Research Study

The Competitiveness of Canadian Stock Exchanges: What Can We Learn from the Experience of the Alternative Investment Market?

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1. Executive Summary

Stock exchanges are key market infrastructure entities. Thus, the existence of well-functioning stock exchanges is an important determinant of the competitiveness of Canadian capital markets. Canadian regulators recognized this fact when they approved the consolidation of stock exchanges in 1999. The specialization of stock exchanges purported to enable them to cater more effectively to issuers and investors, and thereby to face the competition from foreign-based exchanges. Indeed, during the same period, competition has increased as foreign stock exchanges increasingly seek to attract listings from Canadian firms.

In this respect, Canadian issuers' interest in listing on the Alternative Investment Market (AIM) of the London Stock Exchange (LSE) is a testament of this growing competition. AIM was created in 1995 to allow companies to access public capital with a reduced regulatory burden in comparison to, for example, the LSE Main Market. It appears that AIM has been extremely successful in attracting investors and issuers, including more recently a number of Canadian public companies.

The attractiveness of AIM is intriguing for policy-makers interested in the competitiveness of Canadian securities markets. From this perspective, this study seeks to provide a better understanding of AIM. Specifically, the objectives of this study are two-fold. First, it examines the extent to which AIM has been successful in attracting investors and issuers, including more recently Canadian public companies. What emerges from the research is a complex picture where market- and legal-based factors play out to explain the attractiveness of AIM for Canadian companies. Amongst those factors, the particularities of the London market have significant weight. Still the alternative regulatory regime of AIM facilitates the ability of Canadian companies to tap into this market.

Second, given the relevance of the regulatory dimension, the study also explored whether the AIM model is informative for the approach followed by Canadian stock exchanges. The study examines whether AIM is doing something "right", which Canadian exchanges should be thinking about doing in order to remain competitive. The study finds two salient differences in the regulatory models used by AIM and Canadian exchanges. The first pertains to the choice made by AIM in favour of a principles-based approach, in contrast with Canadian exchanges that used a rules-based approach. The other relates to the scope of ongoing obligations imposed to listed companies. Ongoing disclosure and corporate governance requirements are lighter on AIM than on Canadian exchanges. Overall, on AIM, it is the Nominated advisor (Nomad) who substitutes for more detailed listing requirements and more rigorous ongoing

obligations. Without an effective Nomad system, it is doubtful that AIM would be a viable market with such a regulatory environment.

Hence, any attempt at importing some elements of AIM's regulatory model in Canada must include the transplantation of the Nomad system. In this respect, the study shows that implementing a Nomad system in Canada could prove a complex and risky task. In fact, it is highly debatable whether an effective Nomad system could develop in Canada.

For this reason, the study does not recommend that policy-makers seek to transplant the Nomad system and related features of the AIM model in Canada. Improvements in the competitiveness of Canadian stock exchanges should be sought by seeking to enhance the flexibility of their admission process, and by making their continuous disclosure requirements more responsive to the needs of capital markets participants, including further harmonizing them with securities regulation. It also seems appropriate to undertake a revision of the costs of the mandatory corporate governance requirements imposed by securities regulation, and assess whether there are effective substitutes for those requirements on Canadian markets. Finally, a revision of hold periods could enable Canadian exchanges to generate greater liquidity to companies' securities, and thereby increase their attractiveness.

2. Summary of Recommendations

Recommendation #1: Canadian stock exchanges and regulators should abstain from transplanting the Nomad system, and related features, of the AIM model in Canada.

Recommendation #2: Consideration should be given by Canadian stock exchanges to enhancing their attractiveness through improvements to the admission process.

Recommendation #3: Consideration should be given by Canadian stock exchanges to exploring solutions to make their continuous disclosure requirements more responsive to the needs of capital markets participants, including further harmonizing them with securities regulation.

Recommendation #4: To address the concerns related to the costs of corporate governance requirements, Canadian regulators should consider reviewing the cost-effectiveness of the existing corporate governance regime, with a special view at smaller issuers' interests.

Recommendation #5: To improve the liquidity of securities issued under private placements, securities regulators should consider eliminating hold periods for securities of reporting issuers.

3. Introduction

Stock exchanges are key market infrastructure entities. Thus, the existence of well-functioning stock exchanges is an important determinant of the competitiveness of Canadian capital markets. Canadian regulators recognized this fact when they approved the consolidation of stock exchanges in 1999. The specialization of stock exchanges purported to enable them to cater more effectively to issuers and investors, and thereby to face the competition from foreign-based exchanges. Indeed, during the same period, the competition has increased as foreign stock exchanges increasingly seek to attract listings from Canadian firms.

In this respect, Canadian issuers' interest in listing on the Alternative Investment Market (AIM) of the London Stock Exchange (LSE) is a testament to this growing competition. AIM was created in 1995 to allow companies to access public capital with a reduced regulatory burden in comparison to, for example, the LSE Main Market. It appears that AIM has been extremely successful in attracting investors and issuers, including more recently a number of Canadian public companies.

The attractiveness of AIM is intriguing for policy-makers interested in the competitiveness of Canadian securities markets. Theoretically, managers should list their firms' securities on the exchange that maximizes firm value. Differently stated, they should select the stock exchange which keeps the firm's cost of capital at its lowest level. The recent trend and relative success of AIM raises the issue as to whether AIM is doing something "right", and which Canadian exchanges should be thinking about doing in order to remain competitive. If they are unable to discharge their core functions effectively, Canadian exchanges risk losing market share as they will be less attractive to companies. Companies will seek listing on more effective exchanges that will enable them to reduce their cost of capital. The departure of a significant number of companies could have some adverse impact for the reputation, operations and, ultimately, the viability of Canadian exchanges

Despite the interest generated by AIM, few studies have been devoted to this specialized stock exchange, either from an economic or regulatory perspective. And none of the existing studies has sought to analyze the relevance of the AIM model for Canadian stock exchanges, and, more broadly, the competitiveness of Canadian capital markets. From this perspective, the following analysis seeks to fill this research gap by providing a better understanding of AIM.

Specifically, the objectives of this study are two-fold. First, this study examines the extent to which AIM has been successful with Canadian issuers. Second, it discusses whether the AIM model is informative for the regulatory approach followed by Canadian stock exchanges.

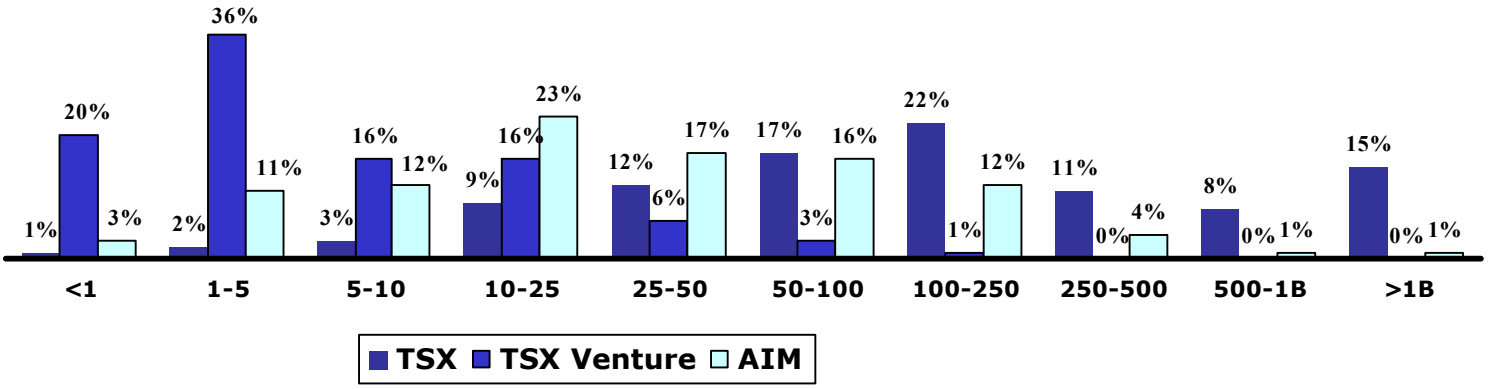
The study is divided into three parts. Firstly, it presents empirical evidence on AIM, concentrating on Canadian companies getting listed on this exchange. Secondly, it highlights the different regulatory approaches of AIM and Canadian exchanges through a comparison of listing and ongoing requirements. Thirdly, it assesses the extent to which the AIM model is informative for Canadian stock exchanges. The study concludes by discussing whether policy-makers should import the AIM model to Canada.

4. Listing by Canadian Companies on the Alternative Investment Market: A Look at the Evidence

i. Overview of the Alternative Investment Market

Since its creation in 1995, AIM has attracted an increasing number of companies and has thus experienced spectacular listing growth. Over the last 10 years, the number of companies listed on AIM has gone from 10 in 1995 to 1240 in June 2005.[1] AIM succeeded the Unlisted Securities Market and was meant to cater to smaller and fast-growing companies. A look at the issuer base of AIM indicates that AIM attracts nonetheless a wide variety of companies that have a broad range of market capitalization. In fact, about half of the listings on AIM are in the market capitalization range of $25 to $250 million, which makes it more directly competitive with the Toronto Stock Exchange (TSX), than with the Venture Exchange (TSXV) (**Figure 1**).[2]

Figure 1: Companies listed on the TSX, TSXV and AIM Market Capitalization ($C M)



[1] This section of the paper relies on data marshalled by the TSX Group as of June 2005. See TSX Group, *A Look at London's Alternative Investment Market (AIM)*, 2005 (on file with the author).
[2] See also Osborne Clark, *Is AIM the New NASDAQ?,* 2006, p. 5.

Although AIM caters mostly to UK-based companies, it has attracted an increasing number of foreign-based companies during the same period, from 3 in 1995 to 157 in June 2005. Most notably, AIM has witnessed a spectacular growth in its international listings over an 18 month period that extends from January 2004 to June 2005. Two-thirds of AIM foreign-based companies (or 104 companies) listed during that period.

In terms of industries, foreign-based companies listed on AIM come predominantly from the natural resources sector, with close to 50% from the oil and gas or mining industries. The importance of this sector is also evidenced by the fact that resource companies accounted for about 65% of the market capitalization of AIM foreign-based companies in June 2005. The data also indicate that the recent surge in international listings growth has been mainly fuelled by mining and oil and gas companies. These companies accounted for 43% of the 104 foreign-based companies listed during the 18 month period extending from January 2004 to June 2005.[3] More precisely, it is worth emphasizing the importance of gold companies among resource companies which accounted for about half of the resource companies that listed during that period.

