | 7.5 | 1.1, 5.3 |
| Acquisition | 7.6 | 5.4 |
| Retirement or repayment of debt | 7.7 | 5.4 |
| Special warrant financing | 7.8 | N/A |
| **Selected consolidated financial information and management's discussion and analysis** | **Item 8** | |
| Annual information | 8.1 | Omitted – information contained in financial statements |
| Quarterly information | 8.2 | Omitted – information contained in financial statements |
| Dividends | 8.3 | 5.2 |
| Foreign GAAP | 8.4 | Omitted – information contained in financial statements |
| Management's discussion and analysis | 8.5 | 4.7 |
| **Earnings coverage ratios** | **Item 9** | |
| Earnings coverage ratios | 9.1 | 5.2 |
| **Description of the securities distributed** | **Item 10** | |
| Shares | 10.1 | 5.2 |
| Debt securities | 10.2 | 5.2 |

| Subject matter under BCF 41-601F | Item in BCF 41-601F | Section of AIF / Guidelines under CMA |
|---|---|---|
| Asset-backed securities | 10.3 | 5.2 |
| Derivatives | 10.4 | 5.2 |
| Other securities | 10.5 | 5.2 |
| Modification of terms | 10.6 | 5.2 |
| Constraints | 10.7 | 4.2 |
| Ratings | 10.8 | 5.2 |
| Other attributes | 10.9 | 5.2 |
| **Consolidated capitalization** | **Item 11** | |
| Consolidated capitalization | 11.1 | 4.2 |
| **Options to purchase securities** | **Item 12** | |
| Options to purchase securities | 12.1 | 3.6, 3.7, 4.2 |
| **Prior sales** | **Item 13** | |
| Prior sales | 13.1 | 4.8 |
| Stock exchange price | 13.2 | Omitted – information about exchange or other market will be disclosed under 4.4 and 5.2 |
| **Escrowed securities** | **Item 14** | |
| Escrowed securities | 14.1 | 4.3 |
| **Principal shareholders and selling securityholders** | **Item 15** | |
| Principal shareholders and selling securityholders | 15.1 | 3.7, 3.8 |

| Subject matter under BCF 41-601F | Item in BCF 41-601F | Section of AIF / Guidelines under CMA |
|---|---|---|
| **Directors and officers** | **Item 16** | |
| Name, address, occupation and security holding | 16.1 | 3.1, 3.2, 3.7 |
| Corporate cease trade orders or bankruptcies | 16.2 | 3.5 |
| Penalties or sanctions | 16.3 | 3.5 |
| Personal bankruptcies | 16.4 | 3.5 |
| Conflicts of interest | 16.5 | 3.4 |
| Management of junior issuers | 16.6 | 3.1, 3.3 |
| **Executive compensation** | **Item 17** | |
| Disclosure | 17.1 | 3.6 |
| Exception | 17.2 | N/A |
| **Indebtedness of directors and executive officers** | **Item 18** | |
| Indebtedness of directors and executive officers | 18.1 | 3.6 |
| **Plan of distribution** | **Item 19** | |
| Name of underwriters | 19.1 | AIF cover page, 5.2 |
| Disclosure of market out | 19.2 | 5.2 |
| Best efforts offering | 19.3 | 5.2 |
| Over-allotments | 19.4 | 5.2 |
| Minimum distribution | 19.5 | 5.2 |
| Approvals | 19.6 | 5.4 |
| Listing application | 19.7 | 5.2 |

| **Subject matter under BCF 41-601F** | **Item in BCF 41-601F** | **Section of AIF / Guidelines under CMA** |
|---|---|---|
| Conditional listing approval | 19.8 | 5.2 |
| Determination of price | 19.9 | 5.2 |
| Special warrants acquired by underwriters | 19.10 | N/A |
| **Risk factors** | **Item 20** | |
| Risk factors | 20.1 | 2.1 |
| **Promoters** | **Item 21** | |
| Promoters | 21.1 | 3.5, 3.6, 3.7 |
| **Legal proceedings** | **Item 22** | |
| Legal proceedings | 22.1 | 1.4, 2.1 |
| **Interest of management and others in material transactions** | **Item 23** | |
| Interest of management and others in material transactions | 23.1 | 3.4 |
| **Relationship between issuer or selling security holder and underwriter** | **Item 24** | |
| Relationship between issuer or selling security holder and underwriter | 24.1 | 5.2 |
| **Credit supporter disclosure** | **Item 25** | |
| Credit supporter disclosure | 25.1 | 5.2, 5.7 |
| **Auditors, transfer agents and registrars** | **Item 26** | |

| **Subject matter under BCF 41-601F** | **Item in BCF 41-601F** | **Section of AIF / Guidelines under CMA** |
|---|---|---|
| Auditors | 26.1 | Omitted – information contained on auditor's report |
| Transfer agent and registrar | 26.2 | 4.5 |
| Registration of securities | 26.3 | 4.5 |
| **Material contracts** | **Item 27** | |
| Material contracts | 27.1 | 1.1 |
| Project financing and limited partnership offering | 27.2 | 5.5 |
| **Experts** | **Item 28** | |
| Opinions | 28.1 | Omitted – information contained on expert opinions [1.1 of Guidelines contemplates names of experts if mining or oil & gas issuer] |
| Tax consequences | 28.2 | 5.6 |
| Interest of experts | 28.3 | 4.6 |
| **Other material facts** | **Item 29** | |
| Other material facts | 29.1 | 1.4, 3.8, 4.8, 5.7 |
| **Project financings** | **Item 30** | |
| Project financings | 30.1 | 3.1 |
| **Purchasers' statutory rights of withdrawal and rescission** | **Item 31** | |
| General | 31.1 | 4.9 – modified to reflect proposal for new investor remedies |

| **Subject matter under BCF 41-601F** | **Item in BCF 41-601F** | **Section of AIF / Guidelines under CMA** |
|---|---|---|
| Non-fixed price offerings | 31.2 | N/A – withdrawal right eliminated under proposal for new investor remedies |
| **Financial statements** | **Item 32** | |
| Financial statements | 32.1 | 4.7 |
| **Certificates** | **Item 33** | |
| Certificates | 33.1 | N/A – no certificates under CMA |

# APPENDIX F

## Proposal to Redefine the Materiality Standard

"Material fact" and "material change" are both defined in BC and under most other provinces' securities legislation in terms of the significance of their impact on the market price of the issuer's securities.

However, the definition of material fact is broader than material change; it encompasses any fact that can "reasonably be expected to significantly affect" the market price or value of an issuer's securities and is not limited to changes in the "business, operations, assets or ownership" of an issuer that would reasonably be expected to have such an effect. *Pezim v. British Columbia (Superintendent of Brokers),* [1994] 2 S.C.R. 577.

Material fact and material change are used for different purposes:

- an issuer must make full, true and plain disclosure of all material facts when it sells securities under a prospectus
- a person (including an issuer) cannot trade a security if the person has knowledge of a material fact or a material change that has not been generally disclosed
- an issuer must disclose material changes as soon as practicable by press release and file a material change report within 10 days, and
- there is a general duty on senior management to enquire about material changes before an issuer trades securities, but there may not be a duty for them to enquire about material facts.

In addition, "misrepresentation" is defined in terms of material fact – a misrepresentation is an untrue statement of a material fact, or an omission to state a material fact that is required to be stated, or necessary to prevent a statement made, from being misleading.

**Summary of Proposal**

***We will redefine the disclosure standard:***

- to be similar to the "material information" standard that is described in the timely disclosure policies of the Canadian exchanges,
- to omit the retroactive test currently contained in the definition of material fact, and
- to omit the reference currently in the definition of material change to a decision by senior management that they think the directors will approve.

***We will apply the standard consistently***

- as the minimum required disclosure in an issuer's CMA entry document
- to prohibit insider trading
- to determine an issuer's continuous disclosure obligations, and
- to determine liability for misrepresentation.

***We will clarify what disclosure is required and when disclosure must be made.***

## The Problem

1. **The current distinction has been problematic to apply**. The courts and Commissions have struggled to characterize information as either changes or facts in order to apply the law.

   Perhaps the best example is found in *Pezim v. British Columbia (Superintendent of Brokers)* [1994] 2 SCR 577 where the BCSC found three matters to be material changes requiring disclosure, one of which was drilling results. At the Court of Appeal, Lambert J.A. determined that this was an error, stating that drilling reports were capable of being material facts, but not material changes. Lambert J.A. said the information might be a basis for a perception that there was a change in the value of an asset, but distinguished that from a change in the asset itself.

   The Supreme Court disagreed. In his opinion Iacobucci J. said
   - the determination of what constitutes a material change for disclosure purposes falls squarely in the regulatory mandate and expertise of the BCSC, and the majority of the BC Court of Appeal in rejecting the BCSC's finding was in error
   - the BC Court of Appeal's majority view was clearly wrong and inconsistent with the economic and regulatory realities the *Securities Act* sets out to address.

   Iacobucci J. buttressed his position by approving the argument that new exploration results can change the character of a mineral property from waste to ore. George C. Stevens and Stephen D. Wortley, *Murray Pezim in the Court of Appeal: Draining the Lifeblood from Securities Regulation*, (1992), 26 UBC L. Rev. 331. Of interest too, is Locke J.A.'s dissenting opinion in the Court of Appeal that information is capable of being an asset. Therefore a change in information could be a change in an asset, and thus a material change, within the meaning of the Act.

   In another example, the OSC found a statement made by an issuer's officers to a significant shareholder, that a take-over would not succeed because 60% of the issuer's shares were in friendly hands, to be a material fact and the basis for finding illegal tipping. *Royal Trustco Ltd. et al., White and Scoles* (1981) 2 OSCB 322C.

   On appeal, the Ontario Divisional Court stated that the term "fact" should not be read "super-critically" and that the "information" in the statement was sufficiently factual or a significant alteration of circumstances to be a material change to fall within the tipping provision. *Re Royal Trustco Ltd. et al. and Ontario Securities Commission* (1983) 43 O.R. (2d) 147 (Div. Ct.).

