

## Multilateral CSA Notice 45-315

### *Proposed Prospectus Exemption for Certain Distributions through an Investment Dealer*

April 16, 2015

#### **Introduction**

The securities regulatory authorities in British Columbia, New Brunswick and Saskatchewan (the participating jurisdictions or we) are each publishing for comment a proposed prospectus exemption (proposed exemption) that would, subject to certain conditions, allow issuers listed on a Canadian exchange to raise money by distributing securities to investors who have obtained advice about the suitability of the investment from an investment dealer.

In developing the proposed exemption, the participating jurisdictions considered the balance of fostering fair, efficient and innovative capital markets with ensuring appropriate investor protection.

This notice summarizes the terms of the proposed exemption and includes a request for comment.

#### **Background**

##### ***Prospectus distributions and prospectus exempt distributions***

One of the main requirements of securities legislation is that an issuer distributing a security must file and obtain a receipt for a prospectus. The prospectus must contain full, true and plain disclosure of all material facts relating to the securities being offered. Investors who purchase securities under a prospectus are provided certain statutory rights.

Securities legislation provides exemptions from the prospectus requirement in circumstances where a prospectus is not necessary (because of the investor's knowledge, sophistication or relationship with principals of the issuer) or where alternative protections exist. The most commonly used prospectus exemption is the accredited investor exemption. The accredited investor exemption is available for the sale of securities to both new investors and existing security holders if they meet the definition of "accredited investor". All jurisdictions of Canada have now adopted the existing security holder prospectus exemption. The existing security holder exemption allows an issuer to distribute securities to an existing security holder if certain key conditions are met. One of the key conditions is that the existing security holder is limited to acquiring \$15,000 under the exemption in a 12-month period unless the security holder has obtained advice about the suitability of the investment from an investment dealer.

##### ***Retail investors that are not existing security holders***

If an issuer wants to raise capital from retail investors that are not existing security holders, without a prospectus, the principal prospectus exemptions available require an offering document. Our data shows that Canadian issuers do not generally use these exemptions to raise capital from retail investors. Market participants report that issuers do not use these exemptions because of the time and cost involved in preparing the required offering document. This is

exacerbated by the risk of a failed financing – they have to incur significant up-front costs that must be paid regardless of the success of the financing.

Because issuers rarely use the prospectus exemptions intended for sales to retail investors, retail investors have limited opportunity to invest directly in issuers. This means retail investors do not have an opportunity to participate in the more favourable terms generally offered through private placements, such as a discount to the current market price allowed under exchange policies.

This also means that if retail investors that are not existing security holders want to invest in an issuer, they must generally buy their securities on the secondary market, in reliance on the continuous disclosure of the issuer and in most cases through an investment dealer. The investment dealer plays an important role in providing investor protection for secondary market trading. An investment dealer that recommends or accepts an order from a client must generally make a suitability determination about the investment. This means that the investment dealer must comply with their know-your-client and know-your-product obligations before recommending or accepting an order for a secondary market purchase for their clients. Currently, retail investors can buy an unlimited number of securities of listed issuers on the secondary market, without any additional disclosure.

### **The proposed exemption**

We are proposing a new prospectus exemption with the following key conditions:

- the issuer must be a reporting issuer in at least one jurisdiction of Canada and have a class of equity securities listed on the Toronto Stock Exchange, the TSX Venture Exchange, the Canadian Securities Exchange or Aequitas Neo Exchange Inc. (the proposed exchanges);
- the issuer must have filed all timely and periodic disclosure documents as required under the continuous disclosure requirements in our securities legislation;
- the offering can consist only of a listed security, a unit consisting of a listed security and a warrant to acquire another listed security, or another security convertible into a listed security at the security holder's sole discretion;
- the news release announcing the offering must
  - disclose, in reasonable detail, the distribution, including use of proceeds, and any material fact not yet generally disclosed, and
  - include a statement that there is no material fact or material change about the issuer that has not been generally disclosed;
- the investor must obtain advice regarding the suitability of the investment from an investment dealer;

- the investor must be provided with a contractual right of action in the event of a misrepresentation in the issuer's continuous disclosure record regardless of whether the investor relied on the misrepresentation; and
- although an offering document is not required, if an issuer voluntarily provides one, an investor will have certain rights of action in the event of a misrepresentation in it.

We propose that the first trade of securities issued under the proposed exemption will be subject to resale restrictions under section 2.5 of National Instrument 45-102 *Resale of Securities* like most other capital raising prospectus exemptions. In addition, issuers will have to file a report of exempt distribution within 10 days after each distribution under the proposed exemption.