Interestingly, the TSX and TSXV issuer base is quite similar to that of AIM from an absolute perspective. In June 2005, a total of 153 foreign-based issuers were listed on the two Canadian exchanges. During the period ranging from January 2004 to June 2005, the number of international listing on the two exchanges has grown 32%, with the addition of 37 new foreign-based companies.

Natural resources companies are also prevalent among international companies listed on the TSX and TSXV. They account for close to 60% of the number of foreign-based companies and 67% of their total market capitalization. Likewise, between January 2004 and June 2005, 30 of the 37 new international listings came from natural resources companies. These companies were however mostly small-cap issuers as they represented only 29% of the market capitalization of the new international listings during that period.

[3] The market capitalization of those new international companies from the natural resources sector was also significant, amounting for 48% of the total market capitalization of new international listings during that period.

ii. Some Statistics on Canadian Issuers Listing on the Alternative Investment Market

a) The Profile of Canadian Issuers Listed on AIM

As of June 30 2005, Canadian companies accounted for about 20% of the foreign-based companies listed on AIM. Of the thirty-one Canadian companies listed on AIM, twenty-three were inter-listed with the TSX and five with the TSXV. There were three Canadian companies solely listed on AIM.[4] It is interesting to note that the majority of Canadian companies seeking listing on AIM have done so since January 2004. Prior to that date, there were only nine Canadian companies listed on AIM. This observation is in line with the evidence presented above and which indicates that listing by foreign-based issuers has surged since January 2004. Note that this fast pace seems to have somewhat declined. Six Canadian companies have listed on AIM during the period of July 1, 2005 to February 28, 2006, with the bulk of the new listings concentrated in the summer of 2005. Thus, it is debatable whether the previous trend will be sustained. **Table 1** provides a summary of the characteristics of Canadian companies inter-listed on AIM as of June 30, 2005.

[4] There were three UK companies that were inter-listed on the TSX.

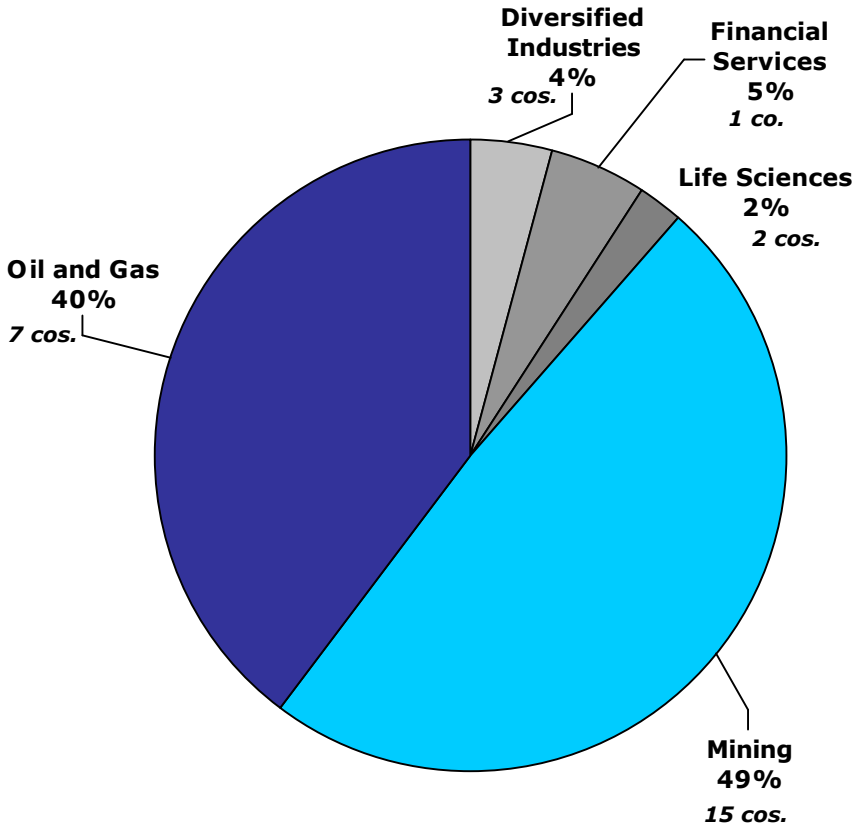
Table 1: TSX/TSX Venture and AIM Inter-listeds and Canadian based AIM Sole Listeds

June 30, 2005

Company	Exchange	Sector	Market Cap C$ Millions
ADULIS RESOURCES INC	TSX-V	OG	$85,7
GROVE ENERGY	TSX-V	OG	$85,1
MANO RIVER RESOURCES INC	TSX-V	MM	$50,1
MEDORO RESOURCES	TSX-V	MM	$10,1
URUGUAY MINERAL EXPLORATION	TSX-V	MM	$174,3
ADASTRA MINERALS INC	TSX	MM	$100,8
ANTRIM ENERGY INC	TSX	OG	$52,7
AZURE DYNAMICS CORP	TSX	DI	$126,3
BEMA GOLD CORP	TSX	MM	$1 157,0
BRAZILIAN DIAMONDS LTD	TSX	MM	$47,9
CALEDONIA MINING CORP	TSX	MM	$54,7
CANACCORD CAPITAL INC	TSX	FI	$447,2
CASPIAN ENERGY INC	TSX	OG	$150,8
CENTURION ENERGY INTERNATIONAL INC	TSX	OG	$1 253,8
EUROPEAN GOLDFIELDS	TSX	MM	$184,7
FIRST CALGARY PETROLEUMS	TSX	OG	$1 523,4
FIRST QUANTUM MINERALS	TSX	MM	$1 330,0
GREYSTAR RESOURCES	TSX	MM	$112,7
KIRKLAND LAKE GOLD INC	TSX	MM	$171,7
MARCH NETWORKS CORP	TSX	DI	$194,7
OILEXCO INC	TSX	OG	$369,3
ONDINE BIOPHARMA CORP	TSX	LS	$67,6
QUESTAIR TECHNOLOGIES INC	TSX	DI	$53,3
SOUTHERNERA DIAMONDS INC	TSX	MM	$43,9
THISTLE MINING INC	TSX	MM	$0,0
WESTERN CANADIAN COAL CORP	TSX	MM	$341,6
YAMANA GOLD INC	TSX	MM	$551,3
YM BIOSCIENCES INC	TSX	LS	$118,4
BDI MINING CORP	AIM Solely	MM	$37,6
HARD ASSETS INC	AIM Solely	FI	$11,5
VISUAL DEFENCE INC*	AIM Solely	DI	$87,9

As seen below, the majority of inter-listed companies come from the natural resources sector, with 22 out of 28 companies being in the mining or oil and gas sectors as of June 2005 (**Figure 2**). Natural resources companies also account for an impressive 89% of the total market capitalization of inter-listed companies. Still, it is worth emphasizing that both in terms of the number of inter-listeds and market capitalization, companies in the mining sector are ultimately those that dominate. Further, companies involved in gold production or development accounted for about 22% of the resources companies, and about the same proportion of the total market capitalization.

Figure 2: Canadian Companies Inter-listed on AIM by Market Capitalization, June 30, 2005



100% = $9.299 Billion

b) Why Do Canadian Issuers List on AIM? The Perspective of Market Participants

Since January 2004, there have been a significant number of Canadian companies seeking listing on AIM. To gain a better understanding of the reasons for this sudden surge, we have sought to gather empirical evidence through discussions with "market participants"[5] in Canada and in the U.K., analysis of the data on listed companies, and consultation of press releases issued by Canadian companies. What emerges from the research is a complex picture where different factors play out to explain the attractiveness of AIM for Canadian companies.

At a general level, Canadian companies list on AIM to raise financing and expand their shareholder base. By being admitted to AIM, Canadian companies have access to the London market which provides them with the opportunity to gain exposure to a vast pool of investors. London is the largest centre in the world for the trading of international securities and this position clearly makes it attractive for overseas companies who wish to extend their shareholder base. Further, where they list on AIM, Canadian companies have access to a market increasingly populated by sophisticated investors, as institutional investors now control over 40% of the AIM market.[6] Following their admission to AIM, Canadian companies are likely to become known by a greater number of sophisticated investors and analysts. Most importantly, market participants have pointed out that sophisticated investors in the United Kingdom are inclined to invest in small and medium-sized companies, even where they are overseas companies. Thus, AIM is an interesting platform that allows companies to make offerings to raise amounts of £10 to 15 million ($20 to 30 million), especially since the offerings can be conducted more easily through private placements with institutional investors. This renders the market more receptive to Canadian companies and facilitates the extension of their investor base.

More specifically, if AIM is attractive for Canadian companies in the resources sector, it is partly due to London's reputation as one of the primary mining financial centres of the world. Being based in London, AIM enables resource companies to enter a sophisticated market that provides both a source of capital and a community of knowledgeable professionals. Some have nonetheless emphasized that the London market is not as sophisticated as the Toronto market in this sector. At any rate, it is interesting to note that the value of institutional investor holdings in the resources sector accounted for close to 40% of total

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[5] Market participants refer to companies, investment banks, corporate lawyers in Canada and the United Kingdom.
[6] See Growth Company, *Institutional Investors in AIM 2005*; Osborne Clark, *Is AIM the New NASDAQ?,* 2006, p. 4, 7.

institutional investments on AIM in 2005.[7] A related feature of AIM is its perceived expertise or experience in trading securities from companies operating in the natural resources sector. This perception may generate a clustering effect as companies in those sectors choose to list on AIM to benefit from this expertise and experience. In turn, clustering may lead companies to list on AIM to join their peers and thereby signal their quality. To summarize, Canadian companies may therefore list to join a cluster on AIM as it is seen as being dominant and enjoying a significant following of sophisticated investors and analysts.

When seeking to understand the recent increase in the number of Canadian resource companies listing on AIM, it is important to bear in mind an important conjectural factor: the growth in commodity prices. On the demand side, this growth has fuelled the need for financing by resource companies pursuing their development and expansion. On the supply side, it has increased the interest of U.K. institutional investors in resource companies. The influence of this factor should not be understated as it may have accelerated the decision of Canadian companies to list on AIM to benefit from its advantages over the recent months.

This raises the question: what would happen in a downturn? The experience of European Junior stock exchanges in the 1980s and 1990s serves as a cautionary note. For instance, after having benefited from positive economic conditions, the U.K. Unlisted Securities Market (USM), AIM's predecessor, was hit by rising interest rates and the recession of the early 1990s. The failure and bankruptcies of listed corporations that ensued stripped the USM of its former identity as an exiting market, rendering it an inferior segment of the market.[8] Hence, the ability of AIM to sustain a downturn depends on there being solid companies in sufficient numbers to preserve its reputation. Otherwise, there is a risk that investors – especially institutional investors – will flee the market, thereby creating a vicious illiquidity circle that will harm the market.