   One commentator has suggested that the distinction between a fact and a change can generally be seen in terms of an internal vs. an external event. This is based on a seemingly sensible notion, that generally speaking, an issuer should only be responsible for making continuous disclosure of "internal type" events. Alboini, *Securities Law* section 18.1.2, at p. 18-110-11. As appealing as this analysis may be, it is not entirely consistent with the definitions or with the analyses made by the courts. Also, it does not address the external event that has a particular impact on an issuer that is both material and different from its impact on other issuers in the same industry (for example, political instability in a localized area where the issuer's property is located), which it seems an issuer should be required to disclose.

Other commentators have suggested that the duty to disclose material changes should be seen as the duty to disclose changes in the basket of facts disclosed originally in the issuer's prospectus and from time to time afterwards. Stevens and Wortley, supra. at 338-339. This more closely approximates the appropriate duty, but does not clearly directly address the "new" fact, except to the extent it can be seen as an omission from disclosed facts.

The niceties of whether information is a change or a fact should not matter. If information could reasonably be expected to have a significant impact on the issuer's market price or value, the issuer should be required to disclose the information and persons who have the information should be prevented from trading while it remains undisclosed.

2. **It is more difficult to determine when disclosure must be made.** The issue of when an issuer must make disclosure is exacerbated by the difficulty in determining whether the information is a material fact or a material change, and by policies stating that even if it isn't either, it should be disclosed anyway.

3. **The current distinctions are inconsistent with the principles of CMA.** The CMA system recognizes that the investor who purchases securities in the market is making an investment decision, the same as an investor who purchases securities directly from the issuer under a prospectus. Under CMA they are both entitled to the same, appropriate, level of disclosure. The distinction that is currently made between material fact and material change, which allows the issuer's securities to be traded, by persons who are not insiders or in a special relationship with the issuer, in the market while material facts are undisclosed, but does not allow the issuer to make a trade in its own securities, is not consistent with the underlying principles of the CMA system.

4. **The retroactive element in the current definition of material fact is inappropriate, particularly in view of potential liability for the disclosure.** The definition of "material fact" includes both a fact that "significantly affects" the market price of a security and a fact that "would reasonably be expected to have a significant effect" on the market price. The first part of the definition allows materiality to be determined retroactively on the basis of actual market activity even if there was no reasonable ground for the issuer's management to expect, when they made their judgment as to whether or not the fact was material, that the fact would have a significant effect on the market price. Our view is the same as the view of the Allen Committee and the CSA Civil Remedies Committee on this matter.

5. **The inclusion of a decision by senior management that they think the directors will approve in the current definition of material change is inappropriate.** It confuses what a material change is – the purpose of the definition – with when disclosure should be made. Pending board approval should be treated like other uncertain events—management must balance the likelihood that the event will occur and the anticipated impact of the event if it were to occur to determine if and when disclosure should be made. This should lead management to either make the disclosure if board approval is anticipated, or keep the event confidential until the board considers the matter.

6. **The timely disclosure policies of the exchanges "go beyond" the issuer's statutory obligations, causing confusion as to the extent of the issuer's obligations and liabilities.** Adding to the confusion is the statement in the policies that a cornerstone principle of securities regulation is that all persons investing in securities should have equal access to information that may affect their investment decisions. This could be interpreted to require disclosure of non-material information.

7. **Applying the statutory definition of material fact in some, but not all instances, where material fact is referred to in the *Securities Act* leads to uncertainty and confusion.** Another difficulty arising from the current definition of material fact is that the definition is stated to apply when the term is used in relation to securities issued or proposed to be issued. This has led to courts to conclude that there are two different definitions of material fact, and that they must determine whether the statutory definition based on market impact applies, or whether the "ordinary" meaning of material fact—important and significant information—applies, to a particular situation. See *R. v. Crimeni* (March 13, 1998) Vancouver Registry No. 21053-01 (unreported) and *R. v. Coglon* [1998] B.C.J. No. 2573 (B.C.S.C.)

8. **Quebec and the US use a "reasonable investor test" that is more subjective than the market impact test.** The US Supreme Court set out this approach in *TSC Industries Inc. v. Northway*, Inc. 426 US 438 (1976). Under the Northway test, information is material if there is a substantial likelihood that a reasonable shareholder would think it important in making an investment decision, or put another way, there must be a substantial likelihood that a fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available. This test is more difficult than the market impact test to apply with certainty, and may result in a different determination of materiality. In the US, there is a line of insider trading cases that have used the market impact test to decide whether facts are material under Northway's reasonable investor test – seemingly concluding that a reasonable investor cares about facts that are likely to affect the value of a security, and it is these facts that are material. See Davis, 24 *Materiality and SEC Disclosure Filings* 24 Securities Regulation Law Journal 180, 187-189 discussing, *Cady, Roberts & Co* 40 SEC 907 (1961), *List v. Fashion Park, Inc.* 340 F2d 457, 462 (2d Cir. 1965), quoting Kohler v. Kohler Co. 319 F2d 634, 642 (7th Cir. 1963), *SEC v. Texas Gulf Sulphur,* 401 F2d 833 (2d Cir. 1968), and *Elkind v. Liggett & Myers* 635 F2d 156, 166 (2d Cir 1980). In his article, Davis argues that this is the proper standard for materiality and there should be no other.

**Details of the Proposal**

We will redefine the disclosure standard in terms of material information**.** Issuers will be required to make disclosure of all material information in their entry documents, and to ensure that the disclosure remains current.

**1. Underlying policy**

The basis for securities legislation is that all persons investing in securities have equal access to material information.

## 2. Definition of "material information"

"Material information" means information relating to the business or affairs of an issuer that would reasonably be expected to result in a significant change in the market price or value of any of the issuer's securities.

(A different definition will need to be proposed for mutual funds.)

The language – "reasonably expected to ***result in a significant change*** in the market price or value" – is from the TSX's policy. We think it expresses more plainly the language that is currently in the legislation – "reasonably be expected to ***have a significant effect on*** the market price or value".

The concept of the change having to be expected to ***result in a significant change*** is very important to ensure that frivolous suits are not brought because of nominal changes in the price of an issuer's securities. Significant means meaningful, important, of consequence-- the information that was misstated or omitted is of such importance that it results in a significant change in the market price or value of the issuer's securities. Similarly, the change contemplated must be distinguished from a change in the market generally, or the issuer's industry segment at large. The change referred to in the definition is that portion of the change in the market price or value of an issuer's securities that is not related to or explained by other movements in the marketplace. This concept of related significant change, coupled with the anticipated costs of litigation, will serve as a gatekeeper, keeping out frivolous litigation.

## 3. Assume a rational, efficient market

We will make it clear in guidance that the definition of "material information" assumes a rational, efficient market where investors' behaviour is based on economic interest alone. Management cannot presume that because historically there has been little response in the issuer's stock price to news released about the issuer, that no news about the issuer's business and affairs is material. Similarly, we know that markets often appear to be interested in information that does not have an economic impact – we can leave it to the market to call for this information, and for issuers to respond to market demand. If an investor learns of information that does not have an economic impact and wishes to sell the shares as a consequence of the information, the investor can do so with nominal financial impact to the price. Also information that is "non-economic" can become economic – for example, when an issuer's policies are so unpopular that they result in a boycott of an issuer's products. At that point the information, provided it meets the significance test, is material.

Under the market impact definition, management must assume that the price of the issuer's securities immediately prior to the time disclosure is to be made is determined in an efficient, free market that has processed all disclosed information, and ask themselves whether, assuming the same efficient, free market, the information would reasonably be expected to result in a significant change to that price. This is extremely important because it permits the decisions of management to be made examined and reviewed based on principles that are fair and transparent. This is especially important because the issuer and management are liable for misrepresentations, ie, misstatements and omissions of material facts.

In addition, under these principles, materiality is capable of measurement using standard market models developed by financial economists that can test whether false information caused a security to trade at an artificially high or low price by measuring whether investors earned any

abnormal returns at the time the correct information was released to the public. The model incorporates the observed relationship between the return on a particular stock and the market or market segment as a whole, to isolate the change in the return that is attributable solely to the allegedly withheld or false information. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities,* 38 The Business Lawyer 1 (Nov. 1982), referring to Schwert, *Using Financial Data to Measure Effects of Regulation,* 24 J. Law & Econ. 121 (1981). This brings greater certainty and assists management in making appropriate decisions in this regard.

## 4. Redefining the standard

The requirement to disclose material information is not the same as the requirement to make "full, true and plain disclosure of all material facts" or "prospectus-level disclosure" which industry has come to understand to mean answering each and every question in the long form prospectus, whether or not the information called for is material to the issuer. Imposing a requirement to keep this detailed level of disclosure current would be overly burdensome to issuers and would delay the release of important information to the market. Disclosure should focus on significant items; if the volume of disclosure increases, focus on the main issues can be lost.

Properly defining the standard for disclosure is fundamental to CMA and the related investor remedies regime. As the US Supreme Court stated in *Northway:*

> "..if the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions and misstatements, but also management's fear of exposing itself to substantial liability may cause it to simply bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decision making." *TSC Industries v Northway*, USSC June 14, 1976, reported at p. 90,069 of CCH Federal Securities Law Reports at ¶ 23, cited with approval in by Montgomery J. *Royal Trustco Ltd. v. Campeau Corp* (Ontario High Court of Justice) (1980) 31 OR 2d 75.

Issuers must disclose all material information in their entry documents. Press releases would be used to disclose material information that should be disclosed between regular filings in a timely way. Should an issuer wish to do so, additional information may be provided in its annual information forms, quarterly reports, in supplemental filings or on their websites. This system ensures that press releases are used for their true purpose: to give the market notice of truly important -- that is, material -- information, but recognizes that there may be additional information of a more detailed or a background nature the issuer may wish to put on the public record.

## 5. Disclosure of "external" events

Issuers would not generally be required to interpret the impact of external political, economic and social developments on their business and affairs. However, if an external development has had or will have a direct effect on the business and affairs of an issuer that is both material and uncharacteristic of the effect generally experienced by other issuers engaged in the same business or industry, the issuer must make disclosure of the development and its impact or potential impact on the issuer.

## 6. Timely disclosure

An issuer will be required to disclose material information as soon as practicable on the information becoming known to management, or in the case of information that is previously known to management as soon as practicable on it becoming apparent that the information is material.

Generally, an issuer should make disclosure when the material information is "established", ie, when management has reviewed the information, has reasonable confidence in it and put it into context. If every suspicion that could affect the market price were to be published the result would be a chaotic market.

