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Chapter 5

Accessing The Canadian Capital Markets

"When I talk about the 'financial system', I am referring to financial institutions and markets, the infrastructure, laws, and regulations that govern and support their operations, and the macroeconomic framework within which they operate. My message for you is that improving the efficiency of Canada's financial system is imperative."

– Remarks by David Dodge, Governor of the Bank of Canada, to the Empire Club of Canada and the Canadian Club of Canada, December 9, 2004.

5.1 A key driver in the competitiveness of Canada's capital markets is the speed at which issuers are able to access capital. Logically, as ease of access to the capital markets increases, the number of participants – both issuers and investors – should also increase. Issuers will be drawn to a market in which capital can be accessed efficiently and, in turn, investors will be drawn with them.

5.2 A goal of Canadian capital markets regulation should be to ensure that, to the extent consistent with investor protection, the Canadian capital markets can be accessed with speed and efficiency that is comparable to, or greater than, other major markets. The focus of our recommendations concern "follow-on" prospectus offerings and prospectus exempt offerings (i.e., private placements) by issuers that have already "gone public" through initial public offerings, as these are the areas where we regard efficient access to be most important. The speed issue centres on the extent to which a securities system should be based on required disclosure and ex post enforcement, or conversely, to what extent must regulators intervene on an ex ante basis through disclosure review.

5.3 Despite our focus on follow-on prospectus offerings, a number of our recommendations in this chapter are equally applicable to initial public offerings. Most notable among them is our recommendation regarding the form in which information is presented in a prospectus. Nonetheless, it is our view that the current regulatory regime in place for initial public offerings, which includes the review of the prospectus by the regulator and, while very rarely (if ever) used, the opportunity for the regulator to decline to issue a receipt for the prospectus if "it is not in the public interest to do so",[1] strikes an appropriate balance between quick and efficient access to the capital markets and ensuring the quality of disclosure by issuers accessing the capital markets.

[1]See *Securities Act, (Ontario) at s.61.*

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The Need for Speed – Follow-on Prospectus Offerings

5.4 Prior to presenting our recommendations to modernize the rules surrounding follow-on prospectus offerings, we feel it is important to devote some attention to an overview of the current state of play, both in Canada and in the United States. What the overview will show is that an issuer's speed to market has been a consideration in the design of the Canadian prospectus offering regime for quite some time. With the recent offering reforms implemented in the United States, certain Canadian issuers are unable to access the capital markets as expeditiously as their cross-border counterparts.

The Current Canadian Regime – POP and Shelf Offerings

5.5 The evolution of the offering process in Canada demonstrates that the importance of quick access to the capital markets has long been recognized by Canadian securities regulators. Canadian issuers currently have two methods available to execute an expedited public follow-on offering of securities: (i) they can proceed by filing a short-form prospectus under the Prompt Offering Qualification System ("POP system") of National Instrument 44-101 – *Short Form Prospectus Distributions* ("NI 44-101"); and (ii) they can file a shelf prospectus and related prospectus supplement when they decide to come to market under National Instrument 44-102 – *Shelf Distributions* ("NI 44-102").

(a) The POP System

5.6 The POP system was Canada's response to the U.S. short form registration system, although somewhat slow in coming. While the U.S. system was initially introduced in 1967, the POP system was not implemented until 1982 with three subsequent iterations in 1991, 1993 and 2000 before the current NI 44-101 was implemented across Canada on December 30, 2005.

5.7 Prior to the adoption of the POP system, Canadian issuers were required to file and clear a long form prospectus for each distribution of securities, regardless of the issuer's size, the extent of its market following or the number of times it had previously gone to market. By contrast, the market in Europe was subject to limited regulation, and the U.S. market, though regulated, was much further along in introducing mechanisms for rapid access to public markets. There was a growing concern that in the absence of rapid and cost-effective market access in Canada, issuers would choose to distribute their securities outside Canada.

5.8 Thus, in 1982, the POP system was adopted to enable Canadian companies to access capital markets more rapidly and at a lower cost through the use of a short form prospectus. This system allows issuers to file a short form prospectus that would make up for its brevity by incorporating by reference other disclosure documents, such as an annual information form, financial statements and material change reports.