For companies involved in research and development in areas such as telecommunications or biotechnology, market participants have suggested that AIM is interesting in that it provides an alternative to another round of financing with venture capital firms. As seen below, AIM's listing requirements are more flexible and this facilitates entry by smaller companies. Moreover, some have mentioned that the London market is more receptive than Canadian markets to offerings from companies in the technology

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[7] Growth Company, *ibid*.
[8] S. Rasch, *Special Stock Market Segments for Small Company Shares in Europe – What Went Wrong?*, ZEW Discussion Paper No. 94-13, Mannheim, 1994.

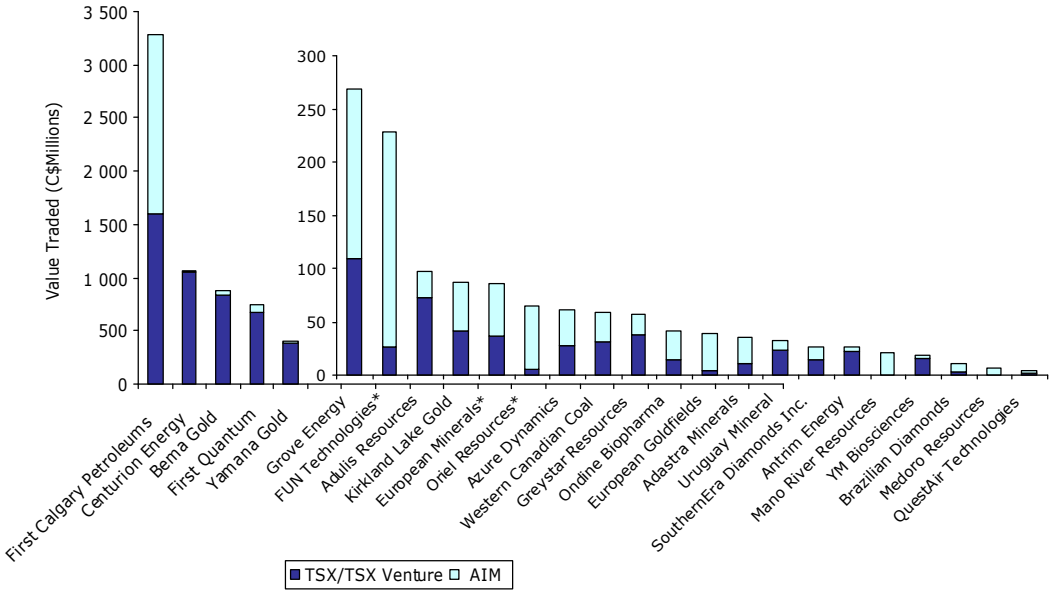
sector. They point out that AIM thus offers valuations that are as attractive as those of NASDAQ without the regulatory burden of being listed in the U.S. Without dismissing this possibility, we must underline that there are only three Canadian companies from those sectors that are listed on AIM, so the advantages of AIM in this respect have yet to materialize.

To explain the attractiveness of AIM to Canadian companies, it is tempting to point to the "fast-track route" that enables companies listed on recognized foreign stock-exchanges to join AIM using a streamlined admission process. The evidence indicates however that the fast-track route is not that popular. During the period from January 2004 to June 2005, there were 104 new international listings on AIM. Only 23 of the foreign companies used the fast-track route. Likewise, of the 16 Canadian companies that inter-listed on AIM during that period, only 7 used this possibility. Discussions with market participants shed light on these results. It appears that the fast-track route is not an interesting option when companies seek financing as the level of disclosure under that procedure is considered to be insufficient by investors. This observation is substantiated by the experience of Canadian companies. All of the companies that inter-listed without using the fast-track route were raising financing concurrently with their admission on AIM.

Finally, some market participants pointed out that AIM is not a very liquid market. In this respect, data indicate that the TSX and TSXV dominate trading measured by value in the most heavily traded inter-listed issuers (**Figure 3**). Although this is true, more in-depth research conducted by Board *et al.* shows that Canadian securities inter-listed on AIM have, overall, seen substantial turnover in London.[9] In fact, in 2005, "AIM turnover in TSX listed stocks represented 29% of the total (TSX + AIM) trading in those stocks".[10]

[9] J. Board *et al.*, *Report on Rate of return for AIM v. Official List Stocks and TSX and AIM volumes in Canadian Stock*, Task Force to Modernize Securities Legislation in Canada, 2006 (draft report).
[10] *Ibid.*

Figure 3: Trading in Canadian Inter-listed Companies Securities, January to June 2005



*U.K. Based Companies

5. Comparison of the Listing Requirements of the Canadian Exchanges and of the Alternative Investment Market

i. General Admission Criteria

a) Two Different Regulatory Approaches: Principles-based Versus Rules-based

The Alternative Investment Market and the TSX and TSXV use two different approaches to regulate admission. AIM relies on a principles-based approach. Pursuant to this approach, AIM Rules do not establish specific requirements to be met by companies seeking admission. Rather they require that every company seeking admission appoints a Nominated Advisor, or Nomad, and a broker.[11] As seen below, the role of the Nomad is to assess whether the company is suitable for the market. When making this suitability assessment, the Nomad has considerable discretion since the concept of suitability is defined generally by AIM Rules. Thus, admission on AIM rests ultimately on the analysis made by the Nomad.[12] Canadian stock exchanges follow a rules-based approach to regulate admission and provide detailed requirements that must be met by companies seeking listing. While they do contain some qualitative criteria, the specific listing requirements of Canadian exchanges tend to be very objective and leave less room for discretion.

b) Comparison of Admission Criteria

The Assessment of the Suitability of the Company Seeking Admission on AIM

The AIM Rules do not provide for detailed prescriptive entry criteria. The task of assessing the suitability of a company for admission to AIM rests with the Nomad. Following the AIM Rules, the Nomad has the responsibility of confirming in writing to the Exchange that the applicant and the securities that are the subject of the listing application are appropriate for admission to AIM.[13] This requires that the Nomad ensures that "the admission and conduct of a company do not impact adversely on the reputation and

[11] *AIM Rules for Listed Companies*, Rule 1.
[12] More technically, the issuer must have no restrictions on the free transferability of its shares. It must also be registered as public limited company or the equivalent. Finally, it must also abide to the AIM rules which set out disclosure obligations to gain admission, as well as ongoing obligations for listed issuers.
[13] *AIM Rules for Listed Companies*, Rule 39, Schedules 6 and 7.

integrity of the Exchange".[14] In other words, the Nomad acts as a gatekeeper for listing on AIM. More precisely, its role can be labelled as that of a "bouncer". In this respect, entry on AIM is different from entry on the Main Market where the suitability of an issuer is assessed by the United Kingdom Listing Authority.

To assess whether an issuer is appropriate for admission to AIM, the Nomad conducts a detailed review of the salient dimensions of the company's activities and organization. More specifically, the Nomad reviews the following elements:

- management;
- corporate governance;
- business viability;
- market potential; and
- working capital.

In light of this analysis, the Nomad evaluates whether the company "will enhance the market's reputation and has a realistic chance of delivering real value to shareholders".[15] This assessment ultimately seeks the same goal as the traditional listing requirements that purport to ensure the efficiency, fairness and liquidity of the stock exchange. However since there are no fixed criteria, the Nomad has more flexibility in making the suitability analysis.

Exceptionally, the AIM Rules impose an escrow requirement that Nomads must oversee. Where a company has a track record of less than two years it must ensure that all related parties and applicable employees have their securities locked in for one year following admission. Related parties include directors, shareholders with more than 10% of the share capital, and their respective families. Applicable employees are those that own more than 0.5% of the share capital, or possess price sensitive information. In theory, where a company has been independent and earned revenue for the previous two years, no escrow requirements apply, and this allows owners to substantially reduce their ownership in the company. In practice, Nomads typically impose escrow requirements even where the company would be

[14] C. AAronson, "The Role of the Nominated Advisor in an AIM Flotation", in *Joining AIM: A Professional Handbook*, 2005, p. 20-21.
[15] *Ibid*., p. 22.

exempted under AIM Rules.[16] They require such arrangements to foster investor confidence and ensure that the market will be orderly in the first few days following admission.

The Minimum Listing Requirements of Canadian Stock Exchanges

A company seeking to list on the TSX and TSXV must satisfy specific listing requirements that deal with public distribution, financial, technical and management aspects.

The listing rules provide specific requirements with respect to the public distribution of the securities of the companies seeking admission that are not found in AIM Rules. For instance, on the TSX, every applicant must have at least one million freely tradable shares with an aggregate market value of $4 million ($10 million for companies qualifying for listing under the Technology subcategory).[17] These shares must be held by at least 300 public shareholders, each with one or more board lots.

On the TSXV, these requirements are somewhat lower to accommodate smaller companies. They will vary whether the company is part of Tier 1 or Tier 2 of the Exchange.[18] Nonetheless they do not provide the flexibility given by AIM which sets no specific threshold in this respect. Furthermore, the rules of the TSXV provide that the Exchange must assess the suitability of the capital structure of the applicant. Specifically, before a listing, all securities issued to principals of the issuer or the resulting issuer as well as securities issued below certain price levels are generally required to be escrowed or held subject to hold periods. In addition, where convertible securities are issued before listing in the private issuer and exercisable or convertible into listed shares at a price that is less than the issuance price per security under a prospectus offering or other financing or acquisition undertaken contemporaneously with the application for listing, the underlying security will be subject to escrow if issued to a principal. Where there is no concurrent financing, the minimum permitted price at which the securities can be exercisable or convertible, and not be subject to escrow or an Exchange hold period, is the greater of their market price and $0.10.

The management of an applicant company is an important factor considered by Canadian exchanges when assessing a company's suitability for listing.[19] Management (including the members of the board of

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[16] See, e.g., Osborne Clark, *supra* note 6, p. 7.
[17] Toronto Stock Exchange, *Company Manual*, s. 310.
[18] TSX Venture Exchange, *Policy 2.1 – Minimum Listing Requirements*.
[19] Toronto Stock Exchange, *Company Manual*, s. 311, 325; TSX Venture Exchange, *Policy 3.1 – Directors, Officers, and Corporate Governance.*

directors) must have adequate experience and expertise relevant to the company's business and industry and adequate public company experience. To ensure compliance with this requirement, all officers, directors and holders of more than 10% of the company's stock must file with the Exchange a personal information form (in a form prescribed by the Exchange) detailing their background, business experience and industry knowledge. Exchange authorities will run detailed check on these issues. In addition, the exchange rules impose requirements with respect to the composition of the board of directors. For instance, the TSX requires that the board of directors of an applicant company be comprised of at least two Canadian directors and two independent directors[20]. Companies are also required to have a chief executive officer (CEO), a chief financial officer who is not also the CEO, and a corporate secretary. Although corporate governance issues are reviewed by the Nomad as part of the suitability analysis, Canadian exchange rules are more detailed with respect to board composition. The Nomad has the discretion to assess the quality of the governance arrangements of the company and is not limited to enforcing specific requirements.