Timely does not mean immediate - it means as soon as practicable. And that means that management must be able to review the information, have reasonable confidence in it and put it into context.

*Amirault v. Westminer Canada Ltd* (N.S. Supreme Court Trial Division)[1993] NSJ No. 129 provides a good illustration. This case considered whether certain information indicating that the company's mineral property was not as promising as the public record indicated was a "material fact" that should have been disclosed. Nunn J. wrote:

> In a mining exploration company there are many facts, ie events, occurrences, results and the like occurring regularly and often important to the company's operations but to hold that all these, or all important things are material and must be disclosed would create not an open and fair market place but rather a chaotic one. For example, as here, if you have an expected grade which upon some initial sampling turns out to be lower that certainly is a fact and undoubtedly an important one. However, to say it is material and required to be disclosed is another matter for within a day or week the sample grade may change upward dramatically. If both were disclosed as material information, the market could go up and down like a yo-yo and would be open to unresolveable and myriad claims of manipulation—reveal a few pessimistic facts, bring down the price of the stock, then release some favourable facts for the reverse effect.
>
> To my mind, this is not what is intended. In order to give proper effect to the policy, a determination of materiality must be based upon a reasonable expectation that the price of the stock would undergo a significant change. In this situation….the facts of grade and ore reserves become material facts when the company is satisfied after performing the necessary work, in this case, as recommended by the consultants, as to the accuracy of the fact and that that is significantly different from earlier facts as to cause a significant change in the market price of the stock.

**However:**

1. While the issuer is establishing the material information, the issuer must have a system in place to keep the information confidential and to prohibit persons with knowledge of the information from trading in the issuer's securities, and the issuer must not trade in its securities.

2. If market activity indicates that the information has leaked or the existence of rumour, or if management has made selective disclosure that it realizes should have been made generally public, the issuer must issue a clarifying press release.
3. In no event, may the issuer make misleading disclosure. Where an issuer is required to make a statement, management is responsible to make appropriate inquiries to assure themselves that the statement they make is truthful and not misleading.

## 7. Clarifying the duties of management

Issuers are responsible for having systems in place:

- to bring important information about the issuer's business and affairs to management's attention
- for management to review the information, to determine whether it is material and to disclose material information as soon as practicable
- to prohibit trading in the issuer's securities by the issuer, its directors, senior officers and anyone with knowledge of undisclosed material information.

Where the application of the materiality test is not straightforward because of the uncertainty an event will occur, management must balance both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the issuer's circumstances to determine if, and when, the information becomes material information and must be disclosed. Similar to the situation where the issuer is establishing material information, the issuer and its management will not be liable for not making disclosure during a pending event, provided the information is held in confidence and there is no trading in the issuer's securities by the issuer or others with knowledge of the information. Again, if there is evidence that the information has leaked or there is a rumour that is in some way associated with the issuer, management must issue a clarifying statement immediately.

When an issuer must make a clarifying statement about a matter (eg, because of rumour or leak or inadvertent selective disclosure), management must make inquiries and otherwise take due care to ensure that the issuer discloses all material information and that it does so within 24 hours of learning of the rumour or leak, or of unintentionally making selective disclosure. If management complies with this, neither the issuer nor management will be liable.

This defence recognizes that during a private placement and in certain other business contexts, management may unintentionally make selective disclosure and permits management to correct the situation without liability. It is not available to anyone who has engaged in tipping, insider trading, fraud or market manipulation.

Management's decisions in determining whether information is material and in timing public disclosure will be viewed in the context of whether management acted reasonably in the circumstances, and not with the benefit of 20/20 hindsight.

An issuer has no general duty to correct or update third party statements or rumours unless:

- The issuer or its management is responsible for the rumour
- The issuer or its management are closely associated with the statements (such as analyst reports where the issuer has provided the information to the analyst or has encouraged the report)
- There is undisclosed material information that appears to have leaked.

**8. Confidential filing where undue detriment**

We will preserve the procedure for an issuer to make a confidential filing with the Commission where management is of the view that disclosure of material information would cause undue detriment to the issuer. This function is currently served by the material change report. As is the case now, the executive director may disagree and require the issuer to make disclosure.

One the basis for confidentiality is no longer present, if the information is still material information, the issuer must make disclosure. In no event can disclosure of material information be deferred permanently.

**9. Materiality depends on the issuer's circumstances**

The materiality of information varies from one issuer to another according to the size of its profits, assets and capitalization, the nature of its operations and many other factors. Information that is "material" in the context of a smaller issuer's business or affairs is often not material to a larger issuer. We will provide a list of developments that are likely to be material to an issuer and will refer to the lists included in the disclosure policy of the exchanges. The issuer, itself, is in the best position to determine the materiality of particular information in the context of its own affairs.

**10. Materiality in financial statements**

Materiality may be defined by others differently in other contexts, for example, by the CICA Handbook for the purpose of financial statement disclosure. Accordingly, information may be material for the purpose of disclosure in an issuer's financial statements that may not be material for purposes of an issuer's continuous disclosure obligations or insider trading prohibitions.

**Advantages of the Proposal**

The Proposal clarifies what disclosure is required and when disclosure must be made.

1. **The difficulties that arise in determining whether something is a fact or a change will disappear.** Issuers and their management will focus on what is really important—if information (of whatever type) would reasonably be expected to result in a significant change in the market price or value of the issuer's securities then it is material, must be disclosed, and until it is disclosed persons who know that information must keep it confidential and cannot trade.

2. **All investors will have an equal right to the disclosure that really matters - information that would reasonably be expected to result in a significant change in the market price or value of the issuer's securities.** This is consistent with the principles of CMA that recognize that investors in the primary market and investors in the secondary market are both entitled to an appropriate level of disclosure and the same rights if the disclosure is not made or contains a misrepresentation.

3. **Issuers and their management will not be liable if there is a significant change in the market price if it was not reasonable to expect this would have occurred.** Issuers and their management will not be judged with the benefit of 20/20 hindsight.

4. **Issuers and their management will be liable for ensuring material information is disclosed in a timely manner.** Not all information is material. In fact, not all important information is material either. In order for information to be material, it must be reasonable to expect that the information would result in a significant change in the market price or value of the issuer's securities.

5. **When an issuer must release information is clarified.** We will provide that an issuer may keep material information confidential until the information is established —ie, management has reviewed the information, has determined that it is material, is reasonably comfortable with its accuracy, has put it into context and has determined that it is material. Issuers will be responsible for having systems in place:
   a. to bring important information to management's attention
   b. for management to review the information, to determine whether it is material and to disclose material information, and
   c. to prohibit trading during the period that material information is being established, during pending events and when the issuer has disclosed material information in confidence to the Commission by anyone with knowledge of the information.

   Management will also be responsible to make appropriate inquiries and to release the information or otherwise clarify the situation by issuing a press release within 24 hours in the event there is evidence that the information has leaked.

6. **There will be only one test for materiality**. The same test will apply for all purposes under the *Securities Act*. Legal requirements and policies will be consistent.

# APPENDIX G

## Table of Concordance
## Registration Exemptions

| Current Exemption | Title | Proposed Exemption | Title |
|---|---|---|---|
| Act, s. 44(2)(a) | Exemption for insurers or savings institutions if solely incidental and no advertising of services | None | Discontinued |
| Act, s. 44(2)(b) | Exemption for Business Development Bank of Canada if solely incidental and no advertising of services | None | Discontinued |
| Act, s. 44(2)(c) | Exemption for lawyers and accountants if solely incidental and no advertising of services | None | Discontinued |
| Act, s. 44(2)(d) | Exemption for dealer re: research reports and analysis | None | Discontinued |
| Act, s. 44(2)(e) | Exemption for registered dealer or representative if reasonably in fulfillment of duty to ensure suitability | None | Discontinued |
| Act, s. 44(2)(f) | Exemption for publisher of, or writer for, a newspaper or business or financial publication if solely incidental and no advertising of services | None | Discontinued |
| Act, s. 44(2)(g) | Person or class of persons designated by regulation | None | Act will have rulemaking power to make exemptions – do not need this catch-all anymore |
| Act, s. 45(2)(1) | Trade by executor, receiver, sheriff, etc. | (1)(n) | Trades to realize on legal obligations |
| Act, s. 45(2)(2) | Trade to Business Development Bank, savings institutions, insurers, governments, municipalities, others | (1)(b) | Trades to an exempt purchaser |
| Act, s. 45(2)(3) | Isolated trade on behalf of owner or issuer | (1)(o) | Isolated trades |
| Act, s. 45(2)(4) | Accredited investors | (1)(b) | Trades to an exempt purchaser |
| Act, s. 45(2)(5) | Purchase of prescribed amount | None | Discontinued |
| Act, s. 45(2)(6) | Asset acquisition, prescribed amount | (1)(b) | Trades to an exempt purchaser |

| Current Exemption | Title | Proposed Exemption | Title |
|---|---|---|---|
| Act, s. 45(2)(7) | Trade solely through registered dealer | (1)(a) | Trades to or through a dealer |
| Act, s. 45(2)(8) | Rights offering | (1)(b) | Trades to an exempt purchaser |
| Act, s. 45(2)(9) | Amalgamation, merger, reorganization or arrangement | (1)(j) | Trades in securities in connection with a corporate reorganization or take over bid |
| Act, s. 45(2)(10) | Trade to directors, officers, employees | (1)(b) | Trades to an exempt purchaser |
| Act, s. 45(2)(11) | Dividend reinvestment plan | (1)(b) | Trades to an exempt purchaser |
| Act, s. 45(2)(12) | Stock dividend, dissolution, or winding up, or exercise of right to purchase, convert, or exchange | (1)(b) | Trades to an exempt purchaser |
| Act, s. 45(2)(13) | Transfer of beneficial ownership to pledgee, mortgagee, etc. under realization on collateral for debt | (1)(n) | Trades to realize on legal obligations |
| Act, s. 45(2)(14) | Dividend in specie | (1)(b) | Trades to an exempt purchaser |
| Act, s. 45(2)(15) | Repealed | None | Discontinued - replaced earlier by MI 45-103 |
| Act, s. 45(2)(16) | Trade to an underwriter or between underwriters | (1)(a) | Trades to or through a dealer |
| Act, s. 45(2)(17) | Trade to promoter or between promoters | (1)(b) | Trades to an exempt purchaser |
| Act, s. 45(2)(18) | Trade between control persons | (1)(b) | Trades to an exempt purchaser |
| Act, s. 45(2)(19) | Trade by lender, mortgagee, etc. for purpose of liquidating debt by selling security pledged or mortgaged as collateral for debt | (1)(n) | Trades to realize on legal obligations |
| Act, s. 45(2)(20) | Execution of unsolicited order through registered dealer by bank or trust company | None | Discontinued |
| Act, s. 45(2)(21) | Trade for acquisition of mining property | (1)(b) | Trades to an exempt purchaser |
| Act, s. 45(2)(22) | Trade in mutual fund security where net asset value/aggregate acquisition cost not less than prescribed amount | (1)(b) | Trades to an exempt purchaser |
| Act, s. 45(2)(23) | Trades through recognized exchange through telephone or other linkages with other exchanges | None | Discontinued |