5.9 A significant consequence of the POP system's introduction was the willingness of the underwriters to offer to issuers a product called a "Bought Deal", under which the underwriters committed to purchase for resale the securities being issued took the risk that, barring extraordinary events, the market might deteriorate between the date of the underwriting agreement and the date of closing. This risk was acceptable to the underwriters community because the period of exposure to the "Market Risk" was substantially reduced. The

ability to offer such a product to issuers in Canada has been a significant competitive advantage for the Canadian underwriting community and has undoubtedly been a positive factor to enhance the competitiveness of Canada's capital markets.

What is a Short Form Prospectus?

5.10 A short form prospectus is less detailed than a long form prospectus because the short form prospectus rules permit an issuer to incorporate by reference in the short form prospectus previously filed public disclosure documents. The short form prospectus rules also provide for an abbreviated review process by the securities regulatory authorities (approximately three working days between the filing of a preliminary short form prospectus and the filing of a final short form prospectus, as opposed to the minimum 15 working day period between a preliminary long form prospectus and a final long form prospectus).

5.11 The key advantage of a short form prospectus is that the relatively short preparation time coupled with the abbreviated period for regulatory review permits an issuer to complete a distribution of securities in a relatively short timeframe (i.e., approximately three weeks from inception to closing). Less management time is required in preparing the prospectus document, and the review process is substantially shorter than in connection with a traditional long-form prospectus. As a result, an issuer using the POP system is able to reduce (or, in the case of a "bought deal" described below, transfer to the underwriters) the deal risk arising from a decline in the market value of its securities during the period between the initial filing of the short form prospectus and the closing of the offering.

5.12 At the foundation of the short form prospectus are the issuer's continuous disclosure documents, which are incorporated by reference. These documents are simply set out in a list within the prospectus. In addition, the short form prospectus must also typically contain basic disclosure about the distribution (i.e., the securities being offered and their price), the names of the underwriters, the use of proceeds of the offering, details about the plan of distribution, details regarding significant acquisitions in the last financial year (which may also require the preparation of pro forma financial statements) and risk factors. Given that most of the "new" disclosure in a short form prospectus is meant only to update the issuer's continuous disclosure record which is incorporated by reference and to give specific information about the offering, it is not unusual for a short form prospectus to be only 10 to 15 pages in length.

Who is Qualified to File a Short Form Prospectus under the POP System?

5.13 There are a number of different eligibility criteria under NI 44-101 that an issuer must satisfy in order to qualify to use the POP system, in general terms they are:

- the issuer must be an electronic filer under National Instrument 13-101 *System for Electronic Document Analysis and Retrieval* (SEDAR);
- the issuer must be a "reporting issuer"[2] in at least one jurisdiction of Canada;

[2]A "reporting issuer" is defined in section 1(1) of the *Securities Act* (Ontario) (the "Act") as, *inter alia*, (i) an issuer that has filed a prospectus and has obtained a receipt for it under the Act, or (ii) an issuer that is the company whose existence continues following the exchange of securities of a company with another company where one of the companies or the continuing company has been a reporting issuer for at least 12 months. Securities legislation in the other provinces and territories contains a similar definition or concept.

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- the issuer must have filed, with the securities regulatory authority in each jurisdiction in which it is a reporting issuer, all periodic and timely disclosure documents that it is required to have filed in that jurisdiction;
- the issuer must have, in at least one jurisdiction in which it is a reporting issuer, current annual financial statements and a current annual information form;
- the issuer's equity securities must be listed and posted for trading on a short form eligible exchange.[3]

5.14 The eligibility criteria are in large measure designed to ensure that the issuer has a reporting history sufficiently long enough to ensure that its "story" is fully detailed in its disclosure record filed on SEDAR. That way, as noted above, the role of the short form prospectus is to simply update that disclosure record.

The "Bought Deal"

5.15 The POP system has generated a uniquely Canadian form of offering – the "bought deal". Under the "bought deal", underwriters contractually commit themselves to purchase the issuer's securities for resale prior to the filing of a preliminary short form prospectus, and therefore assume the risk associated with any change in market sentiment or their failure to resell the securities. The risks associated with a material adverse change or an international event (as opposed to "normal" market volatility) remain with the issuer. The underwriters are, in turn, permitted under NI 44-101 to solicit expressions of interest from prospective purchasers for a period of four business days prior to the filing of the preliminary short form prospectus qualifying the offering.[4]

(b) Shelf Prospectuses

5.16 An issuer that is qualified to file a short form prospectus in a jurisdiction is also qualified to file a base shelf prospectus in that jurisdiction. The shelf prospectus system is now established as one of the principal Canadian alternatives to expedite the long form prospectus qualification process. It is an offering document prepared and filed in respect of an aggregate dollar amount of securities, which are then put on a metaphorical "shelf" for up to 25-months until the issuer decides to take some or all of the qualified securities "off the shelf" to distribute them. The securities regulators review base shelf prospectuses as they would review any other short form prospectus (typically within three working days of filing).