In addition, the TSX *Company Manual* has established separate financial and assets requirements for three categories of issuers: (i) Industrial/General (**Appendix 1**); (ii) Mining (**Appendix 2**); and (iii) Oil and Gas (**Appendix 3**). Therefore, Canadian companies seeking a listing on the TSX must meet the specific listing requirements that are set forth for their own category of issuers and that concern net tangible assets, earnings, and working capital.[21] The TSXV provides similar requirements that vary depending on whether the company belongs to Tier 1 (**Appendix 5**) or Tier 2 (**Appendix 6**).

The Flexibility Provided by the Capital Pools Program

What is the CPC Program?

The Capital Pool Company (CPC) program of the TSXV allows a newly created private company, which has no assets other than cash and no commercial operations, to conduct an initial public offering in order to raise start-up capital and list its securities for trading on the TSXV.[22] Once the initial public offering is completed, the CPC then has twenty-four months to identify and acquire a business or pool of assets

[20] Toronto Stock Exchange, *Company Manual*, s. 311.
[21] The TSX *Company Manual*, s. 306, provides that the Exchange may exercise its discretion in applying those requirements. The Exchange may, in its discretion, take into account any factors it considers relevant in assessing the merits of a listing application and may refuse to grant an application notwithstanding that the prescribed minimum requirements are met. The Exchange will also take into consideration an applicant's status regarding compliance with the requirements of other regulatory agencies.
[22] TSX Venture Exchange, *Policy 2.4 – Capital Pools Company.*

using the funds raised from the distribution of its seed shares and its IPO. The acquisition is called a "Qualifying Transaction". Once the Qualifying Transaction is completed, the resulting issuer must meet the applicable minimum listing requirements of the TSXV in order for its securities to begin trading. Once approved by the TSXV, the resulting issuer loses its status of CPC and its securities are traded on the Exchange as a regular Tier 1 or Tier 2 issuer.

How It Works

To create a CPC, three to six individuals put up a minimum of $100,000 (and a maximum of $500,000) in seed capital. These founders incorporate a shell company - the Capital Pool Company - and issue shares in exchange for seed capital at a minimum price between the greater of $0.05 and 50% of the price at which the shares are to be issued during the CPC's IPO. The seed shares are always subject to an escrow and released over a three-year period beginning on the date the Qualifying Transaction is completed.

The CPC then prepares and files a prospectus with the appropriate securities commissions and the TSXV and applies for listing on the TSXV. The TSXV issues comments on the preliminary CPC prospectus and the application for listing. The application for listing is then presented to the TSXV's Executive Listing Committee for consideration. If the application is conditionally accepted and the securities commissions indicates that they are clear to receive final materials, the CPC then files its final prospectus and all supporting documents with the Exchange and the securities commissions. The minimum listing requirements applicable to a CPC differ from those typically applied to other types of issuers. They include:

- the board of directors of the CPC as a whole must have adequate public company experience. In addition, each proposed director and senior officer of the CPC must be either a resident of Canada or the United State. The Exchange requires that the directors and senior officers of the CPC must collectively possess the appropriate experience, qualifications and history which demonstrates that the management of the CPC will be capable of identifying, investigating and acquiring significant assets;
- the minimum total amount of seed capital raised by the CPC through the issuance of the seed shares must be equal to or greater than $100,000. The amount of seed share capital raised by seed shares issued at less than the IPO price can be no greater than $500,000;
- the minimum price at which the IPO shares may be issued is $0.10. Only a single class of common shares may be issued as Seed Shares and IPO shares;

- the gross proceeds to the treasury of the CPC from its IPO must be equal to or greater than $200,000 and must not exceed $1,900,000 and the maximum aggregate gross proceeds to the treasury of the CPC from the issuance of IPO shares and all seed shares must not exceed $2,000,000;
- upon completion of its IPO, the CPC must have at least 1,000,000 of its issued and outstanding common shares in the public float and must have a minimum of 200 shareholders with each shareholder beneficially owning at least 1,000 common shares free of resale restrictions exclusive of any common shares held by non arm's length parties to the CPC; and
- the maximum number of common shares that may be directly or indirectly purchased by any one purchaser pursuant to the IPO will be 2% of the IPO shares.

Within 24 months of the closing of the IPO, the CPC must identify, evaluate and acquire an operating business with private capital or assets that represents a good investment opportunity. Such acquisition constitutes the Qualifying Transaction. As soon as an agreement in principle has been reached with the potential target, the CPC must issue a detailed press release disclosing such fact. If a shareholder vote is not required to complete the Qualifying Transaction, the CPC must submit a filing statement in prescribed form within seventy-five (75) days of the announcement of the Qualifying Transaction with the TSXV and the applicable securities commissions. If a vote by the shareholders of the CPC is required, an information circular providing prospectus level disclosure on the targeted business must be prepared and filed with the same 75-day delay and a special meeting of shareholders must be called to approve the Qualifying Transaction. The TSXV reviews the filing statement or information circular and evaluates the targeted business to ensure that its minimum listings requirements are met. Following shareholder approval (if required), the Qualifying Transaction closes and the resulting issuer becomes a regular TSXV Tier 1 or Tier 2 issuer.

At the stage of the Qualifying Transaction, the Exchange requires that a sponsor ensures that each step leading to the completion of the Qualifying Transaction is carried out in accordance with its policies. The sponsor must, among other things, complete a thorough due diligence review of the target company or assets and submit a duly completed sponsor report to the TSXV.

Summary

The suitability analysis done by the Nomad on AIM touches on similar issues as those dealt with by the specific listing requirements of Canadian exchanges. Since AIM rules provide no indication as to the

suitable public distribution, net tangible assets, earnings, and working capital, the Nomad makes his own assessment of a company's suitability. Although it is tempting to argue that AIM has a clear-cut advantage over Canadian exchanges in this respect, caution is warranted.[23] Even though they are more precise, the listing requirements of Canadian exchanges offer some flexibility that enables them to respond to the needs of smaller companies. It is doubtful that the financial and asset requirements preclude small companies with a history of earnings from listing. Likewise, although smaller companies tend not to have significant working capital, the working capital requirement may not weigh too heavily on them since they can meet the requirements in several ways. The public distribution requirements allow smaller companies to raise financing through relatively small offerings. Finally, the CPC is seen by some as being responsive to the needs of small companies that need to raise financing on the public markets.[24] It is important not to overstate the contribution of the CPC, however, as its success is debatable in light of the quality and performance of the companies involved. In fact, some have argued that it is not advisable to encourage listing at a precocious stage of development, as the CPC does.[25]

c) Stock Exchange Gatekeepers: The Nominated Advisor and the Sponsor

The Nominated Advisor (Nomad) of the AIM

The Nomad is the hallmark of the AIM, acting as both a gatekeeper and an advisor. It is a gatekeeper in that it is responsible for deciding whether an issuer is suitable for admission. The Nomad acts also as an advisor to the issuer by providing assistance and guidance through the flotation process, as well as after flotation to ensure that it complies with AIM Rules. The Nomad is thus an integral part of AIM's regulatory framework.

The London Stock Exchange has the authority to grant the status of Nomad. In order to obtain approval from the Exchange to act as a Nomad, the applicant must satisfy the following minimum criteria.[26] Firstly, it must be a firm or company. Secondly, it must have practiced corporate finance for two years. Thirdly, it must have acted as the principal corporate finance adviser in three relevant transactions during that two-

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[23] M.J. Robinson, "Raising Equity for Small and Medium-sized Enterprises Using Canada's Public Equity Market, in P.J.N. Halpern, Ed., *Financing Growth in Canada*, Calgary, University of Calgary Press, 1997, p. 607-608 (making a similar point prior to the restructuring of Canadian stock exchanges in 1999).
[24] P. Puri, "Legal and Regional Interests in the Debate on Optimal Securities Regulatory Structure", in A.D. Harris, Ed., *It's Time: Research Studies*, Wise Persons' Committee, 2003, pp. 231-233. See also M.J. Robinson, *ibid.* pp. 611-618.
[25] C. Carpentier et J.-M. Suret, *Bypassing the Financial Growth Cycle: Evidence from Capital Pool Companies*, 2004s-48, Cirano Scientific Series, 2004.
[26] AIM, *Nominated Advisor Eligibility Criteria*, April 2005.

year period. A relevant transaction includes an initial public offering, a take-over bid, and other major corporate transactions for publicly listed companies in the European Union or elsewhere in the world. Finally, the applicant must employ at least four qualified executives. A qualified executive "is a full-time employee of an applicant who is involved in giving corporate finance advice and who has acted in a corporate finance advisory role, which includes the regulation of corporate finance, for at least three years and in at least three relevant transactions".[27]

In addition to these criteria, the Exchange will assess whether the recognition of the applicant as Nomad might endanger the reputation or integrity of AIM. This assessment will involve the consideration of the following elements:

- whether the applicant is adequately regulated;
- the applicant's standing with regulators;
- the applicant's general reputation;
- whether the applicant or its executives have been the subject of adverse disciplinary action by any legal, financial or regulatory authority;
- whether the applicant is facing such disciplinary actions; and
- insofar as it is relevant the commercial and regulatory performance of its clients to whom it has given corporate finance advice.

If the applicant satisfies these requirements, then it is entered on a register of firms authorized to act as Nomads, which is maintained by the Exchange. As of May 2006, there were about 84 Nomads recognized by the Exchange, 55% of which also act as brokers on AIM. Most Nomads are investment banks or corporate finance firms, including major American institutions, such as Credit Suisse, J.P. Morgan, Morgan Stanley, and Merrill Lynch. It is interesting to note that five of the major global accounting firms are also Nomads. As of this date, there is only one Canadian Nomad, Canaccord Adams.

Once it is recognized by the Exchange, the Nomad must respect the ongoing responsibilities set forth in the AIM Rules.[28] At a general level, the Nomad must abide by its responsibilities pursuant to the AIM Rules. Specifically, the Nomad and its executives must be independent from the AIM companies for which it acts. It must not have and must take care to avoid the semblance of a conflict between the

[27] *Ibid*., p. 2.
[28] *AIM Rules for Listed Companies*, Rule 39.

interests of the AIM companies for which it acts and the interests of any other party. At a more technical level, the Nomad must ensure that it continues to meet the minimum eligibility criteria, and that it has proper procedures and records. Finally, it must pay the annual fees as set by the Exchange.