| Current Exemption | Title | Proposed Exemption | Title |
|---|---|---|---|
| Act, s. 45(2)(24) | Trade of security of offeree issuer to offeror under take over bid or issuer bid | (1)(j) | Trades in securities in connection with a corporate reorganization or take over bid |
| Act, s. 45(2)(25) | Securities issued as reinvestment of dividends or distributions of income or capital gains by mutual funds | (1)(b) | Trades to an exempt purchaser |
| Act, s. 45(2)(26) | Trade to underwriter for services in connection with a distribution of securities | (1)(a) | Trades to or through a dealer |
| Act, s. 45(2)(27) | Trade in bond or debenture by unsolicited order to bank or trust company if bank or trust company acting as principal and dealing with registered dealer to buy and sell bond | None | Discontinued |
| Act, s. 45(2)(28) | Trade in securities of offeror exchanged with security holders of offeree under take over bid or issuer bid | (1)(j) | Trades in securities in connection with a corporate reorganization or take over bid |
| Act, s. 45(2)(29) | Trades to issuers as purchases, redemptions, or acquisitions by the issuer | (1)(d) | Trades in securities back to the issuer |
| Act, s. 45(2)(30) | Trade or trade within a class of trade designated by regulation | None | Act will have rulemaking power to make exemptions – do not need this catch-all anymore |
| Act, s. 46(a)(i) | Bonds, etc., of or guaranteed by governments, etc. | (1)(m) | Trades in specific types of securities |
| Act, s. 46(a)(ii) | Bonds, etc., of or guaranteed by countries | (1)(m) | Trades in specific types of securities |
| Act, s. 46(a)(iii) | Bonds, etc, of or guaranteed by Canadian municipal corporations | (1)(m) | Trades in specific types of securities |
| Act, s. 46(a)(iv) | Bonds, etc, of or guaranteed by insurer or savings institution | (1)(m) | Trades in specific types of securities |
| Act, s. 46(a)(v) | Bonds, etc, of or guaranteed by International Bank for Reconstruction and Development | (1)(m) | Trades in specific types of securities |
| Act, s. 46(a)(vi) | Bonds, etc, of or guaranteed by Asian Development Bank or Inter-American Development Bank | (1)(m) | Trades in specific types of securities |
| Act, s. 46(b) | Certificates or receipts of a trust company or credit union for guaranteed investment | (1)(m) | Trades in specific types of securities |

| Current Exemption | Title | Proposed Exemption | Title |
|---|---|---|---|
| Act, s. 46(c) | Securities issued by a private mutual fund administered by a trust company | None | Discontinued |
| Act, s. 46(d) | Negotiable promissory notes or commercial paper | (1)(m) | Trades in specific types of securities |
| Act, s. 46(e) | Mortgages sold by mortgage broker | (1)(e) | Trades in non-syndicated mortgages under mortgage brokerage legislation |
| Act, s. 46(f) | Securities that evidence indebtedness under conditional sales contract, provide for acquisition of personal property and are not sold to individuals | None | Discontinued |
| Act, s. 46(g) | Securities issued for educational, benevolent, fraternal, charitable, religious or recreational purposes and not for profit | None | Discontinued |
| Act, s. 46(h) | Securities issued by a co-operative to its members | None | Discontinued |
| Act, s. 46(i) | Shares or deposits of credit unions | None | Discontinued |
| Act, s. 46(j) | Securities of private issuer if not offered for sale to public | (1)(c) | Trades in securities of restricted issuers |
| Act, s. 46(k) | Securities of real estate co-op that evidence right to use part of land owned by co-op | (1)(f) | Trades in real estate securities sold by a licensed real estate agent |
| Act, s. 46(l) | Trades in variable insurance contracts | (1)(g) | Trades in variable insurance contracts issued by an insurer and sold by a licensee under financial institutions legislation |
| Act, s. 46(m) | Securities or securities within a class of securities designated by regulation | None | Act will have rulemaking power to make exemptions – do not need this catch-all anymore |
| Act, s. 47(a) | Trade of exchange contract solely through a registered dealer | (1)(a) | Trades to or through a dealer |
| Act, s. 47(b) | Trade resulting from unsolicited order placed with non-resident individual who does not carry on business in BC | (1)(i) | Unsolicited trade with foreign dealers |
| Act, s. 47(c) | Trade or trade within a class of trade designated by regulation | None | Act will have rulemaking power to make exemptions – don't need this catch-all anymore |

| Current Exemption | Title | Proposed Exemption | Title |
|---|---|---|---|
| Rules, s. 86 | Exemption for investment dealer or representative at IDA member firm who follow IDA rules re: portfolio management | (2)(b) | Advising if member of SRO |
| Rules, s. 87 | Underwriter acting in distribution if trading registration not required | None | Underwriters will not constitute a separate category of registration going forward |
| Rules, s. 89(a) | 50 purchasers | None | Discontinued – replaced earlier by MI 45-103 |
| Rules, s. 89(b) | $25,000 – sophisticated purchaser | None | Discontinued – replaced earlier by MI 45-103 |
| Rules, s. 89(c) | Security for debt | (1)(k) | Trades in securities issued to satisfy debt or as consideration for a bonus or finders' fee |
| Rules, s. 89(d) | Trade by beneficial owner of escrow securities under terms of escrow agreement | (1)(b) | Trades to an exempt purchaser |
| Rules, s. 89(e) | Bonus or finders' fee | (1)(k) | Trades in securities issued to satisfy debt or as consideration for a bonus or finders' fee |
| Rules, s. 89(f) | Management company employees | (1)(b) | Trades to an exempt purchaser |
| Rules, s. 89(g) | Trade by exchange issuer to friends and relatives of principals | None | Discontinued – replaced earlier by MI 45-103 |
| Rules, s. 89(h) | Trade by security holder in "quasi-private" issuer | None | Discontinued – replaced earlier by MI 45-103 |
| BCI 31-503 | Exchange contracts dealers trading in commodity pool securities | None | Discontinued |
| BCI 32-101 | Small security holder selling and purchase arrangements | None | Discontinued |
| BCI 32-501, paragraph 2 | Advising and related trading under an exemption | (1)(m)<br><br>(2)(a) | Trades in specific types of securities<br><br>Advising in exempt market |
| NI 35-101 | Conditional Exemption from Registration for US Broker-Dealers and Agents | (1)(i) | Unsolicited trades with foreign dealers |
| BCI 35-501 | Remote Access Trades on the Canadian Venture Exchange | (1)(a) | Trades to or through a dealer |

| Current Exemption | Title | Proposed Exemption | Title |
|---|---|---|---|
| MI 45-103 | Capital Raising Exemptions | (1)(b)<br><br>(1)(c) | Trades to an exempt purchaser<br><br>Trades in securities of restricted issuers |
| BCI 45-501 | Mortgages | (1)(e) | Trades in non-syndicated mortgages under mortgage brokerage legislation |
| BCI 45-504 | Trades to trust companies, insurers, and portfolio managers outside BC | (1)(b) | Trades to an exempt purchaser |
| BCI 45-507 | Trades to employees, executives, and consultants | (1)(b) | Trades to an exempt purchaser |
| BCI 45-510 | Trades in self-directed RESPs | None | Discontinued |
| BCI 45-511 | Trades of government warrants | (1)(m) | Trades in specific types of securities |
| BCI 45-512 | Real estate securities | (1)(f) | Trades in real estate securities sold by a licensed real estate agent |
| BCI 45-513 | Re-sale relief for eligible real estate securities | (1)(f) | Trades in real estate securities sold by a licensed real estate agent |
| BCI 91-501 | Over-the-counter derivatives | None | Discontinued |
| BCI 91-504 | Government strip bonds | (1)(m) | Trades in specific types of securities |
| None | New | (1)(h) | Trades outside Canada |
| None | New | (1)(l) | Trades by a senior issuer that is in the CMA system in its own securities |
| None | New | (2)(c) | Advising by foreign adviser where no solicitation |
| None | New | (3) | Those trading or advising on behalf of a person with a trading or advising exemption also exempt |

# APPENDIX H

# The Australian Firm-only Registration System

Firm-only registration for dealers and advisers is a concept that is in use in other parts of the world. To provide some context for the Firm-only Registration Proposal, we have summarized the Australian system.

In Australia, the Australian Securities and Investment Commission (ASIC) does not require that individuals register for financial services licenses under its new *Corporations Act 2001* and the *Financial Services Reform Act, 2001*. Rather, the system allows for the possibility that an individual might apply for a financial services licence, but the practical impediments posed by capital adequacy requirements and other aspects of prudential regulation make it unlikely that individuals can actually hold financial services licenses.

## 1. Australian Firm-only Registration

The AFS licensing system is generally very mindful of the overlap between the oversight of ASIC and the oversight of the Australian Prudential Regulation Association (APRA). This results in many variations on and many exemptions from requirements.

### (a) Licensees and representatives

ASIC recently (March 11, 2002) introduced a "one licence for all" concept for all people and companies providing financial services. The new licensing system affects securities dealers, financial planners and financial advisers, futures brokers and advisers, and foreign exchange dealers (among others).

Every person who carries on a financial services business must hold an Australian Financial Services (AFS) Licence, represent someone who does, or be exempted from the licensing requirement..