5.17 At the time of the actual sale, the issuer prepares a shelf prospectus supplement, that is often relatively brief, containing only deal-specific information, including disclosure about the securities being sold, that was not available at the time the base shelf prospectus was prepared and receipted. This new information is then incorporated by reference in the base shelf prospectus for purposes of the offering.

5.18 Shelf prospectuses allow eligible issuers to qualify large amounts of securities at once for subsequent issuance. The shelf prospectus procedure can be faster than both the long form and regular short form

[3]The TSX, Tiers 1 and 2 of the TSX Venture Exchange and the Canadian Trading and Quotation System Inc. are designated in NI 44-101 as "short form eligible exchanges".
[4]See section 7.1 of NI 44-101.

prospectus processes because shelf prospectus supplements are not normally subject to any review by regulators at the time of issuance (subject to exceptions for novel derivatives and asset backed securities, for which supplements must be pre-cleared with the securities regulators).

5.19 In most cases, the prospectus supplements can be filed following the date that they are first delivered to purchasers, and it is therefore possible for issuers to take quick advantage of narrow windows of market opportunity. The securities regulators do not review prospectus supplements. With this separation of the prospectus preparation, review and clearance process from the offering, the issuer can exert greater control over its ability to go to market. Typically a distribution under a shelf prospectus supplement can be completed in as little as five days.

The Unallocated Shelf

5.20 While the basic shelf prospectus provides flexibility to issuers because the timing of the eventual offering is determined by market or business opportunities that arise within the 25-month shelf period, the unallocated shelf prospectus provides even greater options because it allows qualification of debt, equity and other securities without a specific allocation of the aggregate offering amount among the classes of securities being so qualified. It is only when an offering is actually made (and upon the preparation and filing of the prospectus supplement) that the type and amount of security to be offered is fixed. Certain limits are imposed, however, as the prospectus must stipulate the total dollar value of the securities the issuer proposes to sell under the shelf prospectus, which value is to be based upon the amount the issuer reasonably expects to sell within the 25-month period following the filing.

5.21 A disincentive to the use of the shelf system, including on an unallocated basis, has been issuers' concerns that the filing of a shelf prospectus signals a pending offering, leading to a perception of a dilutive market overhang. Disclosure of an issuer's intent to issue a significant amount of equity can be material to investors particularly in the case of smaller companies as a result of the dilutive effect, or a perception that management believes that the stock has peaked. Issuers are concerned that arbitrageurs may view the filing as an opportunity to sell the stock short exacerbating the decline because of the anticipated additional supply of stock.

The U.S. Public Offering Reforms

5.22 In July 2005, the United States Securities and Exchange Commission (the "SEC") released a wide-ranging set of rules that will have a profound effect on the public offering process in the United States[5] (the "U.S. Public Offering Reforms"). Most of the rules are deregulatory in nature and while the reforms affect all registered offerings in the United States, the most liberalizing aspects are available to large issuers with a reporting history. Among other things, the U.S. Public Offering Reforms create a new class of issuer called a "well-known seasoned issuer" ("WKSI"), modify the offering communication rules around the time of registered offerings and permit the use of "free writing prospectuses" and, in some cases, eliminate the need to physically deliver a final prospectus. Most notably, WKSIs are permitted to access the U.S. capital markets without SEC review of their registration statements.

[5]See Securities Offering Reform, Securities Act Release No. 33-8591 (July 19, 2005) (adopting release) and Release No. 33-8501 (November 3, 2004) (proposing release).