Given the important role that Nomads play in the AIM regulatory framework, the Exchange monitors their performance.[29] The Exchange has the power to conduct a formal review of the Nomad. It also has the power to remove an employee as a qualified executive where the circumstances indicate that the latter can no longer be considered to be qualified. Finally, the Exchange can take disciplinary action against a Nomad where it is in breach of its responsibilities under the eligibility criteria, or has failed to act with due care and skill, or has impaired the reputation and integrity of AIM through its conduct or judgment. In such a case, the Exchange may censure the Nomad, remove it from the register, and/or publish the action it has taken and the reasons for it.

As seen above, the primary function of the Nomad is to assess the suitability of companies seeking to list on AIM. In addition, it is important to emphasize that the Nomad plays a central role in the admission process. The Nomad coordinates the contribution of all professionals involved in the process, identifying their responsibilities and setting up the timeline. The Nomad participates in the drafting of the admission document along with the company and the other professionals. In the latter part of the process, the Nomad oversees the compilation of the various parts of the admission documents. Finally, it drafts and issues the pre-admission statement that must be produced by the company, as well as the formal application documents.

The relationship between the Nomad and the issuer does not end upon the latter's admission to the exchange. The Rules of AIM require that the Nomad maintains an advisory relationship with the issuer. At a general level, the AIM Rules provide that the Nomad must be available at all times to advise and guide the directors of the company about their obligations to ensure compliance on an ongoing basis with these rules.[30] It must liaise with the Exchange where requested to do so by the Exchange or the AIM company, and provide the Exchange with any other information it may reasonably require. Specifically, the Nomad has the responsibility to ensure that the company complies with its continuous disclosure obligations.[31] This responsibility is central to the Nomad's work following admission: "Much of the work

[29] See notes and accompanying text.
[30] *AIM Rules for Listed Companies*, Rule 39.
[31] See also *infra* notes and corresponding text on the continuous disclosure requirements and the role of the Nomad.

[of the Nomad] will involve advising on the need for announcements and on their form and content."[32] Aside from these responsibilities, the Nomad may also furnish advice to companies regarding corporate governance matters not covered in the AIM Rules, such as share option plans or related-party transactions.

In this context, one benefit of the Nomad system could be that it allows for a more tailored approach to disclosure. The Nomad, through its knowledge of the market, arguably has the ability to identify the information that is relevant for investors. This may reduce compliance costs for issuers as they avoid having to disclose information that is of no specific value or interest to investors. Since the Nomad is acting as regulator, this framework can reduce the risk of non-disclosure of important information by issuers for "good reasons". The possibility of issuers being subject to a more tailored disclosure regime could render more attractive the prospect of a continuing relationship with the Nomad.

The Sponsor

A cursory look at the requirements of Canadian stock exchanges may suggest that they provide an equivalent to the Nomad with the sponsor. On the TSX, sponsorship by a participating organization[33] of the TSX is a factor in the consideration of the suitability of an applicant. It is theoretically mandatory for all companies, except for companies listing under the senior issuer criteria[34]. The sponsorship letter purports to give the TSX an assessment of the applicant and evidence of market support for the company's stock. The Participating Organization must also confirm whether the issuer satisfies all the listing requirements and comment on the company's ability to meet its obligations as a Canadian public company. On the TSXV, a sponsorship report produced by a Participating Organization of the exchange is required to be filed by an applicant for listing on the Exchange in connection with any application for a new listing.

The sponsorship requirement is not frequently relied upon, however. It is the practice of the TSX not to require sponsorship for companies that list as part of an initial public offering as the participation of an investment dealers and its liability for prospectus disclosure provides sufficient comfort. Sponsorship is only required in particular circumstances where pointed issues have to be resolved, either with respect to the issuer, its management or its operations. Likewise, the TSXV rules provide that sponsorship is not

[32] C. AAronson, *supra* note 14, p. 34.
[33] Participating Organizations are securities firms that comprise the shareholders of the TSX.
[34] See Appendixes 1, 2 and 3.

required in the case of a listing pursuant to an initial public offering, where the prospectus is executed by at least one member of a Participating Organization. Further, the Exchange may exempt an issuer from all or part of the sponsorship requirements if certain conditions are met[35].

Even if it were more frequently used, the institution of the sponsor would remain quite different from the Nomad. Firstly, the sponsor operates within the detailed framework established by the rules that regulate admission. Thus, it has far less discretion than the Nomad. Secondly, unlike the Nomad, the sponsor is not acting as a representative of the exchange to assess the suitability of companies or to enforce exchange rules. Finally, there is no obligation for a listed company to retain a sponsor following admission.

d) The Costs of Going Public and of Listing

A company seeking to list and raise financing on AIM incurs various expenses. They must pay for the services of professionals involved in the admission and offering processes. They must also pay listing fees with AIM. The following is a standard estimate of the costs provided by one market participant:

- Nomad : £50,000 to 125,000;
- Lawyers: £100,000 (company) and £40,000 (Nomad);
- Accountants: £ 30,000 to 50,000;
- Investor relations: £ 5,000 to 15,000;
- Printing costs: £10,000 to 20,000;
- Road show: £10,000 to 30,000;
- Exchange fees: £4,180

These expenses that total between £250,000 to 380,000 (or $500 000 to $760 000), plus the brokers' commission, typically 8% of the total proceeds of the offering. Thus, if AIM is used to make an offering of £10 million (or $20 million), the direct expenses would range between 10.5% and 12% of gross proceeds.[36]

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[35] See section 3.4 of Policy 2.2 of the TSXV: "Sponsorship and Sponsorship Requirements".
[36] More generally, some have mentioned that totals costs of admission on AIM are of approximately 5 to 12% of the gross proceeds raised. See P. Finlan, "Mining Companies Go Public on the AIM", (2005-2006), 22:2 *Mining Law Monitor* 6, 7.

In Canada, many factors influence the costs of going public and listing, including the exchange on which the listing is sought. One should consider the following costs that may be incurred in connection with a listing: securities commissions fees (depending on the number of jurisdictions in which the issuer is filing a prospectus), sponsor fees, accounting and auditing and legal fees, investment dealers fees, costs associated with printing, transfer agency, investor relations, expert reports, etc.

On the TSX, the costs of listing vary depending on the type of listing i.e. whether a company is seeking a direct listing or a listing concurrently with an initial public offering and on the nature and complexity of the transaction.

With respect to exchange fees, an issuer filing an application for listing on the TSX must pay an initial fee based on the value of the securities to be listed (the "Listing Capitalization")[37] . This initial fee is calculated as follows[38]:

Listing Capitalization	Base Fee	+ Variable Fee Rate
Less than $5M	$10,000	0.130%
$5M to $10M	$16,500	0.125%
$10M to $50M	$22,750	0.120%
$50M to $100M	$70,750	0.115%
More than $100M	$128,250	0.110%
Maximum	$160,000	

The TSXV charges an application fee of $2,000, applied towards the minimum fee payable upon an initial submission for the listing. The total fee payable by an issuer in connection with a new listing, a listing of a resulting issuer in connection with a qualifying transaction or a reverse take-over, cannot exceed $30,000. The fee is calculated as follows: a minimum of $7,500 + 0.5% of deemed value of the shares issued (with a maximum of $30,000). "Deemed value per share" means the value of the share as accepted by the Exchange. This may be the market price, discounted market price or any other price set by the issuer that is acceptable to the Exchange.

[37] The Listing Capitalization is calculated as (i) either the Issue Price per security or the Market Price per security, as applicable, multiplied by (ii) the number of securities to be listed - the number of securities issued and outstanding, together with any securities which have been authorized for issuance for a specific purpose. A non-refundable amount of $10,000 must be submitted at the time of the application and will be applied to the final total fee. The fees do not include the GST, which issuers must remit with the fee payment.

[38] For example, the initial listing fee of an issuer having a listing capitalization of $25M will be : $40,750 [i.e. $22,750 base fee+ $18,000 variable fee (($25,000 - $10,000 (base)) * 0.120%]

The total fee payable by an issuer in connection with the listing of a capital pool company cannot exceed $10,000. It is calculated as follows: a minimum of $5,000 + 0.5% of deemed value of the shares issued (with a maximum of $10,000). All fees are subject to the 6% GST.

The following chart indicates the minimum and maximum fees that a Canadian company will pay to the TSVX in connection with the listing of its securities:

	IPO + Direct Listing	**CPC (including Qualifying Transaction)**	**RTO**
TSXV Listing Fees	$7,500 - $30,000	$12,500 - $40,000	$7,500 - $30,000

Additional filing fees may be charged in connection with the filing of certain documents such as stock option plans.

A recent study in Canada indicates that the direct costs of going public in Canada, excluding capital pools offerings, amount to 9.45% of gross proceeds for offerings of the equivalent of £10 million (or $20 million).[39] In other words, for offerings of similar size, there would not appear to be a cost advantage of going public on AIM.[40]

Surprisingly, where the company relies on the Capital Pool Program, the fees can be significant and concentrate on the Qualifying Transaction. For example a CPC with a minimum capitalization of $300,000 raising $4.7 million as part of its qualifying transaction would incur direct costs of over $700,000, about 15% of gross proceeds.[41]

ii. The Admission Process

The Canadian exchanges and AIM have different admission processes. On AIM, companies can take the standard route which takes about three to six months to complete. This route involves the drafting of an

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[39] M. Kooli & J.-M. Suret, *How Cost-Effective Are Canadian IPO Markets ?,* Cirano Scientific Series, 2002-83, 2002, p. 12.
[40] See also V. Heffernan, "AIM Steps Up Marketing Drive in Canada: Recruiting Efforts Down Under Pay Off for Secondary Market", (2002) 88:8 *The Northern Miner*, 9 (AIM listing is costly).
[41] Lang Michener, *Going Public in Canada*, 2006, p. 18.

admission document that provides extensive information on the company as a prospectus. The admission document is not vetted by exchange authorities. Prior to the official admission date, the company must then disclose a pre-admission document which is basically an announcement of the listing. Alternatively, companies already quoted on recognized stock exchanges can use the fast-track route, which involves a lighter disclosure regime. On Canadian exchanges, the listing process can take between two to three months and involves the production of various documents along with the prospectus, which are actively reviewed by exchanges authorities.

a) Admission Documents

The Admission Document for AIM: Standard Route

Issuers applying for listing on AIM must prepare an admission document to be submitted to exchange authorities. The contents of the admission document are established by the AIM Rules as well as by practice. Although there are few requirements with respect to format, the admission document tends to be structured and formatted in a similar way developed by practitioners.