An AFS licence holder may have internal representatives, employees and directors or partners, who are exempt from the licensing requirement. AFS licence holders can also have external representatives, who can be natural persons or corporations, if the licensee provides written authority. These are called authorized representatives, and a database of authorized representatives is maintained by ASIC and available to members of the public. The ability of corporations to be authorized representatives is a significant departure from the previous licensing regime; previously, only natural persons could be authorized representatives.

Internal representatives are not listed in any ASIC database.

The effect of the Australian licensing rules is that individuals do not register. Instead, they always provide trading or advising services as employees of registered firms or independent contractors.

### (b) What activity requires a licence?

Persons carrying on a financial services business must have an AFS licence, or be exempted from the licensing requirement. The factor that distinguishes those persons who carry on business from those who are representatives is whether the person acts as principal or agent. ASIC provides written guidance about when a person is acting as a principal or a agent(representative), in which the following factors are listed:

- conduct is not monitored or supervised by others
- the person holds out as a principal (i.e. in business)
- conduct is not covered by other's compensation (i.e. insurance and bonding, investor compensation fund) arrangements
- client assets are held in an account in that person's name
- clients are directed to pay any fees owing into an account in that person's name
- commissions are received by that person directly from product issuers
- that person has ownership of, access to, or liability for client information.

Further guidance is provided about how a representative can handle funds and how a representative can advertise.

Persons in the business of providing financial services require an AFS licence regardless of whether those services are provided retail or wholesale. However, the AFS licensing regime provides for different and additional financial product and risk disclosure for retail clients than for wholesale clients.

### (c) Licensee and representative accountability

To ensure licensees are accountable for the actions of their representatives, they must:

1. do all things necessary to ensure the financial services covered by the licence are provided efficiently, honestly and fairly;
2. comply with all conditions of the licence;
3. take reasonable steps to ensure their representatives comply with financial services laws;
4. have available adequate resources;
5. adequately train representatives and ensure they are competent to provide the financial services;
6. have a dispute resolution system which meets prescribed requirements;

7. have adequate risk management systems;

8. have compensation (i.e. insurance and bonding, investor compensation fund) arrangements where financial services are provided to retail clients.

A licensee is ultimately responsible for all financial services provided under its license, regardless of how those services are provided.

The primary obligation for compliance is imposed on licensees, but some legal obligations are imposed on representatives, including:

1. disclosure obligations relating to the nature of the service, product and advice;

2. consumer protection obligations.

**(d) Authorized representatives**

A licensee can provide written authority to another person to provide some or all of the services within the scope of the licensee's licence, and can revoke that authority at any time. Any authorization that purports to give authority outside the scope of the licensee's authority or is contrary to a banning or disqualification order is void.

Authorized representatives can't authorize other persons to be authorized representatives or make others representatives of the licensee. They can give an individual employed by them or a director the ability to carry out activities under the authorized representative's authorization, but only if the licensee first consents to specified individuals or classes of individuals.

A person can be the authorized representative of one or more licensee if the licensees each consent to the arrangement.

Licensees must provide notice to ASIC of a written authorization within 10 days of making it, including the authorized representative's name, business address, the specific services authorized, the date made, and the details of other licenses the authorized representative holds. Any changes to or revocation of the authorization must also be reported to ASIC within 10 days.

**(e) Information sharing**

If ASIC thinks it is appropriate, it may give information to a licensee about a person ASIC believes is or will be a representative if ASIC has reasonable grounds to believe the information is true. The licensee receiving the information can only use it, make a record of it, or disclose it to decide what action (if any) to take regarding the representative or to take action against the representative after making such a decision.

If a licensee receives and uses information about a person in that way, the licensee is granted a qualified privilege and protected from court processes, including production processes.

**(f) Liability**

The licensee is liable for the representative's conduct in providing a financial service where the client could reasonably be expected to rely on, and did rely on in good faith, the representative's conduct. If the representative only represents one licensee, the licensee is responsible, as

between the licensee and the client, for the representative's conduct whether it was within the written authority or not.

The AFS licensing regime provides a detailed formula for apportionment of liability between licensees in the event representatives have more than one authorization.

1. If the representative's conduct was within the scope of one authority, but not the other(s), then the licensee that granted the authority within which the representative acted is liable, as between the licensee and the client, for the representative's authority.

2. If the conduct was within the scope of multiple authorities, those licensees are jointly and severally liable for the representative's conduct.

3. In a case where the representative's conduct is outside the scope of all the authorizations, the licensees are jointly and severally responsible, as between the licensees and the client, for the representative's conduct even though it was outside the scope of the written authorities.

The licensee is not responsible, as described above, if the client was told about the limits of the authorized representative's authority in a way reasonably necessary for deciding whether or not to get a financial service.

If a licensee is responsible as described, then clients have the same remedies against the licensee as they do against the representative.

Any agreement to alter the responsibility of representatives is void, except agreements by representatives to indemnify licensees.

### (g) Enforcement

ASIC has broad powers to make banning orders in a variety of circumstances against licensees and against all other persons. A banning order prevents a person from providing some or any financial services. It is an offence to breach a banning order.

ASIC is responsible for notifying the public and the markets when it makes a banning order.

ASIC is also able to apply to court for a disqualification order.

The AFS licensing regime includes a prohibition on licensees engaging in unconscionable conduct, in addition to other causes of action.

### (h) Conduct rules

Licensees must give priority to client orders. The regulations then contain various requirements relating to client instructions to deal through licensed markets and can contain requirements for record keeping relating to transactions on licensed and foreign markets.[13]

Licensees must also disclose when they are acting as principal if they are dealing with non-licensees. Licensees cannot charge clients a fee if acting as principal (unless permitted by the

[13] We have not reviewed the regulations.

regulations). If this rule is contravened, the non-licensee client has 14 days within which to rescind. The regulations may also impose additional record keeping requirements on licensees for principal transactions.

Subject to the regulations, licensees and their employees cannot acquire a "financial product" on their own behalves.[14] This sounds odd to North Americans, until one examines the concept of "financial product" as used in the *Corporations Act* 2001. The definition is:

> **- SECT 763A**
> **General definition of *financial product***
>
> (1) For the purposes of this Chapter, a *financial product* is a **facility** [emphasis added] through which, or through the acquisition of which, a person does one or more of the following:
>
> (a) makes a financial investment (see section 763B);
>
> (b) manages financial risk (see section 763C);
>
> (c) makes non-cash payments (see section 763D).
>
> This has effect subject to section 763E.
>
> (2) For the purposes of this Chapter, a particular facility that is of a kind through which people commonly make financial investments, manage financial risks or make non-cash payments is a *financial product* even if that facility is acquired by a particular person for some other purpose.
>
> (3) A facility does not cease to be a financial product merely because:
>
> (a) the facility has been acquired by a person other than the person to whom it was originally issued; and
>
> (b) that person, in acquiring the product, was not making a financial investment or managing a financial risk.

Licensees also cannot extend credit to an employee or an employee's associates in order to acquire financial products.

Employees of licensees must trade securities through their employers.

ASIC maintains a "no contact/no call" register for persons who do not wish to be contacted, on an unsolicited basis, by AFS licensees and their representatives. For those persons who are not in the "no contact/no call" register and do receive unsolicited communications from representatives, there is a "hawking" prohibition preventing sales of financial products during the course of, or because of, an unsolicited contact, unless a stringent regime of privacy and product disclosure rules is first followed. There are specific hawking prohibitions for managed investment products.

[14] We have not reviewed the regulations.

# APPENDIX I

## Comparison of CSA Civil Liability Regime to Investor Remedies Proposal

| | CSA Proposal | Deregulation Proposal | Rationale for changes |
|---|---|---|---|
| **Definitions** | The CSA proposal defines compensation, core document, derivative security, document, equity security, expert, failure to make timely disclosure, forward looking information, influential person, investment fund, investment fund manager, issuer's security, liability limit, market capitalization, material change, material fact, MD&A, mutual fund, non-redeemable investment fund, principal market, public oral statement, release, responsible issuer, trading day and trading price. | Our proposal defines derivative security, document, due diligence provider, expert, market capitalization, material information, misrepresentation, public oral statements, release and representative. | We have not included some of the definitions from the CSA proposal for a variety of reasons including that the term is not relevant to our proposal or the definition did not seem to be necessary. Specifically, material change and material fact are not defined as we propose to use the term material information instead, which is defined in our proposal.<br><br>We will be reconsidering some of these definitions before our next publication, and some may be included at that time. |
| **Application** | The CSA proposal applies to purchases or sales of securities of a responsible issuer, which is a reporting issuer or a non-reporting Canadian issuer with securities publicly traded. It does not apply | Our proposal applies to purchases or sales of securities of a CMA issuer or a derivative security in the primary and secondary market. it does not currently cover purchases or sales of securities of | Under the CSA proposal, liability for the primary market was not covered as remedies were already available in the legislation for misrepresentations in prospectuses. As we are |

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| | to purchases of securities under a prospectus or an exemption. It also does not apply to purchases or sales under a take over bid or issuer bid (section 140.1(2)). It does include purchases or sales of derivative securities, which are securities that are issued by a third party but tied to the responsible issuer. | a Canadian non-CMA issuer with publicly traded securities. | proposing a system that does not require offering documents, our proposal includes liability for this new system where issuers can issue a press release and offer securities on the basis of their continuous disclosure record.<br><br>This proposal is focused on CMA issuer liability but we expect that the final version of the proposal will contain a concept similar to the responsible issuer concept in the CSA proposal. |
| ***Action for misrep. in continuous disclosure*** | | | |
| **Who has an action** | The plaintiff in the CSA proposal is a person who purchased or sold a responsible issuer's security or a derivative security between the time when a document containing a misrepresentation is released and the time when the misrepresentation is publicly corrected (section 140.2(1). | Our plaintiff is the same. | |
| **Who is liable** | 1. issuer<br>2. its directors<br>3. involved officers of the issuer | The defendants are the same except as follows:<br>1. due diligence providers are also included as defendants where the | Due diligence provides were not included in the CSA proposal as it primarily dealt with liability for secondary offerings. |