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5.23 The WKSI category covers the largest public companies in the United States – companies that have filed periodic reports with the SEC for at least one year (and are current in those filings) and that (i) have outstanding a minimum US$700 million in market value of equity held by non-affiliates, or (ii) have issued US$1 billion in aggregate in non-convertible securities in the preceding three years.[6] According to the SEC, 30% of U.S. listed issuers would meet the test for WKSI status.[7]

5.24 The creation of the WKSI category allows issuers in that category to access the capital markets in the United States with great speed and efficiency. WKSI status means that a company is eligible for "automatic shelf registration", which affords WKSIs immediate effectiveness for their registration statements, so there are no delays in going to market.[8]

5.25 Under Rule 163 of the U.S. Public Offering Reforms, WKSIs are permitted to make unrestricted oral and written offers before filing a registration statement, but any offer will be considered to be a free writing prospectus and will generally have to be filed when the registration statement or amendment covering the offered securities is filed.[9]

"As a result of the active participation of [WKSIs] in the markets and, among other things, the wide following of these issuers by market participants, the media and institutional investors, we believe that it is appropriate to provide…registration flexibilities to these [WKSIs] beyond that provided to other issuers."

– Securities Offering Reform, Securities Act Release No. 33-8591 (July 19, 2005)

5.26 The liberalization of the registration rules and the speed to market afforded to WKSIs is predicated on the conclusion that within this category are issuers deemed entitled to special treatment since they are most closely watched by the media, analyst community and institutional investors. If a company is big enough, has at least a year long disclosure record and has a sufficient number of "eyes" watching it on a constant basis, the SEC is willing to permit its gatekeeping function (in the form of registration statement review) to be partially subsumed by the review undertaken by these other market participants. As Professor Pritchard has noted, it is not the economic clout of WKSIs that justifies relaxed regulation.[10] According to the SEC, "as a result of the active participation of [WKSIs] in the markets and, among other things, the wide following of these issuers by market participants, the media and institutional investors, we believe that it is appropriate to provide…registration flexibilities to these [WKSIs] beyond that provided to other issuers."[11] We find this logic to be compelling.

[6]See United States Securities Act of 1933 Rule 405.

[7]See A. Pritchard, "Well-Known Seasoned Issuers in Canada," in Volume V at 10.

[8]See *Ibid*. at 5.

[9]In this paragraph we rely heavily on a memorandum prepared by Cleary Gottlieb Steen & Hamilton LLP, "*SEC Adopts Securities Offering Reforms*," August 1, 2005.

[10]Pritchard, *supra* note 7 at 9.

[11]See Securities Offering Reform, Securities Act Release No. 33-8591 (July 19, 2005) at 25.

A Canadian Offering Reform Proposal

5.27 Automatic shelf registration under the U.S. Public Offering Reforms for those issuers in the WKSI category has allowed for nearly instantaneous access to the U.S. capital markets for 30% of U.S. listed companies. In contrast, those Canadian issuers qualified to use the POP system (which, after amendments to NI 44-101 in late 2005, covers a vast majority of Canadian reporting issuers) and completing a "bought deal" financing typically have at least three to five business days until they can confirm sales and begin collecting funds for closing. Admittedly, those using a shelf prospectus would have a shorter lag.

5.28 So, what can Canadian securities regulators do to ensure that Canadian issuers are able to access the capital markets at a speed comparable to their counterparts in the United States?

5.29 The Task Force commissioned Professor Adam Pritchard to examine the background behind the determination by the SEC that it could safely reduce its direct regulatory oversight of offerings by such companies, and to comment to the Task Force on whether, and, if so, how such a model might be introduced into Canada.

Continuous Market Access

5.30 Some have suggested[12] that Canada move to a "continuous market access" model for follow-on offerings of securities, which would certainly allow for speedy access to the capital markets. Under such a model an issuer would be permitted to offer securities using a very short one or two page document resembling a press release or a term sheet, which in turn would incorporate by reference the issuer's continuous disclosure record, most notably, the issuer's annual information form. The theory behind such a system is that the only "new" information that a potential purchaser needs to know about the issuer concerns the actual terms of the offering – the rest of the issuer's "story" is posted for all to see on SEDAR.

5.31 The obvious impediment to making the continuous market access model work within the current regulatory framework is that it would require either (i) that the continuous disclosure obligations of issuers change to include the on-going disclosure of "material facts" as well as "material changes" or (ii) that the back page certificates change appropriately, as discussed below. Canadian securities laws currently require that only "material changes" – i.e., changes in an issuer's business, operations or capital that would reasonably be expected to have a significant effect on the market price or value of the issuer's securities – be disclosed on an on-going basis. In contrast, "material facts" – i.e., facts that would reasonably be expected to have a significant effect on the market price or value of the issuer's securities – need only be disclosed in a prospectus[13] and, implicitly, in the issuer's annual information form. Consequently, unless an issuer is required to disclose both material facts and material changes (together, "material information") on an on-going basis,[14] offerings under a continuous market access model run the risk of containing material fact "gaps".

