



Overview of Canadian Securities Law

A special presentation for Institute of Law Clerks of Ontario

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Topics

1. Background to Canadian Capital Markets & Purpose of Regulations
2. "Closed System"
3. What is a Security?
4. What is a Prospectus?
5. Process and Documentation
6. Types of Prospectuses
7. Private Placements and Exemptions
8. Reporting Requirements
9. Offering Memoranda
10. Resale Restrictions
11. Continuous Disclosure Obligations for Reporting Issuers (*Background; Types; Annual Information Form (Example); and Continuous Disclosure Review Program of Canadian Securities Administrators*)

Capital Markets

- 2 main purposes of capital market regulation
 1. Protect investors from unfair, improper or fraudulent practices
 2. Foster fair & efficient capital markets and confidence in the markets
- No national system yet constantly considering unifying Canadian securities laws → provincial securities systems add to the cost of capital
- Status of the **Capital Markets Regulatory Authority**
- Regulation increases cost of capital → cheaper capital improves health of economy
- Confidence is essential to a strong market >> regulation helps increase confidence

Principles of Securities Law

1) Information Flow

- ✓ Requirement for timely and accurate disclosure of information

2) Anti-Fraud Measures

- ✓ Restrictions on fraudulent and unfair market practices

3) Registration

- ✓ Honest and responsible conduct from market participants

4) Transparency

5) Self-Regulatory Organizations (SROs)

efficiency

6) Cost Effectiveness

- ✓ Not everything is regulated because that would impose too much cost and affect the ability of companies to raise capital

Closed System

- In Canada we do not have a national regulator, instead securities law is scattered amongst provinces and territories
- The system in Canada is referred to as a '**closed system**' because a security never becomes freely tradeable unless (i) a prospectus is filed to qualify the securities or (ii) if securities are distributed under an exemption (private placements), enough time has passed for the marketplace to absorb information about the issuer
- For private placements, where securities are sold without a prospectus in reliance on an exemption, the securities may not be freely traded unless
 - sold pursuant to an exemption,
 - qualified by a prospectus, or
 - specified resale rules are met.

Definition of Security

- ✓ An investment with some element of speculation and risk >> you are delegating control over the investment to a 3rd party (i.e. investing in stocks, development project, etc.)
- ✓ Section 1.1 of the **Securities Act (Ontario) (OSA)**
Security **includes***** very broad definition, not exhaustive***
 - (a) Any document commonly known as a security
 - (d) Evidence of an option, subscription or other interest in or to a security
 - (e) Bond, debenture, note, share, stock, unit etc.
 - (g) Agreement to buy stock, units or interests >> subscription
 - (i) Profit-sharing agreement
 - (n) Any investment contract ***most litigated***
(i.e. pyramid scheme, scotch speculation, virtual stock exchange (*SEC v. SG Ltd.*))

General Prospectus Requirement

Section 53 of OSA - **No person or company shall trade in a security** where such trade would be a distribution of such security unless:

- a preliminary prospectus and a prospectus have been filed (and receipts obtained) or
- an exemption is available

What is a Prospectus?

- Comprehensive disclosure document that provides "**full, true and plain disclosure**" of all material facts relating to the securities being offered, including significant disclosure about the issuer
- *Helps the potential investor make an informed decision*
- Purchaser's Right of Rescission (s. 71 of OSA):
 - Purchasers have 48 hours to rescind after receiving ticket when final prospectus issued
 - After 48 hours, only way out of investment is through civil liability for misrepresentations

Process and Documentation

- Due diligence
- Prepare preliminary prospectus (file and obtain receipt)
- Translation of prospectus (if offered in Quebec)
- Prepare final prospectus (file and obtain receipt)
- Underwriting/agency/dealer agreement
- Auditor's comfort letter (circle up)
- Legal opinions
- Due diligence update
- Closing

Types of Prospectus

- Specific form requirements:
 - *Long form* – lengthy document; includes audited financial statements; used by issuers to go public (public companies are referred to as reporting issuers)
 - *Short form* – short document that incorporates by reference reporting issuer's continuous disclosure (which public companies are required to have); allows faster access to markets
 - *Shelf system* – type of short-form prospectus that uses supplements for multiple offerings and types of securities offered (commonly used by Banks)