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| | 4. an expert who provided written consent to the use of an opinion or report that the expert produced in the document where the misrepresentation was also in the expert's report or opinion<br>5. influential person and each director and officer of the influential person, who knowingly influenced the making of the misrepresentation | investor participated in an offering<br><br>2. we did not include influential person and their directors and officers | We have not included influential persons as specified defendants. If the relationship between the issuer and the influential person is such that the influential person can cause these events, it is likely that the influential person, or its directors and officers, is a *de facto* director or officer and would be liable on that basis. However, only individuals can be *de facto* officers and directors, |
| **What does the investor have to prove** | The investor must prove the misrepresentation and damages but is not required to prove reliance on the misrepresentation.<br><br>The standard of proof varies depending on if the document is a core or non-core document. If it is a non-core document, the standard of proof, except for experts, is higher than for non-core documents. | Our proposal is the same except that the standard of proof does not vary with the documents. It only changes for directors where the issuer had a compliance system. In that case, the investor must prove that the director knew or was reckless or willfully blind about the misrepresentation. | As a result of the defence where there is a reasonable, monitored system, there is no need to distinguish core documents from non-core documents and no need to have multiple standards of proof. |
| ***Action for misrep in public oral statement*** | | | |

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| **Who has an action** | A person who purchased or sold an issuer's securities between the time when the public oral statement containing a misrepresentation is made and the time when it is corrected (section 140.2(2)). | Our plaintiff is the same. | |
| **Who is liable** | 1. issuer<br>2. the person who made the statement if they had actual, implied or apparent authority<br>3. each involved director and officer<br>4. each influential person and each officer and director who knowingly influenced the making of the public oral statement or a director or officer of the issuer to authorize it<br>5. each expert if the misrepresentation is also in the expert's report, the person who made the statement summarized the report and the expert provided written consent to the use of the report in the public oral statement if someone other than the expert made the statement | Our proposal does not include experts or influential people and their directors and officers. We also include all directors regardless of if they authorized, permitted or acquiesced in the making of the public oral statement. | We did not include experts as the limits on their inclusion in the CSA proposal makes it seem unlikely that they will ever be caught. We included all directors as they are responsible for the policies and actions of an issuer. They also have defence for a reasonable, monitored system that is broader than the defence available in the CSA proposal.<br><br>The rationale for the exclusion of influential people and their directors and officers is discussed above. |

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| **What the investor must prove** | The investor must prove the misrepresentation in a public oral statement about the issuer made by the issuer or a person with actual, implied or apparent authority to speak on behalf of the issuer. Reliance on the misrepresentation is not required. Proof of damages is also required.<br><br>The investor must also prove for each defendant other than the expert, that the defendant knew or deliberately avoided acquiring knowledge about the misrepresentation or was grossly negligent about the making of the misrepresentation. | The proof required is the same except that the only time the standard of proof changes is for directors where the issuer had a compliance system. In that case, the investor must prove that the director knew or was reckless or willfully blind about the misrepresentation. | As a result of the defence where there is a reasonable monitored compliance system, there is no need to treat misrepresentations in "core" documents and public oral statements differently from misrepresentations in other documents and no need to have multiple standards of proof. |
| ***Action for statements by influential persons*** | | | |
| **Who has action** | A person who purchased or sold an issuer's securities between the time when the pubic oral statement about the issuer that contains a misrepresentation is made or the document containing a misrepresentation is released and the time when it is corrected (section 140.2(3)). | There is no separate action for influential persons. | We did not include a separate action because if an influential person has actual, implied or apparent authority to speak on behalf of the issuer they will be caught in the other actions noted above. Otherwise they will be caught in the separate general action for misrepresentations that we are proposing. |

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| **Who is liable** | 1. the issuer if a director or officer of the issuer was involved in the release of the document or the making of the public oral statement<br>2. the person who made the public oral statement<br>3. each involved director and officer<br>4. the influential person<br>5. each involved director and officer of the influential person<br>6. each expert where the misrepresentation is also in expert's report, the public oral statement includes, summarizes or quotes from the report and if the document was released or statement is made by someone other than the expert, the expert consented in writing to the use of the report | N/a | |
| **What the investor must prove** | The investor must prove the misrepresentation was made in a public oral statement by an influential person or a person with actual, implied or apparent authority to speak on behalf of the influential person. The investor must also prove damages but is not required to prove reliance on the misrepresentation. | N/a | |

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| | The investor must also prove that any defendant, other than an expert, knew or deliberately avoided acquiring knowledge about the misrepresentation or was grossly negligent about the making of the misrepresentation. | | |
| ***Action for failure to make timely disclosure*** | | | |
| **Who has an action** | A person who purchased or sold an issuer's securities or a derivative security between the time when material change/information was required to be disclosed and the time when it was disclosed (section 140.2(4). | Our plaintiff is the same. | |
| **Who is liable** | 1. issuer<br>2. involved directors and officers of the issuer<br>3. an influential person and each director and officer of the influential person who knowingly influenced the failure to make timely disclosure | The defendants are the same except for influential people. | See rationale for exclusion of influential persons discussed above. |
| **What an investor has to prove** | The investor must prove the failure to disclose the material | The proof required is the same except that the only time the | |

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| | change/information and damages but is not required to prove reliance on the issuer having complied with its disclosure obligations.<br><br>The investor must also prove that the defendant knew or deliberately avoided acquiring knowledge about the failure to disclose or was grossly negligent about the failure. | standard of proof changes is for directors where the issuer had a compliance system. In that case, the investor must prove that the director knew or was reckless or wifully blind about the misrepresentation. | |
| ***Defences*** | | | |
| **Plaintiff acquired or disposed of security with knowledge of misrepresentation or material change/material information** | Yes – section 140.3(5) | Yes | |
| **Defendant conducted a reasonable investigation and had no reasonable grounds to believe the document or public oral statement contained a misrepresentation or that the failure to disclose would occur** | Yes – sections 140.3(6) and 140.3(7) | Yes except that is it not available to directors and the issuer who have a broader reasonable system defence. | Directors and the issuer should have a defence as long as they establish an appropriate system and monitor it to ensure it is complied with. |
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| **Not liable for failure to disclose material change/information if confidential disclosure made to commission and certain other conditions are met** | Yes - section 140.3(8) | Yes but there are some additional conditions to the defence in our proposal. The additional conditions are that the issuer has a reasonable regime to keep undisclosed material information confidential, a system to monitor compliance with that regime and there is no tipping or trading in the issuer's securities by the issuer or its insiders. | The defence should only be available if the issuer has a reasonable monitored system to keep information confidential. It should not be available if the issuer or its insiders are trading on the inside information or tipping.<br><br>The CSA civil remedies proposal included another condition for this defence relating to not releasing a document or making a public oral statement that due to the undisclosed material information contained a misrepresentation. We have not included that this as it is included in the definition of misrepresentation, which includes the omission of material information. |
| **Not liable for misrepresentation in forward looking information if certain conditions met** | Yes - section 140.3(9) | Yes | |
| **No person, other than expert, is liable for part of document or public oral statement using expert's report if expert consented** | Yes – section 140.3(11) | Yes | |

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| **to the use of the report, the person did not know and had no reasonable grounds to believe that there had been a misrepresentation in the document or public oral statement and the disclosure fairly represented the report of the expert** | | | |
| ***Expert not liable if written consent previously provided was withdrawn in writing before the release of the document or the making of the public oral statement*** | Yes – section 140.3(12) | Yes | |
| **Person had a reasonable expectation that the document, other than a document required to be filed with the commission, would remain confidential** | Yes – section 140.3(13) | Yes | |
| **Not liable for misrep in a document or public oral statement if misrepresentation also** | Yes – section 140.3(14) | Yes | |

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| **contained in a document filed by another person with the commission or an exchange and not corrected in that document** | | | |
| **Not liable where no knowledge or consent to action and upon becoming aware, notify the board and if no corrective action is taken in 2 days, and unless precluded by law or professional privilege, promptly notify the Commission** | Yes - section 140.3(15) | No | We do not think that this defence is necessary given the broad defence for directors where the issuer had a reasonable monitored system. |
| **Other Provisions in the Proposals** | | | |
| **A person that is a director or officer of an influential person is not liable in that capacity if liable as director of officer of issuer** | Yes – section 140.2(5) | No | We have not included a similar provision, as unlike CSA, influential persons and their directors and officers are not expressly included as liable in our proposal. Our rationale for this exclusion is discussed above. |
| **Multiple misrepresentations or** | Yes – section 140.2(6) | Yes | |

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| **failure to make timely disclosure can be treated as one event in discretion of court** | | | |
| **If the person who made the public oral statement had apparent but not implied or actual authority to speak on behalf of the issuer, no other person is liable until became or should reasonably have become aware of misrepresentation** | Yes – section 140.2(7) | Yes | |
| **Standard of proof for non-core documents and public oral statements** | Yes – sections 140.3(1) and (2) | No | This section was not necessary in this Proposal as we do not treat misrepresentations in "core" documents and public oral statements differently from misrepresentations in other documents. This distinction is less important in this Proposal because we have given all directors a defence if the issuer has an appropriate regime to manage information disclosure and a monitoring system. |
| **Standard of proof for failure to make timely** | Yes – section 140.3(3) and (4) | No | The CSA proposal varies the standard of proof on this action |

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| **disclosure** | | | with the defendant. The standard does not vary in our proposal as there is a broader range of defences available to the defendants. |
| **Assessment of damages** | Yes - section 140.4 | No | We have not included provisions on the assessment of damages other than to require the court to take into account contributory negligence on the part of the investor. This level of detail does not seem to be necessary as the court has expertise in assessing damages. |
| **Limit recovery to only damages caused by misrepresentation or failure to disclose** | Yes - section 140.4(3) | Yes | |
| **Proportionate liability of defendants unless acted knowingly, except issuer, when will be held jointly and severally liable** | Yes - section 140.5 | Yes, however joint and several liability also applies where defendant was reckless or willfully blind. | We think that defendants who are reckless or willfully blind should be held to the same liability as defendants who acted knowingly. |
| **Caps on damages unless defendant, other then issuer, acted knowingly** | Yes - section 140.6 | Yes. We also provide that there are no caps if a defendant was reckless or willfully blind. | We think that defendants who are reckless or willfully blind should be held to the same liability as defendants who acted knowingly. |