[12]See written submissions of the British Columbia Securities Commission and The Canadian Listed Company Association in Volume VII.

[13]In the context of primary market disclosure, once a receipt is issued for a prospectus by securities regulators, the issuer has no obligation to update material facts during the offering period, whereas there continues to be an obligation to disclose material changes.

[14]The TSX Company Manual requires that listed companies disclose all "material information" (i.e., material changes and material facts) on an on-going basis.

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5.32 There has been a lengthy debate among Canadian securities law practitioners, academics and regulators[15] regarding the merits of requiring the on-going disclosure of both material changes and material facts.[16] To many observers this debate is seen as an exercise in sophistry and we are reluctant to be pulled into the morass.

5.33 Until a shift in disclosure requirements is made, we recommend a different approach. We recommend that the best features of the continuous market access model and the WKSI concept from the United States be brought together along with our recommendations in Chapter 4 for more effective disclosure documents (i.e., "access equals delivery" and electronic information layering) to permit increased speed to market for what we will call, unimaginatively, Canadian Well Known Seasoned Issuers or C-WKSIs.

Recommendation: *The Task Force recommends that a Canadian version of the "well-known seasoned issuer" concept be introduced in Canada to allow eligible issuers the ability to access the capital markets with increased speed.*

C-WKSIs

5.34 The essential elements of the C-WKSI framework encompass (i) the eligibility criteria for an issuer to enter the C-WKSI category, (ii) the form of offering documentation to be used by a C-WKSI and, of course, (ii) the speed advantage of being a C-WKSI. Each of these elements will be dealt with in turn.

(a) C-WKSI Eligibility Criteria

5.35 As with WKSIs in the United States, the Task Force believes that C-WKSIs should receive less regulatory scrutiny because they are presumed to receive greater market scrutiny. The trick, of course, is to establish objective indicators of sufficient market scrutiny. The obvious starting point is to look at the WKSI eligibility criteria set by the SEC.

5.36 The Task Force commissioned research by Professor Adam Pritchard, an American legal academic, to determine whether the WKSI standards could be adopted in Canada. The threshold question was to determine the appropriate market capitalization cut-off.[17] The most easily defended standard would be the one adopted by the SEC: US$700 million or roughly $800 million in Canadian currency. However, as Professor Pritchard noted, that standard may not accord with the realities of a Canadian market place which is generally made up of companies with smaller market capitalizations than the United States. Our goal is to extend the more rapid access to the capital markets to as many issuers in Canada as possible.[18]

[15]See for example the British Columbia Securities Commission "Proposal to Redefine the Nationality Standard" (2002).

[16]See for example: the *Five Year Review Committee Final Report – Reviewing the Securities Act (Ontario)* at Chapter 13; J. Sarra, "Modernizing Disclosure in Canadian Securities Law: An Assessment of Recent Developments in Canada and Selected Jurisdictions," in Volume II at 49; and the *Interim Report of The Toronto Stock Exchange Committee on Corporate Disclosure, Toward Improved Disclosure* (December 1995) at 83 where that committee said the following: "Frankly, this sort of Irish stew of provisions where lawyers talk about material facts, material information and material changes, as if there were any significance to the distinction serves, in our view, no useful purpose and contributes to a lack of clarity in the rules…. If material information that has not been previously disclosed comes to light, it should be disclosed."

[17]The SEC's second category of WKSI – issuers selling more than US$1 billion (approximately $1.15 billion in Canadian currency) in debt over the past three years – would appear to be of very limited importance in the Canadian context as Professor Pritchard's analysis has shown that only one issuer would have sold more than that amount of debt in public debt offerings between 2002 and 2004. Accordingly, we have focused only on the market capitalization criterion.

[18]This paragraph and the following paragraph rely heavily on Pritchard, *supra* note 7 at 20.

5.37 Moreover, a sensible approach for augmenting the role of other gatekeepers in the C-WKSI offering process might be the introduced of a "due diligence attorney" who would be retained by an issuer on a permanent basis to perform this on-going role. We find this to be an interesting concept, but not one we have explored to the extent that we are ready to formally recommend. More will be found on the topic of gatekeepers in Chapter 8.