Long Form Prospectus

- Lengthy disclosure document that does not rely on existing continuous disclosure
- Must be used for initial public offerings
- Time-consuming and expensive to prepare
- Must file a preliminary and final prospectus (and obtain receipts)
- Following filing of preliminary a minimum of 10 working days for first comment letter

Short Form Prospectus

- Allows faster, simpler access to markets by issuers that meet certain specific criteria
- Generally, issuer must be listed on a Canadian exchange and have up-to-date continuous disclosure
- Relies on continuous disclosure that is "incorporated by reference"
- Must file a preliminary and final prospectus (and obtain receipts)
- Following filing of preliminary a minimum of 3 working days for first comment letter so typically can be done in 4-5 days

Short Form Qualification Criteria

Basic Qualification Criteria (s. 2.2 of NI 44-101)

- the issuer is an electronic filer under NI 13-101;
- the issuer is a reporting issuer in at least one jurisdiction;
- the issuer has made all of its continuous disclosure filings required under securities law;
- the issuer has filed current annual financial statements and a current Annual Information Form;
- the issuer's securities are posted for trading on a short form eligible exchange and it is not an issuer whose operations have ceased or whose principal asset is cash, cash equivalents or its exchange listing;
- there are alternative qualification criteria as well.

Base Shelf Prospectus (MTN/Shelf Programs)

Base Shelf Prospectus: A short-form prospectus that is available "on the shelf" for issuances of securities from time to time over a 25-month period

- Allows quick access to the markets (unforeseen needs, pricing windows, etc.)
- Must be eligible to file a short form prospectus
- Certain "specific variable terms" can be omitted from the base shelf prospectus
- Must file prospectus supplement (pricing supplement) for each issuance

Various Deal Types

- **Marketed Deal:**

- UW or UW group markets to potential investors following filing of preliminary prospectus (which has bullets for size and price) and then price and size of issue set upon filing an amended and restated preliminary with details which is the same point in time the UW or UW group commit to purchase at closing.

- **Underwritten Deal:**

- Commitment made by an UW/UW group to buy the issue at closing but note that there is typically a “market out” clause in the underwriting agreement.

- **Bought Deal:**

- Underwriter commits to buying securities irrespective of whether there is a market >> used for seasoned issuers with proven track record
- Issuer gets \$ at closing from the UW irrespective of how many investors have bought at that point, & underwriter takes risk if unable to sell at the bought price
- There are usually “disaster-out clauses” with regard to disasters generally in the market
- Sometimes have other “out clauses”

- **Agency Deal:**

- Underwriter agrees to use its best efforts to sell securities, BUT is has no obligation to purchase securities at closing
- Typical on IPOs (“initial public offerings”) where trade a security that has not been previously issued

Private Placements (exempt offerings)

Remember the general rule:

No person or company shall trade in a security where such trade would be a distribution of such security unless:

- A preliminary prospectus and a prospectus have been filed (and receipts obtained) or
- An exemption is available

Private Placements

Common prospectus exemptions:

- AIs (investors with + + + financial means or sophistication)
- Minimum amount (C\$150,000 cash, N/A to individuals)
- Offering memorandum (form requirements) * *
- Private issuer (depends on nature of issuer and other items)
- Certain individuals with a relationship to issuer (founder, control person, friends, family, employees)

There is also an “offering memorandum” prospectus exemption in which case there are form requirements for the OM. This exemption is not commonly relied upon and an OM is often used in connection with other prospectus exemptions at the discretion of the issuer. More details to come

Reporting Requirements (report of exempt distribution may be required)

AI Exemption

- A purchaser must be purchasing as principal
- A person acting on behalf of a fully managed account managed by that person, if that person is registered or authorized to carry on business as an adviser or the equivalent under foreign jurisdictions, is deemed to be purchasing as principal
- AI Exemption does not apply to a distribution to a person created or used solely to purchase or hold securities as an accredited investor

Examples include:

- Banks; pension funds; registered advisers or dealers
- Individuals that either alone or with a spouse own financial assets of \$1M+
- Individuals who own financial assets of \$5M+
- Individuals whose net income before taxes is \$200,000+