Following the AIM Rules and market practice, the admission document contains four main parts.[42] The first part deals with non-financial matters and provides a description of the business, the activities, the organization, and the governance of the company. This part also discloses the risk factors relevant to the company. The second part contains the financial information, including historical financial information relating to the company and its subsidiaries for the last three years, and the accountant's report certifying that the historical information shows a true and fair view. It may also contain pro forma financial information if the Nomad considers that it would be useful to underscore the impact of flotation. Where the company operates in a specialized area, such as technology, intellectual property, mining or oil and gas, the professional advisors will usually require an expert's report "to give prospective investors sufficient information on which to base their decision on whether to invest in the company",[43] which will become the third part of the admission document. Fourthly, the back end of the admission document sets out information on matters such as the company's legal structure and share capital, material contracts, material legal proceedings, management-related information, executive compensation, substantial shareholders and related-party transactions. In addition, in this fourth part, the directors make two

[42] C. AAronson, *supra* note 14, p. 30-32.
[43] M. Audley, "The Role of the Corporate Lawyer in an AIM Flotation", in *Joining AIM: A Professional Handbook*, 2005, p. 74

important statements. One deals with the adequacy of the company's working capital and that provides that "in their opinion having made due and careful enquiry, the working capital available to [the company] and its group will be sufficient for its present requirements, that is for at least twelve months from the date of admission". The other is a responsibility statement pursuant to which directors accept responsibility for every statement contained in the admission document. Finally, the company must disclose any other information which it reasonably considers necessary to enable investors to form a full understanding of the assets and liabilities, financial position, profits and losses, and prospects of the company and the rights attaching to the company's securities.

Where the company undertakes fundraising in conjunction with its admission on AIM, it will have to comply with the Prospectus Rules of the Financial Services Authority if it makes an offer to the public. In this case, the prospectus will serve as the admission document. This will entail additional disclosure requirements for the company so that the information provided by the admission document is equivalent to that which would be required in a prospectus. Moreover, the admission document will need to be approved by the UK Listing Authority. However, market participants have pointed out that companies usually make private placements on AIM rather than offers to the public. Where the fundraising does not constitute an offer to the public, the company will be able to use the "standard" admission document to proceed to the placing of its securities. In either case, the admission document serves as a "pathfinder", i.e. the equivalent of a preliminary prospectus, by the brokers to market the securities and assess the level of investors' interest.

At any rate, the admission document is a key document for the company in the listing and fundraising processes. It must thus be prepared with care by the company and its advisors. For directors, this is even more important given that they are responsible for the accuracy of the admission document and for ensuring that there are no material omissions.[44] Further, the Nomad and broker will require that the company and its directors sign a placing or introduction agreement where they will namely give warranties that the contents of the admission document are accurate and not misleading.

As mentioned above, the Nomad manages the admission processes. It assists the company in the drafting of the admission document. It circumscribes the work of the lawyers and of the auditors, and determines

[44] *AIM Rules for Listed Companies*, Rule 31. Where the company produces a prospectus in lieu of the admission document, directors are liable for misrepresentations following the Prospectus Rules. See S. Gleeson & H.S. Bloomenthal, "The Public Offer of Securities in the United Kingdom", (1999) 27 *Denv. J. Int'l L. & Pol'y* 359, 431 ss.

whether additional expertise is required. The lawyers of the company conduct the legal due diligence review, as well as the verification process that seeks to ensure that the admission document is not misleading. The accountants review the company's financial information and assist in the preparation of the financial information to be disclosed. It appears that this verification process "is not dissimilar to the Canadian-style due diligence undertaken by underwriters in connection with prospectus offerings but generally requires a more formal and detailed written analysis of the information in the admission document".[45] Thus, the verification "can be a lengthy and time-consuming exercise".[46]

Once it is completed, the admission document is produced to the exchange authorities. It must be made available publicly, free of charge, for at least one month from the admission of the company's securities.

The Admission Document for AIM: The Fast-track Route for Quoted Issuers

Since 2003, the AIM Rules provide for a fast-track admission procedure for issuers listed on recognized foreign stock exchanges. The purpose of the fast-track route is to "make it easier for smaller growing companies across the world to join AIM" by providing a streamlined admission process.[47]

To use the fast-track route, a company must be a "quoted applicant", that is it must have had its securities traded on an AIM Designated Market for at least 18 months prior to applying to have those securities admitted on AIM. The AIM Designated Markets include namely the "main market" of the Toronto Stock Exchange, which excludes the TSX Venture Exchange. In addition, a company seeking to use the fast-track route must also abide to more technical requirements. Firstly, the company must prepare its financial statements in accordance with the United Kingdom or United States GAAP, or with the International Accounting Standards. Thus, a Canadian issuer has to reconcile its financial statements prepared in accordance with Canadian GAAP with one of these recognized reporting standards prior to admission. Secondly, the company must take appropriate steps to ensure the electronic settlement of its securities.

The most significant advantage of the fast-track route is that the company does not have to produce an admission document. To the extent that it does not make an offer to the public, the company need only to

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[45] Stikeman Elliott, *Aiming High : Listing on London's Alternative Market*, May 2004, p. 2.
[46] *Ibid*., p. 2.
[47] London Stock Exchange, "AIM : the most successful growth market in the world", in *Joining AIM: A Professional Handbook*, 2005, p. 14.

make a pre-admission announcement that will provide the Exchange with the information required by the AIM Rules, and that will disseminated to the public. As seen below, the pre-admission document prepared by companies following the fast-track route is more detailed than for companies admitted following the standard route. Still, the fast-track route reduces the length of the admission process significantly to about four to six weeks, compared with three to six months for the standard route.[48]

AIM: The Pre-Admission Document

Companies following the standard route must provide the Exchange with a pre-admission document at least ten business days prior to the expected date of admission to AIM. The pre-admission document is a straightforward document that discloses basic information about the company, such as its business, its directors and important shareholders, and the securities in respect of which it seeks admission.

For companies that use the fast-track route, the pre-admission document will contain additional information that respects the detailed content requirements set out in the Schedule One of the AIM Rules, including:

- confirmation that it has adhered to any legal and regulatory requirements involved in having its securities on the AIM Designated Market;
- details of its intended strategy following admission;
- a description of any significant change in financial or tradition position of the company since the end of the last financial period for which audited statements have been published;
- a statement that the directors have no reason to believe that the working capital available to the company will be insufficient for at least twelve months from the date of admission; and
- the rights attaching to, and the arrangements for settling transactions in, the securities being admitted.

Most importantly, beyond these specific requirements, the Schedule provides that a quoted applicant must disclose information equivalent to that required for an admission document which is not currently public. Although this may seem to be a broad provision that significantly diminishes the advantages of the fast-track option, this requirement may be satisfied by making this information available publicly at an address in the United Kingdom or a web-site address accessible to users in the United Kingdom. Thus, the

[48] Stikeman Elliott, *supra* note 45, p. 3.

company does not have to assemble all this information into an admission document, and the pre-admission document will be substantially shorter than the latter.

AIM: The Listing Application Document

Any company seeking to list on AIM, including those joining through the fast-track process, must submit an application form at least three business days prior to the expected date of admission to the Exchange. The application form is a short document that provides basic information on the company, as well as a declaration of undertakings with respect namely to compliance with the AIM Rules. Where the company is using the fast-track route, it must also submit an electronic version of its latest report and accounts. In any case, the application form must be accompanied by the Nomad's declaration which includes confirmation of the responsibilities of the Nomad as set out in the AIM Rules.

Disclosure Documents on Canadian Exchanges: The Toronto Stock Exchange

The first step of the application process requires an applicant company to submit to the Exchange a listing application form duly completed as well as all supporting documents.[49] The listing application form is divided into sections that address similar subjects as those dealt with in the AIM admission document: background on the company, capitalization and share distribution, geological/engineering (natural resource companies), investments and properties (industrial companies), trading information, trading history, other information, and a certificate of the company. The exhaustive list of documents to be filed with the listing application form is set out in **Appendix 4**. However, where a company applies for the listing of securities to be issued concurrently with a prospectus offering, the company may, prior to filing the listing application form, request that the Exchange conditionally approve the listing prior to the public offering. Copies of the preliminary prospectus[50] must then be filed with the TSX for this purpose, together with complete personal information forms. Such conditional approval is subject to the following conditions: (i) there are no material changes in the final prospectus to the information disclosed in the preliminary prospectus; and (ii) all other required documentation (see **Appendix 4**) and evidence of satisfactory distribution of the securities are filed with the Exchange within ninety days.

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[49] The Exchange recommends that prospective applicants obtain a preliminary opinion as to the eligibility of listing. The Exchange may provide a confidential opinion based on informal discussions and a review of the applicant's recent financial and business information.

[50] In the case, of a natural resource company, the preliminary prospectus must be accompanied by the requisite engineer's or geologist's reports.

Following the receipt of an original listing application form, the TSX notifies the applicant within five business days, as to whether all the required documentation to complete an assessment has been submitted in an acceptable form. Should the documentation submitted be incomplete, the applicant has seventy-five days to submit any outstanding document, failing which, its application is deemed withdrawn.

Disclosure Documents on Canadian Exchanges: The Venture Exchange

The issuer must first file the complete documentation required by section 1.1 of Policy 2.3. A complete description of the required documentation is reproduced in **Appendix 7.** Upon receipt of the initial submission, the TSXV may require the issuer to respond to any questions or comments or to submit additional documentation that the Exchange considers appropriate. When an application is made concurrently with a prospectus offering, the issuer shall file copies of all correspondence with the applicable securities commissions.

b) Admission to Trading on AIM and Canadian Exchanges

On AIM, admission will become effective when the Exchange issues a dealing notice to that effect following the process described above. Theoretically, the Exchange has the discretion to assess the applicant's suitability for AIM. The AIM Rules provide that the Exchange may make the admission subject to a special condition. Moreover, where there are reasons to doubt the applicant's appropriateness, the Exchange may delay the admission and require further due diligence. Ultimately, it may refuse admission if the applicant does not comply with any special condition imposed, or if the applicant's situation is such that admission would be detrimental to the orderly operation or reputation of AIM. However, this power is rarely used by exchange authorities in practice.

In comparison with AIM, Canadian exchanges play a more active role in the review of applications and in the admission of the securities to trading. When the TSX is satisfied that the application documentation is in order,[51] the application is submitted to the Exchange's Listings Committee. The Listings Committee may require additional information in order to clarify certain areas of the applications. It may also consult the TSX Listings Advisory Committee, which is comprised of securities industry actors.