5.38 The question is: how low could the market capitalization cut-off be set without unduly risking a lack of attention by media, analysts and institutions to issuer disclosure? The data compiled and analyzed by Professor Pritchard suggest that analyst coverage "remains relatively robust – for those companies making offerings – down to the level of $345 million in market capitalization." A $350 million cut-off would place nearly 30% of TSX issuers in the C-WKSI category (using market capitalizations at the end of 2005). Moreover, only twelve issuers on the TSX-30 index would be excluded if this standard were imposed. The table below, which has been taken from Professor Pritchard's study,[19] shows analyst coverage at various levels of market capitalization based on a sample of ten random companies at each range of market capitalization.

Analyst Coverage

Market Capitalization ($ millions)	Mean number of of Analysts	Max/Min Number of Analysts	Number of Issuers with no Analysts
$1,150-$2,300	8.3	16/3	0
$1,000-$1,150	7.1	10/2	0
$920-$1,000	7.0	12/2	0
$800-$920	7.7	13/1	0
$690-$800	3.6	9/1	0
$575-$690	3.9	10/0	1
$460-$575	3.7	9/0	3
$345-$460	5.8	11/1	0
$230-$345	2.5	5/0	2
$85-$230	3.2	6/0	2
Overall	5.3	16/0	8

Recommendation: *The Task Force recommends that C-WKSI status be granted to those issuers meeting the qualification criteria for the POP system and with market capitalizations of $350 million and over.*

[19] *Ibid*. at 16.

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(b) C-WKSI Offering Documentation

5.39 To facilitate speedy access to the capital markets, the Task Force recommends that C-WKSIs be allowed to offer securities to the public using a simple "term sheet" that summarizes the material terms of the securities being offered. This term sheet would be posted on SEDAR and on the issuer's website thereby fulfilling the delivery requirement under our recommended move to an "access equals delivery model".

5.40 As outlined in Chapter 4, one of the advantages of the "access equals delivery" model is that it allows for more effective disclosure by permitting the electronic "layering" of information and allowing information to be "pulled" electronically from existing data sources. So, from the C-WKSI "term sheet" an investor would be able to "click" to access information about the issuer pulled from its annual information form, material change reports and financial statements – the types of disclosures that would otherwise be incorporated by reference into the current paper form of short form prospectus under the POP system.

5.41 At the point where a seasoned issuer comes to market, the market is trading every day with the benefit of full disclosure of material facts as at the date of the issuer's last annual information form and with the benefit of full disclosure of material changes up to the date in question. When the issuer comes to market (unless we alter what is required – as to which we will make suggestions below) the disclosure record will be augmented by a short form prospectus which will contain details of the offering, any consequent disclosure, such as use of proceeds (as expansive or cursory as may be appropriate), together with such additional information as the issuer and the underwriters believe is required to be disclosed to bridge the gap between material facts and material changes. The latter will have been disclosed but the former (if they do not amount to material changes) will not necessarily have been disclosed and the secondary market will have been trading oblivious of them.

5.42 We see no compelling reason why the making of a treasury offering should oblige an issuer to bridge this disclosure gap. If knowledge of material facts, which are not material changes, do not need to be disclosed to secondary market participants, we see little logic in introducing delay into the offering timetable for C-WKSIs to allow a full (material facts included) disclosure document to be prepared.

5.43 Accordingly, we recommend that C-WKSIs should be permitted to come to market in a follow-on offering with an offering document which contains only the details of the offering, the use of proceeds and related disclosure which would be tantamount to a material change statement, assuming the use of proceeds is transactional in nature. For this to be manageable there will have to be alterations to the certificates of the issuer and underwriter. The issuer's certificate would read "The foregoing, together with the documents incorporated by reference herein, constitutes full, true and plain disclosure of all material facts as at [the date of the last filed Annual Information Form] and of all material changes in the business, operations and capital of [issuer] since that date."

5.44 This document would not be subject to regulatory review in advance. The scrutiny of such an issuer by other market intermediaries would be regarded as sufficient. On an *ex post* basis, any issuer whose disclosure was inadequate could be denied C-WKSI status.