AI Exemption – Recent Changes

NEW RISK ACKNOWLEDGEMENT FORM – 45-106F9

- To be completed by individual purchasers (unless individual has \$5M+ financial assets without spouse, in which case also a "permitted client") at or prior to signing agreement to purchase security
- Identifies key risks associated with purchasing securities in the exempt market
- Purchaser must select which AI criteria applicable to individual applies
- The seller must retain signed Form 45-106F9s for 8 years after the distribution

Guidance for Sellers on Purchasers' Status (Companion Policy 45-106CP)

- Responsibility on seller to confirm purchaser is eligible to purchase under AI Exemption
- Seller is issuer or selling security holder relying on the AI Exemption
- Seller cannot merely rely on 45-106F9 unless it takes "reasonable steps" to verify the 24 representations made by the purchaser

MA Exemption

- No longer available for individual purchasers (i.e., natural persons)
- Purchaser must purchase as principal and the acquisition threshold remains at \$150,000
- Purchaser must not have been created or used solely to purchase in reliance on MA Exemption

What is an Offering Memorandum?

Any document that describes the business of the issuer prepared primarily for delivery to and review by a prospective investor.

- Broad scope of marketing documents caught by definition (substance over form)
- Attracts liability
- Liability for **misrepresentations** (untrue statement of material fact; or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made)
- Material fact means a fact that would reasonably be expected to have a significant effect on the market price or value of securities
- Rules require description of certain statutory rights

Resale Restrictions

The first trade of securities distributed under certain prospectus exemptions is a distribution that will be subject to the general prospectus requirements **UNLESS** a further exemption is available **OR** certain resale conditions are met.

Hold Periods in NI 45-102

Seasoning Period

- **Single trigger**
- Issuer has been a reporting issuer for 4 months (not related to date of distribution)
- Issuer becomes reporting issuer by filing a prospectus
 - This allows market to react to all the information in the market b/c issuer is now subject to continuous disclosure

Restricted/Hold Period

- **Double trigger**
- Must hold the security for a 4 month period (from the date of distribution)
- The issuer is and has been a reporting issuer in a jurisdiction of Canada for the four months immediately preceding the trade

Reporting Issuer Obligations

- The continuous disclosure system is the backbone of securities laws
- Convey important and timely information (periodic and episodic) about reporting issuers to shareholders and to the market
- Gives equal access to all investors
- Creates and maintains confidence in the Canadian capital markets
- Forms a key element of the short form prospectus system

Continuous Disclosure

- 2 Types: Financial and Non-Financial
 - **Financial Disclosures**
 - Annual Financial
 - Interim Financial Statements
 - Management's Discussion and Analysis of Financial Results ("MD&A")
 - Certifications

Continuous Disclosure

■ **Non-Financial Disclosure**

- Annual Information Form
- Proxy Circular
- Material Change Reports
- Insider Reports
- Press Release
- Business Acquisition Reports
- Material Contracts

Continuous Disclosure

- NI 51-102 – *Continuous Disclosure Obligations*
 - Purpose – to harmonize continuous disclosure requirements across the provinces
 - Contains requirements for major disclosure documents (i.e. AIF, MD&A, Proxy Circular, Financial Statements, Material Change Report and Business Acquisition Report)

Annual Information Form

- NI 51-102 Part 6 and form 51-102F2
- Base disclosure document
- Material information
- Can incorporate by reference
- Plain language
- File within 90 days of financial year end

Annual Information Form

- Corporate structure and relationships
- 3 year history of business
- Significant Acquisitions
- Business Description
 - Products, services, distribution methods, competitive conditions, seasonality, employees, dependence on foreign operations, bankruptcies, reorganizations, material social or environmental policies
- Risk Factors
- Capital Structure
- Legal Proceedings
- Material Contracts
- Trading Price and volume of Securities Traded

Continuous Disclosure Review Program

- **Continuous disclosure review program**
 - Annual program conducted by securities regulators
 - Purpose is to review continuous disclosure filings of a sampling of issuers to determine if issuers are complying with disclosure obligations
 - Helps issuers better understand disclosure obligations
 - Often targets a specific area of disclosure (such as MD&A, executive compensation material changes)
 - Issuers can be asked to modify disclosure going forward, re-file documents, or, in extreme cases, be subject to cease trading or enforcement

Any Questions?



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