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| **Court approval required to commence action** | Yes - section 140.7 | Yes. We did not include a requirement to provide the commission with a copy of an application for leave and any affidavits. We also did not include provisions similar to the CSA about the details of the application (i.e. the filing of affidavits and examining of the parties). | We have not included notice to the Commission for reasons similar to why we did not include automatic standing for the Commission in actions. This is because counsel on one side or the other, if not both, are likely to argue the policy objectives of the legislation. The Commission will still be entitled to request intervenor status on a case by case basis.<br><br>We will consider further whether we need to provide the court with specific guidance on hearing matters. |
| **Court approval to settle an action** | Yes – section 140.9 | Yes | |
| **Loser pays rule** | Yes - section 140.10 | No | We have omitted the “loser pays” provision and been silent on costs. As a result, the usual court rules about costs will apply. We heard in our initial consultations on this issue that a loser pays rule without a government-funded contingency fund similar to that in Ontario is a serious disincentive to class |

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| | | | actions. While we want to deter abusive class actions, we view class actions as a necessary method for ensuring our proposed remedies have the intended deterrent effect.<br><br>Defendants still enjoy significant protection through the requirement for plaintiffs to obtain court approval before commencing or settling an action and the caps on liability. Costs are a less serious issue in these circumstances. |
| **Automatic standing of commission in actions and applications for leave including notice of actions and applications** | Yes - sections 140.7(4), 140.8 and 140.11 | No | Our rationale for this exclusion is discussed above. |
| **Provision stating that statutory liability does not derogate from other rights** | Yes - section 140.12) | Yes | |
| **Provision setting out imitation periods** | Yes - section 140.13 | No | Our next publication will contain limitation periods for the various actions. |
| **Act amendments to give** | Yes – section 140.13 | No | We will be considering appropriate |

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| **Lt. Governor in Council power to make regulations about civil liability** | | | rule and regulation making authority, including whether any are necessary for the investor remedy provisions. |

# APPENDIX J

# SUMMARY OF RESPONSES TO COMMENTS

This Appendix responds to the most significant comments we received expressing concerns or reservations about our February 18, 2002 Concept Paper, *New Concepts for Securities Regulation.* The comments considered include those submitted formally pursuant to our request for comments, and those we heard through consultation sessions held in Vancouver, Calgary, Winnipeg, Toronto and Montreal.

This Appendix does not include comments on two of the concepts in the February paper: Concept 3 *A Better Mutual Funds Regime* and Concept 4 *Trade Disclosure*. Those comments will be published at a later date in the Proposals relating to those concepts.

Most of the comments we received were supportive of our concepts and therefore do not require a response. Others however, expressed concerns or reservations about the ideas. This Appendix focuses on these.

## I. Continuous Market Access

### 1. Continuous disclosure

***Comments***

*Shorten the filing deadlines for annual and interim financial statements to those recently proposed by the SEC.*

*Mandate auditor review of interim financial statements.*

*All issuers should be subject to the same deadlines (no two-tier requirements for junior and senior issuers).*

***Response.*** These issues are related to the proposed CSA continuous disclosure harmonization rule. CSA will consider these issues as part of the consultation process on that rule.

***Comment***

*Make disclosure compliance review "high level" and place more reliance on other lines of defense such as auditors and civil remedies.*

***Response.*** We intend that the focus of compliance reviews will be whether the issuer's continuous disclosure record is misleading, taken as a whole. We would avoid requiring issuers to re-file documents that contain non-material deficiencies. In those cases we may provide comment for the issuer to consider in future filings.

## 2. Disclosure issues

***Comments***

*Eliminating prospectuses will make it harder for investors to get a good overall view of the company.*

*A mandated disclosure document with prescribed disclosure ensures that all issuers disclose the same information in the same form. This fosters comparability of disclosure among issuers.*

*Without a mandated offering document, companies have a tendency to emphasize the good news and to downplay or suppress the bad news.*

***Response.*** The AIF will consolidate all material information about an issuer that was disclosed in the period since the previous AIF and will provide market participants with a comprehensive picture of the issuer and its business. At the time of an offering, we expect issuers will prepare an offering document that will at least consolidate any material information released since the filing of the AIF because there will be market demand for that form of presentation.

The CMA Guidelines remind issuers that some market participants seek comparability of disclosure and suggest that issuers arrange their disclosure according to the five parts of the AIF. However, we believe that the market will develop a standard document even if we do not mandate one. CMA issuers who do not provide near-standard disclosure will risk not getting investor or analyst attention.

The CMA Guidelines remind issuers that they are required to disclose all material information, which includes both good news and bad news. An issuer that excludes material bad news will be guilty of misrepresentation and risks regulatory sanctions and civil liability.

***Comment***

*Mandate the use of plain language by issuers.*

***Response.*** In the CMA Guidelines, we have encouraged issuers to use plain language in their AIFs. We hope we have set an example by drafting the AIF and CMA Guidelines using plain language principles. Plain language is important to all market participants who want to understand the material information about an issuer.

## 3. Materiality

***Comments***

*Give guidance on the meaning of "material fact". Expand the scope of this concept to include political, economic, social and environmental information specific to an issuer's operations*

*Ensure materiality assessments are based on both qualitative and quantitative factors.*

***Response.*** We are proposing the concept of "material information" in Chapter 1 of the paper. We have also included in the CMA Guidelines a detailed discussion of materiality, along with

examples of what might constitute material information, to help issuers better understand their disclosure obligations under CMA.

Issuers are generally not required to interpret the impact of external political, economic, social or environmental developments on their business and affairs. However, if an external development has had or will have a direct effect on the business and affairs of an issuer that is both material and uncharacteristic of the effect generally experienced by other issuers engaged in the same business or industry, the issuer must disclose the development and its impact or potential impact on the issuer.

Both qualitative and quantitative factors must be considered under the proposed materiality standard.

***Comment***

*What is the effect of a system that combines a "material fact" standard with civil liability for misrepresentations in an issuer's disclosure record?*

***Response.*** We believe we have provided sufficient guidance as to what might constitute material information to assist issuers in preparing appropriate disclosure. The CMA Guidelines discuss how to handle information that needs to be established or pending transactions as well as focusing on the new material information requirement that continues to be tied to the market price or value of the issuer's securities.

The risk of frivolous litigation is small (even ignoring the proposed requirement that the court must approve the bringing of an action): we have clarified that not all important information is material, there is a safe harbour for failure to disclose while information is being developed and is held in confidence, and issuers' conduct will be tested under a business judgment rule.

## 4. Offering process

***Comment***

*An offering document or some other form of minimum disclosure standard for subsequent offerings is necessary to limit underwriter and expert liability and to provide a context for due diligence and reviews.*

***Response.*** The Proposal contains a mechanism for limiting the liability of underwriters, due diligence providers and experts. Underwriters' and due diligence providers' liability is limited to the issuer's offering document, if any, and the issuer's continuous disclosure record at the time of the offering. This corresponds to the situation under the POP system today. Experts' liability is further limited by the contents of their report.

An offering document is not necessary for underwriters, issuers and experts to determine the level of review they required before signing off on an offering. We expect they will negotiate with issuers to ensure they have adequate time to do the necessary reviews.

### 5. Underwriter and due diligence issues

***Comments***

*It is questionable whether the underwriter is really adding value. Underwriters often expect the issuer to provide the distribution. It is not clear that the costs are commensurate with the service the underwriter provides.*

*Underwriters perform a valuable function. They help issuers get "cleaned up" for the market and negotiate the price and terms of the issue on investors' behalf.*

***Response.*** The CMA Proposal is designed to give issuers more options both as to how they sell securities and as to who they retain to conduct due diligence. Senior issuers are not required to use a due diligence provider for offerings after the IPO and can sell directly to investors under a direct purchase plan. Junior issuers must use a due diligence provider, but under the Proposal, entities other than registrants are acceptable as due diligence providers. This may lead to more competition in the provision of these services.

***Comments***

*Non-registrants will not conduct due diligence because they will not to expose themselves to potential liability.*

*Non-registrants will have a competitive advantage in the due diligence arena since they are not subject to the same capital requirements that registrants are.*

***Response.*** We believe that some non-registrants will conclude that this is a profitable business and worth exploring as they have in London's AIM market. Ultimately, however, we think it is appropriate to let the market decide whether the same holds true in Canada.

Under the Proposal, non-registrant due diligence providers will have to meet financial adequacy and proficiency criteria.

## II. Code of Conduct

### 1. The approach

***Comments***

*A move to a principles-based system of regulation will greatly increase the need for definitive guidance, as market participants will demand assurance that they are on side.*

*The published guidelines could end up as voluminous as the rules they are intended to replace.*

***Response.*** We agree that industry will require sufficient guidance to understand their obligations under the Code. We believe we have achieved the right balance between principles and prescription in the draft Guidelines to the Code in the Proposal.

***Comments***

*The Code and related guidance must be specific enough so that registrants understand what is expected of them.*

*The Code will expand the Commission's discretionary power. Appropriate checks and balances will be needed.*

*A Code of Conduct approach will only work with adequate enforcement and oversight to ensure that industry complies. Regulators may not administer the Code in a way that is consistent with the Code's principles-based approach.*

***Response.*** We recognize the need to balance principles and guidance so we are proposing both a mandatory Code and a set of guidelines that will set out our general interpretation of the Code. Our goal is to provide reasonable certainty and, therefore, our guidance will contain various examples of the type of behaviour we are contemplating with each Principle in the Code.

The Commission currently has the power to sanction market participants for conduct that is "contrary to the public interest". Many of the things that do not breach any of the prescriptive rules but are abusive are sanctioned under this public interest power. For registrants who are subject to the Code of Conduct, sanctions will, in most cases, be for breaches of the Code. This is more certain than the existing public interest power. Rather than expanding the Commission's discretionary power, the Code of Conduct should provide industry with more certainty about the circumstances in which it will be exercised.

We recognize the importance of an active examination program to ensure firms are aware of the importance of compliance. Through our enhanced enforcement powers and the new investor remedies we hope to foster a culture of compliance within industry.

***Comments***

*Under a Code of Conduct approach the compliance staff of firms will likely be involved at the recruiting stage.*

*A firm's compliance department would have more difficulty enforcing in-house rules under a Code approach than they currently have enforcing the regulatory rules.*

***Response.*** One of the goals of the Code is to encourage firms to have their regulatory obligations in mind when hiring sales representatives. We believe that enforcing Code principles should be easier for firms than enforcing the current detailed prescriptive requirements. The broad principles of the Code leave less room for debate in areas where the current prescriptive rules fail to provide a specific prohibition.