[51] Following the receipt of an original listing application form, the TSX notifies the applicant within five business days, as to whether all the required documentation to complete an assessment has been submitted in an acceptable form. Should the documentation submitted be incomplete, the applicant has seventy-five days to submit any outstanding document, failing which, its application is deemed withdrawn.

Following completion of the assessment, the Exchange will either: (i) grant conditional approval (subject to meeting conditions within a ninety-day period); (ii) defer its approval pending resolution of specified issues to the satisfaction of the Exchange; or (iii) decline the application[52]. Such decision is generally rendered within sixty days from the date of receipt of complete documentation. Once the listing has been approved, the posting of the securities for trading may take place shortly thereafter but, as a general rule, not more than ninety days after approval of the application.

iii. Ongoing Obligations of Listed Issuers

Once approval has been given for its securities to be listed on the TSX or TSXV, an issuer becomes a reporting issuer in one or more provinces and/or territories of Canada and must fulfil a number of requirements on a continuing basis in order to maintain its listing privilege. Those requirements primarily arise from the TSX *Company Manual* or TSXV Corporate Finance Manual and Policies, as applicable, instruments of the Canadian Securities Administrators, including Multilateral Instrument 51-102 – *Continuous Disclosure Obligations* (MI 51-102), and the applicable Canadian securities statutes and regulations. Unless otherwise indicated, the rules discussed below apply to Canadian companies listed on either the TSX or TSXV.

Likewise, once admitted, AIM companies are subject to continuing obligations in order to retain their AIM quote. The Disclosure Rules of the United Kingdom Listing Authority, to which companies listed on the London Stock Exchange's Main Market are subject, do not apply to AIM companies. Instead, the main body of rules that governs the ongoing obligations of AIM companies is set out in the AIM Rules, which generally impose fewer and less onerous obligations than the LSE's Main Market rules or the rules of other main markets such as the TSX and TSXV. A key difference between AIM and other markets is that rather than being regulated directly by a securities regulator, AIM companies are supervised by a Nominated advisor.

Ongoing obligations of listed issuers are varied in nature and, for the purpose hereof, have been classified in four categories (despite some overlap amongst categories).

[52] At least six months must pass before the applicant becomes eligible for reconsideration.

a) Disclosure Obligations

Timely Disclosure of Price Sensitive Information

Canadian exchanges and AIM both impose timely disclosure obligations to ensure that investors remain informed of all price sensitive information.

In Canada, every reporting issuer must, upon the occurrence of a material change[53] in its affairs, issue and file a press release and as soon as practicable but in any event, within ten days of the occurrence of such material change, file a material change report in prescribed form.[54] In addition, TSX- and TSXV-listed issuers are required to disclose, through press releases[55], "material information" concerning their business and affairs forthwith upon the information becoming known to management or forthwith upon it becoming apparent that the information is material.[56] The TSX considers material information as any information relating to the business and affairs of a company that results in or would reasonably be expected to result in significant change in the market price or value of the company's listed securities. The Exchange also considers that "material information" is a broader concept than "material change", as it consists of both material facts and material changes. In addition to material information, trading on the Exchange is sometimes affected by rumors and speculation. Where this is the case, the Exchange[57] may require that an announcement be made by the issuer to confirm whether or not such rumors and speculation are factual[58]. In restricted circumstances, disclosure of material information may be delayed and kept confidential temporarily where immediate release of the information would be unduly detrimental to the interests of the company[59]. When an issuer intends to release material information, the Exchange must be advised of its content and supplied with a copy of the news release in advance[60].

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[53] Generally, a material change is a change in the business, operations or capital of an issuer that would be reasonably be expected to have a significant effect on the market price or value of any of the issuer's securities (or a decision to implement such change by the issuer).
[54] Section 7.1, MI 51-102.
[55] TSX and TSXV guidelines require that news releases be transmitted to the media by the quickest possible method and by one that provides the widest simultaneous dissemination possible.
[56] Section 408, TSX *Company Manual* and TSVX Policy 3.3 – *Timely Disclosure*. In addition to the TSX and TSXV guidelines, National Policy 51-201 *Disclosure Standards*, developed by the Canadian Securities Administrators, provides guidance for all public companies on "best disclosure" practices. The policy recommendations help companies avoid selective disclosure of material corporate information.
[57] Since March 1, 2001, the TSXV has retained Market Regulation Services Inc. to act as its agent in connection with the monitoring of issuers' timely and continuous disclosure.
[58] Section 414, TSX *Company Manual* and Section 2.1, TSVX Policy 3.3 – *Timely Disclosure*.
[59] Sections 423.1-423.3, TSX *Company Manual* and Section 9, TSVX Policy 3.3 – *Timely Disclosure*.
[60] Section 416, TSX *Company Manual* and Section 4, TSVX Policy 3.3 – *Timely Disclosure*.

Trading of the issuer's securities may be halted upon the release of material information during normal trading hours[61].

Similarly, the AIM Rules require that an AIM-listed issuer disclose, without delay[62], through a Regulation Information Service ("RIS")[63], any new developments which are not public knowledge concerning a change in its financial condition, its sphere of activity, the performance of its business or its expectation of performance, which, if made public, would be likely to lead to a substantial movement in the price of its securities[64]. As a general principle, reasonable care must be taken to ensure that any information so disclosed is not misleading, false or deceptive or does not contain material omissions[65]. The AIM Rules also expressly require that specific events or developments be promptly notified.[66] Where it is proposed to announce information at any meeting of shareholders that might lead to substantial movement in the price of those securities, arrangements must be made for public disclosure of that information through RIS so that the disclosure at the meeting is made no earlier than the time at which the information is publicly disseminated.

Ultimately, the disclosure obligations of AIM and Canadian exchanges reviewed above require that listed companies provide to investors all material information in a timely fashion. While the wording of the obligations may somewhat differ, there are no significant differences in this respect between the two regulatory regimes.

Corporate Transactions

The AIM Rules specifically require notification[67] of certain corporate transactions, such as: substantial

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[61] Section 420, TSX *Company Manual* and Section 7, TSVX Policy 3.3 – *Timely Disclosure*.
[62] No later than the moment the information is published elsewhere.
[63] A wire service approved by the LSE for the distribution to the public of AIM announcements and included within the list maintained on the LSE's website.
[64] *AIM Rules*, Rule 10.
[65] *AIM Rules*, Rule 10.
[66] *AIM Rules*, Rule 17.
[67] "Notification" is defined in the AIM Rules as the public disclosure of information through an RIS.

transactions,[68] related-party transactions,[69] reverse take-overs,[70] and disposals resulting in fundamental changes of business.[71] As a general rule applicable to all of the above-listed transactions, disclosure must include: (i) particulars of the transaction, including the name of any company or business, where relevant; (ii) a description of the business carried on by, or using, the assets which are the subject of the transaction; (iii) the full consideration and how it is being satisfied; (iv) the effect on the issuer; and (v) any other information necessary to enable investors to evaluate the effect of the transaction upon the issuer.

Companies engaged in one of those operations must provide specific information that supplements the general disclosure requirement. Thus, in the case of related-party transactions, disclosure required in connection with a related-party transaction must also include (i) the name of the related party concerned and the nature and extent of their interest in the transaction; and (ii) a statement that with the exception of any director who is involved in the transaction as a related party, its directors consider, having consulted with its Nomad, that the terms of the transaction are fair and reasonable insofar as its shareholders are concerned[72]. Notification made in connection with an RTO must contain the above-noted general information and the information required for related-party transactions, insofar at it qualifies as such. Finally, any agreement that would effect a disposal resulting in a fundamental change of business must be disclosed along with the above-mentioned general transaction information and, as the case may be, the information required for related-party transactions.

The comparison of AIM disclosure obligations with Canadian obligations is not easy. At first glance, it may appear that the AIM Rules impose more stringent disclosure requirements. Indeed, a cursory reading

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[68] A substantial transaction is one which exceeds 10% in any of the class tests (as such tests are defined in Schedule 3 of the AIM Rules). The class tests are defined in Schedule 3 of the AIM Rules. They are: the Gross Asset Test (gross assets subject of the transaction / gross assets of the AIM company X 100), the Profit Test (profit attributable to the assets subject of the transaction / profit of the AIM company X 100), the Turnover Test (turnover attributable to the assets subject of the transaction/turnover of the AIM company X 100), the Consideration Test (consideration / aggregate market value of the ordinary shares (excluding treasury shares) of the AIM company X 100) and the Gross Capital Test (gross capital of the company or business being acquired / gross capital of the AIM company X 100).

[69] A related-party transaction means any transaction whatsoever with a related party which exceeds 5% in any of the class tests.

[70] A reverse take-over is a transaction where any of the ratios relating to defined class tests exceed 100% or where there is a fundamental change in business, board or voting control of the company

[71] Any disposal by an AIM company which, when aggregated with any other disposal or disposals over the previous twelve months, exceeds 75% in any of the class tests**,** is deemed to be a disposal resulting in a fundamental change of business.

[72] *AIM Rules*, Rule 13.

of Canadian regulation indicates that it is only where an issuer completes a "significant acquisition"[73] of a business or related business that it is subject to disclosure obligations. Pursuant to the significant acquisition disclosure obligations, the issuer must, subject to certain exceptions, file with the relevant securities regulatory authorities, a business acquisition report ("BAR") containing prescribed information within seventy-five days of the significant acquisition[74]. The required information contained in the BAR, in some cases may include, among other things, annual, interim and/or pro forma financial information.[75]

However, to have a complete picture of disclosure obligations, it is important to emphasize that security holder approval may be required in connection with a significant transaction either pursuant to Canadian corporate and securities statutes or stock exchange rules. Security holder approval will trigger additional disclosure obligation for the company under the proxy regime. Further, related-party transactions, reverse take-over bids and fundamental changes are specifically regulated either by corporate law, securities regulation or stock exchange rules.[76] Regulation imposes a shareholder approval requirement as well as specific disclosure obligations for those operations.

Periodic Reporting

Companies listed on a Canadian exchange are subject to extensive periodic disclosure obligations set out by securities regulation. The obligations establish requirements concerning the information that must be disclosed annually and quarterly.

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[73] Generally, an acquisition of a business or related businesses is a "significant acquisition" for a public company with securities listed on the TSX if the acquisition results in any of the following: (a) the reporting issuer's proportionate share of the consolidated assets of the business or related businesses exceeds 20% of the consolidated assets of the reporting issuer; (b) the reporting issuer's consolidated investments in and advances to the business or related businesses as at the date of the acquisition exceeds 20% of the consolidated assets of the reporting issuer as at the last day of the most recently completed financial year of the reporting issuer ended before the date of the acquisition; or (c) the reporting issuer's proportionate share of the consolidated income from continuing operations of the business or the related businesses exceeds 20% of the consolidated income from continuing operations of the reporting issuer. However, an acquisition of a business or related businesses is a "significant acquisition" for a public company with securities listed on the TSXV only if the any of the three above significance tests is satisfied using a 40% threshold rather than a 20% threshold; Section 8.3, MI 51-102.