Recommendation: *The Task Force recommends that C-WKSIs be permitted to come to market in a follow-on offering with an offering document (that would not be subject to regulatory review) which contains only the details of the offering, the use of proceeds and related disclosure which would be tantamount to a material change statement.*

Recommendation: *The Task Force recommends that the certificate of a C-WKSI using such an offering document speak only to material facts as at the date of the C-WKSI's last annual information form and material changes since that date, specifically saying: "The foregoing, together with the documents incorporated by reference herein, constitutes full, true and plain disclosure of all material facts as at [the date of the last filed Annual Information Form] and of all material changes in the business, operations and capital of [issuer] since that date."*

(c) The C-WKSI Speed Advantage

"What's happened in today's information age is the windows for raising capital, they used to move slowly, you'ld feel a draft and then the window would open and it would be open for a time.... All of the sudden there's a financing window and then they close as quickly as they open.... So really there has to be a quick and very cost effective method [so that a company can raise capital] and can raise it at a low cost."

– Bruce MacLeod, Canadian Listed Company Association and BC and Yukon Chamber of Mines (oral submission to the Task Force)

5.45 Even with streamlined offering documentation, there still remains another impediment to a C-WKSI's speedy access to the capital markets in Canada: the requirement that the underwriters to an offering sign a certificate attached to the prospectus attesting that, "to the best of [their] knowledge, information and belief", the prospectus "constitutes full, true and plain disclosure of all material facts relating to the securities" being offered.

5.46 To defensibly make such a statement, the underwriter must be duly diligent in its enquiries of the issuer, either through the review of the issuer's material documents or the questioning of the issuer's management and advisers or, more typically, both. The difficulty is reconciling the underwriter's requirement of due diligence, which is usually a time consuming exercise, with the issuer's desire to access to the capital markets as quickly as possible – a difficulty that is common even under the POP system.

5.47 It is our view that the underwriter's certificate for offerings by C-WKSIs should reflect commercial reality – achieving speed to market sometimes means that something less than full-blown due diligence should be acceptable to the regulatory system. Accordingly, we recommend that the underwriter's certificate for offerings by C-WKSIs be modified such that an underwriter will

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certify that "to the best of its knowledge, information and belief, *based on a review reasonable under the circumstances*, the prospectus constitutes full, true and plain disclosure of all material facts as at [the date of the last filed Annual Information Form] and of all material changes in the business and affairs of [issuer] since that date." We would expect that securities regulators would provide guidance as to how the standard of reasonable review could be achieved.

Recommendation: *The Task Force recommends the underwriter's certificate for offerings by C-WKSIs take into account the restricted time that underwriters will have to complete a full-blown due diligence review of the issuer, specifically saying: "To the best of [our] knowledge, information and belief, based on a review reasonable under the circumstances, the prospectus constitutes full, true and plain disclosure of all material facts as at [the date of the last filed Annual Information Form] and of all material changes in the business and affairs of [issuer] since that date." We would expect that securities regulators would provide guidance as to how the standard of reasonable review could be achieved.*

5.48 We do not make this recommendation lightly and do acknowledge that the adoption of this recommendation may preclude the use of offering mechanisms such as the Multijurisdictional Disclosure System. As Chapter 8 will reveal, we place great weight on the role that "gatekeepers" can and do play in ensuring the competitiveness of Canada's capital markets. However, in this instance we regard it as appropriate to shift a portion of the gatekeeping function played by the underwriter in its pre-offering due diligence review to the research analysts, media and institutional investors following the disclosures of a C-WKSI on a daily basis.

Private Placements

Broadening the "Accredited Investor" Category

5.49 The other method by which issuers can access the capital markets is the issuance of securities using a prospectus exemption – i.e., by "privately placing" securities to a portion of the public deemed not to require a prospectus prior to making an investment decision. The Task Force applauds the recent efforts of the Canadian Securities Administrators, through National Instrument 45-106 – *Prospectus and Registration Exemptions*, to harmonize the private placement exemptions across Canada.

5.50 For individuals, the most commonly used private placement exemption is the "accredited investor" exemption. By measure of his wealth, an accredited investor is regarded as being sufficiently financially sophisticated (or to be able to afford sophisticated advice) to purchase securities without a prospectus. The Task Force received submissions from several parties[20] indicating that the wealth of an investor is not an appropriate proxy for his financial sophistication. We agree. However, we have struggled to identify a more appropriate objective standard.