### 2. Cost

***Comments***

*The Commission's proposal downloads the responsibility and cost of creating rules for registrant conduct onto firms. This will result in the duplication of efforts between firms at significant cost and may also lead to different standards within the industry.*

*The cost of developing compliance systems could be a barrier to entry for small firms.*

***Response.*** The advantage of the Code approach is that each firm can design its compliance system to suit its business. Firms will have more control over costs and will be able to design systems that target their particular compliance vulnerabilities without imposing costs in areas where they have little exposure. If there are services that can be more efficiently provided through a third party consolidator, the market is likely to provide one.

### 3. SRO issues

***Comment***

*Commissions would need to coordinate with SROs to ensure that their approach is consistent with the Code.*

***Response.*** We have had preliminary discussions with the IDA about all of our ideas for a simpler registration system and we will coordinate with them as we continue to develop our Proposals. Ultimately, as with any self-regulatory organization, it is up to their members to ensure that the SRO adopts a system or style of regulation that is acceptable to their members.

## IV. Firm-only registration

### 1. Information sharing

***Comments***

*Individual registration provides comfort to firms, clients, and insurers.*

*Insurance coverage is currently based on the premise that regulators reduce their risk through fitness reviews of individuals wanting to work in the industry. Going to a firm-only registration system might well impact insurance availability, or coverage, or pricing, or all of them.*

***Response.*** In Chapter 2, Part 4 we explain how the protections afforded by the individual registration system are preserved under the Proposal. Consultations with the relevant insurance underwriters will be part of our cost-benefit analysis of this Proposal.

***Comments***

*Regulators can monitor disciplinary history and conduct checks of police records better than firms.*

*Uniform Termination Notices need to be retained because they are useful to regulators and firms alike on a number of levels.*

*Employers may be worried about being sued if they divulged negative information about a former employee.*

*Firms would need the same information as regulators have now.*

***Response.*** A potential employer can, with the candidate's consent, obtain information, including criminal record checks, securities industry disciplinary or other disciplinary history, history of complaints (as opposed to hearings or settlements), and any other relevant information. The Proposal also contains broad information-sharing powers for regulators and registrant firms, together with protections from personal privacy legislation and from defamation actions. Disciplinary history will continue to be public information. Firms will be aware of any regulatory action taken against their own employees or independent contractors.

***Comment***

*Less information about individuals will be publicly available.*

***Response.*** We agree that information important to the client/adviser relationship should be easily available. Under the Proposal, the names of individuals trading or advising for firms, the activities they are authorized to engage in on behalf of the firms, the limitations or conditions on their authorizations, and their disciplinary histories would all be publicly available. In addition, under the Code of Conduct Proposal, firms and the individuals trading and advising for them would be required to provide all information important to the client/adviser relationship to clients and potential clients. Breaches of the Code would expose both the firms and the individuals to civil liability.

## 2. Costs and benefits

***Comments***

*A move to firm-only registration degrades the status of the individual and threatens the ability to have consistent proficiency between insurance and security based financial products.*

*A new category of registrant is needed to allow independent advisers to deal directly with a mutual fund company.*

***Response.*** We believe the compliance systems and responsibilities of the dealer are an important aspect of investor protection. At this point, we are not convinced that a new category of independent agent would be appropriate.

***Comments***

*The costs and benefits of firm-only registration should be examined.*

*Industry will save time and money if individuals do not have to be registered, but industry also needs to understand how much additional effort will be required if firms are the only screeners of individuals working in the industry.*

***Response.*** We will analyze the costs and benefits of the Firm-only Registration Proposal. We will have that information available for our next publication.

# V. Investor Remedies

## 1. General comments

***Comments***

*The existing common law rights of investors are not inadequate.*

*You should not create statutory liability for breaches of the Code of Conduct. Lapses in compliance are inadvertent and inevitable. The important thing is to ensure that the funds are available to make an adversely affected person whole.*

*The civil courts should not be available as a means of enforcing compliance with securities legislation and rules.*

*Significant study should be done before altering the existing civil remedies for investors.*

***Response.*** The need for a civil liability regime for continuous disclosure has been long since established. The issue was debated thoroughly in the Allen Committee process and again as the CSA proposal was developed. Implicit in the conclusions drawn from those exercises is the acceptance of the idea that civil liability is a useful and appropriate tool for deterring market misconduct.

We agree that implementing new remedies should be carefully considered. We are fortunate that we are not starting with a blank slate. We can make good use of the experience of the Allen Committee and CSA to this point. Of course, we will be reviewing the law of other jurisdictions, consulting with industry and investors and looking at the potential costs and benefits of the new remedies before making final recommendations.

***Comment***

*The Allen Committee did not recommend any change to liability for issuers for misrepresentations in a prospectus other than providing that issuers are also liable to secondary market participants.*

***Response.*** There is no reason to treat investors differently if CMA is implemented. The Allen Committee and the CSA proposal did not apply to offerings as prospectuses and liability for prospectuses still existed. That is no longer the case in CMA. All investors are buying securities based on the issuer's continuous disclosure record and should be treated equally.

***Comments***

*Your concepts place a great deal of reliance on going directly to court at an early stage of any dispute to determine if an allegation has sufficient merit to proceed. Yet the courts may not have the expertise and resources to process these types of reviews in an efficient manner making it time consuming and expensive for issuers.*

*An administrative tribunal or procedure would be more effective in weeding out frivolous actions for misrepresentations.*

***Response.*** The courts deal effectively with complicated commercial matters all the time, so there is no reason to believe that they will not dispose of these applications appropriately. We think that as between the Commission and the courts, the courts are the more appropriate forum to hear these applications. Adjudicating disputes between parties is their role.

## 2. Actions for misrepresentations by CMA issuers

***Comment***

*Making directors and officers liable will reduce the quantity of available directors and officers, will encourage directors and officers to judgment proof themselves, and will cause issuers to incur more cost in terms of D&O insurance that will simply be passed on to clients in any event.*

***Response.*** This concern was thoroughly debated during Allen and CSA. With the protections for defendants, we think this Proposal strikes the right balance. Consultations with relevant insurance providers will be part of our cost-benefit analysis of this Proposal.

***Comment***

*Concurrent implementation of more stringent continuous disclosure requirements, which will entail a learning curve, and new statutory civil remedies could have unintended, harsh consequences on management and directors of reporting issuers.*

***Response.*** We will consider this issue when we turn our minds to implementation issues related to the final Proposals.

## 3. Actions against dealers

***Comments***

*The client must be required to show that the breach caused the harm alleged.*

*By providing for statutory liability and absolute liability we are encouraging investors to abdicate responsibility for their affairs and seek opportunistic windfalls.*

*Absolute liability does not recognize that investors often contribute to their own misfortune.*

*A due diligence defence as opposed to absolute liability is necessary for fairness.*

*Director and officer liability needs to be capped, at least for outside directors.*

***Response.*** Under the Proposal, the investor must show that the breach of the Code caused damage. Firms will also have available to them any defence that is available to the representative, so if the court finds that the client is partly responsible for the losses, the firm can raise that finding as a defence.

Under the Proposal, there is no due diligence defence for firms. Our objective is to ensure that, as between an innocent client and a firm whose representative breached the Code, the firm will be the one to incur the costs of the breach. The Proposal does provide a due diligence defence and liability caps for directors and officers of the firms, just as it does for directors and officers of issuers.

***Comment***

*Absolute liability will achieve little unless firms are required to back it up by increased capital requirements or insurance coverage, both of which could add significant costs.*

***Response.*** We recognize this Proposal for enhanced dealer liability may impact on the capital and insurance requirements that currently apply to firms. We will consider these issues as part of our cost benefit analysis.

### 4. Class actions

***Comment***

*This idea is unnecessary as class action regimes work quite well. After an initial period of caution, the courts have exhibited a much greater willingness to use the flexibility of the class action systems to overcome administrative and even substantive hurdles to their use in the securities context.*

**Response.** Under the Proposal, the class action regime in the securities legislation will closely parallel existing class action legislation.

## VI. Enforcement and Public Interest Powers

**Comment**

*The Commission should not have the power to make orders against professionals.*

***Response.*** The Proposal is not an attempt to regulate the professions. However, we do have a responsibility to deal effectively with conduct that is prejudicial to the public interest in our capital markets. The power to deal effectively with market misconduct of professionals by ordering them not to appear or practice before the Commission is founded on that responsibility.

# VI. Foreign Market Participants

## 1. Foreign-regulated issuers

***Comment***

*Why would foreign regulated issuers be permitted to access our markets if no reciprocal arrangements were made for Canadian regulated issuers to offer securities in the foreign country using Canadian documents?*

***Response.*** Our focus as securities regulators is on the protection of Canadian investors and the efficiency of Canadian markets. We have not been able to identify any securities regulation reason to refuse approved foreign regulated issuers access to Canadian markets.

***Comments***

*Foreign regulated issuers should not be allowed access to Canadian markets based on disclosure that does meet Canadian standards.*

*A comprehensive list should be developed of approved foreign countries before finalizing the Proposal Paper.*

*The US should be recognized but not other foreign jurisdictions.*

***Response.*** Our starting premise is that we will not permit foreign regulated issuers to access our markets unless they are subject to appropriate disclosure standards and a credible foreign system of securities regulation. The US, UK and Australia meet these requirements. We will consider those countries if demand warrants us investigating other systems to see that they should be added.

***Comment***

*Will foreign issuers be required to translate documents into English?*

***Response.*** We do not propose mandating translation. We expect that market forces will drive issuers to translate their documents if they wish to sell to a broad range of investors in Canada. We will monitor the situation to see if this issue becomes a problem.

## 2. Access to foreign registrants

***Comments***

*US and other foreign registrants should not have the benefit of a foreign registrant exemption when Canadian registrants would not have a reciprocal benefit in the foreign jurisdictions.*

***Response.*** Our focus as securities regulators is on the protection of Canadian investors and the efficiency of Canadian markets. We have not been able to identify any securities regulation reason why foreign registrants ought not to be free to serve Canadian investors who voluntarily and without solicitation seek out their services.