### **Investor protection considerations**

We created the proposed exemption so that it contains sufficient alternative protections for investors such that the prospectus requirement is not necessary. We think it would address the inconsistency in our securities legislation that retail investors can purchase any amount of securities of a reporting issuer through the secondary market based on the issuer's continuous disclosure but cannot purchase any securities directly from the issuer without obtaining some form of offering document.

### ***Involvement of investment dealer***

One of the conditions of the proposed exemption is that the investor must receive suitability advice from a registered investment dealer. The exemption would not be available if the dealer is a restricted dealer or an exempt market dealer. The exemption would also not be available if the dealer is exempt from providing suitability advice. For example, the exemption would not be available to discount brokers that have received exemptive relief from providing suitability advice.

This condition is intended to provide protection to the investor as the suitability determination involves the investment dealer meeting their know-your-client and know-your-product obligations. Specifically,

- the know-your-client obligations require the investment dealer to accurately determine the investor's current financial situation, investment knowledge, investment objectives and time horizon, risk tolerance, and current investment portfolio composition and risk level,
- the know-your-product obligations require the investment dealer to understand the structure, features and risks of the relevant product, and
- a suitability determination entails the investment dealer ensuring that the product is suitable for the investor using the results of the know-your-client and know-your-product processes.

### ***Continuous disclosure obligations***

The proposed exemption would only be available to reporting issuers whose continuous disclosure is up-to-date and in compliance with applicable securities legislation. Our securities legislation provides a robust continuous disclosure regime that ensures investors have sufficient information to make informed investment decisions. Under our continuous disclosure regime:

- issuers are required to provide both periodic and timely disclosure
- executive officers are required to certify certain of their continuous disclosure
- there are statutory rights of action for rescission or damages available to purchasers on the secondary market in the event of a misrepresentation in the issuer's continuous disclosure
- there are prohibitions against insider trading, i.e., where material facts or material changes relating to the issuer have not been generally disclosed.

Under the proposed exemption, the issuer must issue a news release containing information about the proposed distribution and use of proceeds and a statement that there is no material fact or material change about the issuer that has not been generally disclosed.

#### ***Contractual rights of action for misrepresentation in continuous disclosure***

We propose to require that issuers provide a contractual right of action for rescission or damages to investors in the event of a misrepresentation in the issuer's continuous disclosure record. We propose this would be an interim measure since we are proposing to adopt the proposed exemption as a blanket order. We would not have the ability to specify that the statutory secondary market civil liability provisions apply to an investor investing under the proposed exemption until we made the proposed exemption into a rule or regulation.

#### ***Sunset clause***

We propose that the blanket order would expire three years after implementation, although it could be extended. We intend to monitor the use of the proposed exemption during this period to assess its usefulness for issuers, whether retail investors want to use it to acquire securities from the issuer rather than on the secondary market, and whether it provides sufficient protections for investors before proposing to make it a permanent rule.

#### **Proposed form of exemption in local jurisdiction**

Attached as Appendix A to this notice is the proposed blanket order in the local jurisdiction.

#### **Questions**

We invite comment on all aspects of the proposed exemption. In particular, we would like to receive feedback in respect of the following questions:

1. If you are an issuer listed on one of the proposed exchanges, will you use the proposed exemption?
2. One of the conditions of the proposed exemption is that the investor must receive suitability advice from a registered investment dealer. Should we consider expanding this provision so that investors could also receive suitability advice from a registered exempt market dealer?
3. We are currently proposing that the exemption be subject to the same resale restrictions as most other capital raising exemptions (i.e., a four month restricted period). Do you agree that a four month hold period is appropriate for this exemption? If not, please explain.

4. Do you agree that the removal of the prospectus requirement for offerings under the proposed exemption maintains sufficient investor protection? If not, please explain.

### **Comments**

We are inviting comments until June 15, 2015.

Please submit your comments in writing. If you are sending your comments by email, please also send an electronic file containing the submissions in Microsoft Word.

Please address your comments to the following participating jurisdictions:

British Columbia Securities Commission  
Financial and Consumer Services Commission (New Brunswick)  
Financial and Consumer Affairs Authority of Saskatchewan

Please send your comments only to the addressees below. Your comments will be forwarded to the other participating jurisdictions.

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Please note that comments received will be made publicly available and may be posted on the websites of the participating jurisdictions. We cannot keep submissions confidential.

### **Questions**

Please direct your questions to any of the following:

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