5.51 We are troubled that a large number of investors are shut out of the private placement market because of the size of their personal fortunes. We recommend that the category of individual regarded as an accredited

[20]See, for example, the written submissions of the Prospectors and Developers Association of Canada in Volume VI.

investor be broadened to include not only those who are wealthy, but also those who rely on a registered adviser in making their decision to invest in the private placement. The financial sophistication of the registered adviser, which comes from his professional training and accreditation, would be transposed onto his client.[21]

5.52 Appropriate safeguards could be put in place to ensure that both the registered adviser and the investor acknowledge that the investor is relying on the adviser. A concern with broadening the class of eligible investors in this way might be the risk of unduly eroding the entire prospectus model. For this reason we recommend that, at the outset, this exemption be limited to 50 investors for any one private placement. Over time, consideration should be given to increasing the number of permitted investors who qualify under this exemption.

5.53 Other limits to our recommendation:

- The issuer must be a "reporting issuer" (or the equivalent) under securities laws.
- The registered adviser would be prohibited from advertising to encourage investors to rely on this exemption and sales under this exemption would only be permitted to clients with whom the registered adviser had a pre-existing relationship.

Recommendation: *The Task Force recommends broadening the category of individual regarded as an accredited investor under the private placement exemptions to include not only those who are wealthy, but also those who rely on a registered adviser. The limits on this exemption would be: (i) sales (utilizing the exemption) limited to no more than 50 investors for any one private placement, (ii) the issuer must be a "reporting issuer" or the equivalent, and (iii) a registered adviser would be prohibited from advertising to encourage investors to rely on this exemption and sales under this exemption would only be permitted to clients with whom the registered adviser had a pre-existing relationship.*

Hold Periods

5.54 Questioning the continued need for attaching "hold periods" to privately placed securities of reporting issuers is not new. Three rationales are traditionally put forward to justify such an imposition. First, hold periods are said to prevent "back-door underwritings", that is the use of exemptions to distribute securities for immediate resale so as to avoid the obligations imposed by the prospectus regime.[22]

[21]This recommendation is not without precedent. The United States Securities Act of 1933 (the "US Securities Act") requires any offer or sale of securities to be registered, unless an exemption from registration is available. Section 4(2) of the US Securities Act provides an exemption for transactions by an issuer not involving any public offering. Regulation D sets forth safe harbour requirements, compliance with which will ensure the availability of the Section 4(2) exemption.
Regulation D provides 3 specific exemptions from registration. Two of these (set forth in Rules 504 and 505) are "small offerings" exemptions. The third safe harbour, Rule 506, which is available to any issuer and with no dollar limit on the amount of the offering, limits sales to "accredited investors" **and up to 35 other purchasers who "alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description"** [Emphasis added].

[22]In this paragraph and the remaining paragraphs in this section we rely on S. Rousseau, "The Competitiveness of Canadian Stock Exchanges: What Can We Learn from the Experience of the Alternative Investment Market" in Volume V at 94.

5.55 Second, hold periods purportedly ensure that investors buying re-sold privately placed securities have access to sufficient information through the issuer's continuous disclosure filings prior to completing the purchase.

5.56 Finally, hold periods are regarded as a disincentive to private placements (and, conversely, an incentive to complete prospectus offerings instead) and thereby minimize what was once thought to be an over-institutionalization of Canada's capital markets.

5.57 As others, such as the Five Year Review Committee,[23] have stressed, these rationale no longer make sense for issuers subject to continuous disclosure obligations under securities laws. In the first place, like the Five Year Review Committee, we regard the risk of back-door underwritings to be overstated. To realize such an operation, an issuer needs to find an exempt purchaser willing to acquire the securities and thereby play the unofficial role of underwriter. To then resell the securities the "back-door underwriter" would need to be registered under securities laws. Even if such a risk exists, it could be dealt with in a more targeted fashion, through regulatory guidance as to the circumstances which would be regarded as offensive.

5.58 With respect to the second rationale, the extent of continuous disclosure obligations coupled with the new civil liability regime for secondary market disclosure have considerably narrowed the gap in the quality and scope of information available to those purchasing securities pursuant to a prospectus and those purchasing pursuant to a prospectus exemption.

5.59 Finally, the use of hold periods to discourage private placements and the concomitant over-institutionalization of the capital markets is not particularly compelling to us in an era of ever-increasing retail investor participation in the market. Indeed, our recommendation outlined in the section above would broaden the private placement exemptions and allow for even greater retail participation.

Recommendation: *The Task Force recommends that hold periods for privately placed securities of reporting issuers be eliminated.*

[23]See the *Five Year Review Committee Final Report – Reviewing the Securities Act (Ontario)* at section 12.3.