[74] Section 8.2, MI 51-102.

[75] A company is exempt from filing a BAR if it has, in connection with the significant acquisition, filed an information circular or a filing statement prepared in accordance with the rules of the TSXV if (i) such disclosure document contains the information and financial statements that would be required by a BAR; (ii) the date of the acquisition is within nine (9) months of the date of the information circular or filing statement; and (iii) there has been no material change to the terms of the acquisition from those disclosed in the information circular or filing statement. Section 8.1(2), MI 51-102. A CPC that files an information circular in connection with a Qualifying Transaction is also exempt from filing a BAR.

[76] See, e.g., *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, ss. 173 ss.; *OSC Rule 61-501 Insider Bids, Issuer Bids, Business Combinations and Related-Party Transactions*. See infra notes and accompanying text.

On an annual basis, companies must file (and send to security holders who request them[77]) with the applicable securities commissions as well as with the applicable stock exchanges, audited annual financial statements prepared in accordance with Canadian GAAP and containing comparative information for the immediately preceding financial year.[78] They must also file a management's discussion and analysis relating to its annual financial statements.[79] A company with securities listed on the TSX must also file an Annual Information Form (AIF) relating to its most recently completed financial year.[80] The AIF is a prospectus-like document that seeks to provide background information that is essential to a proper understanding of the nature of an issuer and its operations and prospects. A TSXV-listed company is not required to file an AIF[81] (although it may choose to do so for a variety of reasons). Where the company produces an annual report, it must be filed with the relevant securities commissions and stock exchanges through SEDAR.[82]

On a quarterly basis, Canadian-listed companies must file (and send to security holders who request them[83]) interim financial statements containing comparative information for the interim period in the immediately preceding financial year as well as an MD&A relating to the relevant interim financial statements[84].

In addition, recent amendments to securities regulation impose certification obligations to the companies' chief executive officer (CEO) and chief financial officer (CFO). Specifically, companies are required to file separately but concurrently with the filing of their annual and interim financial statements a certificate signed by each of its CEO and CFO who must certify the integrity of the information disclosed, and that

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[77] Section 4.6 of MI 51-102 requires that an issuer annually sends a request form to the registered holders and beneficial owners (applying the procedures set out in National Instrument 54-101 – *Communication with Beneficial Owners of Securities of a Reporting Issuer*) of its securities that they may use to request a copy of the issuer's annual financial statements and MD&A and the interim financial statements and related MD&As.
[78] Section 4, MI 51-102; Section 436, TSX *Company Manual* and Section 1, TSXV Corporate Finance Manual and Policies. For issuer that has its securities listed on the TSX, the filing deadline is the earlier of ninety days following its financial year-end and the date on which it files its annual information form. For an issuer that has securities listed on the TSVX only, the filing deadline is 120 days following its financial year-end.
[79] Section 5, MI 51-102; Section 437, TSX *Company Manual* and Section 1, TSXV Corporate Finance Manual and Policies.
[80] Sections 6.1 and 6.2, MI 51-102.
[81] Section 6.1, MI 51-102.
[82] Section 437, TSX *Company Manual*.
[83] See Note 28 above.
[84] Section 4.3, MI 51-102; Section 437, TSX *Company Manual* and Section 1, TSXV Policy 3.2 – Filing Requirements and Continuous Disclosure. If the issuer has securities listed on the TSX, the filing deadline is 45 days following the end of the interim period and if the issuer has securities listed only on the TSVX, the filing deadline is 60 days following the end of the interim period.

they have responsibility for the disclosure controls and procedures and internal control over financial reporting of the issuer.[85]

AIM Rules impose less stringent disclosure requirements than Canadian securities regulation. An AIM-listed company must issue its annual audited accounts as soon as possible after they have been approved but no later than six months after its financial year-end.[86] The AIM Rules mandate that the annual accounts be prepared in accordance with UK GAAP, US GAAP or International Accounting Standards (IAS). It acceptable to provide accounts prepared in accordance with other accounting principles as long as they contain notes reconciling the differences between such principles and either UK GAAP, US GAAP or IAS.[87] Other than the requirement to file annual accounts and half-yearly reports, an AIM company is not currently subject to any annual filing requirements such as annual information forms, management's discussion and analysis and annual reports.

With respect to interim disclosure requirements, in contrast with Canadian listed companies, AIM-listed companies must only establish a half-yearly report on the six-month period from the end of the financial period for which financial information has been disclosed in its admission document and at least every subsequent six months thereafter (apart from the final six-month period preceding its accounting reference date for its annual accounts) within three months of the end of the period. The half-yearly report must be presented and prepared in a form consistent with that which will be adopted in the company's annual accounts in line with accounting standards for such annual accounts.[88]

Finally, it is important to note that there are no certification requirements for the CEOs and CFOs of AIM companies.

Shareholders' Meetings and Communications

In Canada, securities regulation and exchange rules govern to some extent shareholder meetings and communications. A TSX-listed issuer is required to hold an annual general meeting of security holders

[85] Multilateral Instrument 52-109 - *Certification of Disclosure in Issuers' Annual and Interim Filings.*
[86] *AIM Rules*, Rule 19.
[87] However, note that AIM intends to mandate IAS for all AIM companies for financial years commencing on or after January 1st, 2007.
[88] *AIM Rules*, Rule 18.

within six months of its financial year-end[89]. The management of a Canadian reporting issuer must send to both registered and beneficial[90] security holders from whom they solicit proxies a management information circular containing prescribed information prior to the said meeting and file[91] with the securities commissions and stock exchanges copies of the management circular, forms of proxy, notices of meeting and all other material required to be sent in conjunction with the meeting.[92] If a certain matter is to be submitted to security holders for approval and also requires the prior acceptance of the Exchange, the acceptance of the Exchange should be obtained prior to the mailing of the meeting materials to the security holders.[93]

Again, the AIM Rules are not very demanding as they require only that any document sent by a company to its shareholders must be available to the public at the same time for at least one month, free of charge, at an address announced to RIS.[94]

b) Legal and Illegal Insider Trading

Insider Reports

Canadian securities regulation imposes strict reporting requirements to insiders. Insiders of a public company must file insider reports which contain prescribed information concerning trading and ownership of securities of the company.[95] An initial insider report must be filed within ten days of a person becoming an insider of the company indicating the position held by the insider and disclosing any direct or indirect beneficial ownership, control or direction over securities of the companies.[96] A subsequent insider report must be filed within ten days of any subsequent change in the beneficial

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[89] Section 464, TSX *Company Manual*. A TSXV-listed issuer is required to hold its annual meeting of security holders every year and not more than fifteen (15) months after its last annual meeting of security holders, Section 3.1, TSXV Policy 3.2 – *Filing Requirements and Continuous Disclosure*.
[90] In compliance with the provisions of National Instrument 54-101 – *Communications with Beneficial Owners of Securities of a Reporting Issuer*.
[91] A filing via SEDAR is satisfactory to the Exchange.
[92] Section 9, MI 51-102; Sections 456 TSX *Company Manual* and Sections 3.2 and 3.4, TSXV Policy 3.2 – *Filing Requirements and Continuous Disclosure*.
[93] Section 463, TSX *Company Manual*; Section 3.5, TSXV Policy 3.2 – *Filing Requirements and Continuous Disclosure*.
[94] *AIM Rules*, Rule 20. An electronic copy of the document must be sent to the LSE
[95] Insiders include directors or senior officers and holders of more than 10% of the voting rights attached to all outstanding voting securities of the company, as well as directors and senior officers of any corporate shareholder holding more than 10% of the voting rights attached to all outstanding voting securities of the company; Section 1, Ontario Securities Act.
[96] *Ontario Securities Act*, Section 107 (1).

ownership, control or direction of the insider's holding of securities of the company stating both the change in holdings and the resulting ownership or control position.[97]

Further, pursuant to early-warning regulation, any person or entity that acquires the voting or equity securities of any class (or securities convertible into voting or equity securities of any class) of a public company that, together with its securities of that class, constitute 10% or more of the outstanding securities of that class must disclose its holdings immediately by issuing and filing a press release, and within two business days by filing an early-warning report.[98] In addition, each time such a person or entity acquires an additional 2% of the outstanding securities of the same class, it must disclose its holdings immediately by issuing and filing a press release, and within two business days by filing an early-warning report[99].

Insider reporting obligations are much lighter on AIM. Pursuant to this regime, companies are obligated to notify the market as soon as they become aware of trading by directors.[100] Generally, the Nomad will require that the company adopt an insider trading policy that compels directors to notify as soon as they trade in the securities. Also, the company must notify without delay whenever it becomes aware of any trade made by any shareholder holding at least three percent of the total voting rights in the company where the trade results in an increase or decrease of such holdings through any single percentage.[101]

To summarize, AIM rules do not impose direct reporting obligations to insiders as is the case in Canada, nor do they impose early-warning disclosure requirements. It is only through the oversight made by the company that insider trading may be disclosed to investors. When the company detects trading, reporting must however be done without delay, unlike under Canadian regulation where there is a delay of ten days.

Insider Trading and Tipping

Insiders of a Canadian public company (and other persons who are in a special relationship with such company) are prohibited from: (i) trading in the securities of the company with knowledge of a material fact or a material change with respect to the company and not yet publicly disclosed (commonly referred

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[97] *Ontario Securities Act*, Section 107 (2).
[98] *Ontario Securities Act*, Section 101 ss.
[99] See National Instrument 62-103 – *The Early Warning Report System and Related Take-Over Bid and Insider Reporting Issues.*
[100] *AIM Rules*, Rule 17.
[101] *AIM Rules*, Rule 17.

to as "insider trading"); and (ii) informing another person or company, other than in the ordinary course of business, of a material fact or a material change with respect to the company before the information has been generally disclosed (commonly know as "tipping").[102] The TSX and the Canadian Securities Administrators also suggest that issuers address employee trading blackouts in written company policies.

Pursuant to AIM Rules, securities of a listed company may not be traded by its directors or "applicable employees" during a trading "closed period".[103] In this context, "applicable employees" are those employees likely to be in possession of unpublished price-sensitive information in relation to the company because of their employment with the company, a parent company or a subsidiary. In addition to any period when the AIM company is in possession of unpublished price-sensitive information (or where it is reasonably probable that such information will be required to be publicly disclosed), a closed period includes:

- the period of two months immediately preceding the preliminary announcement of the company's annual results (or, if shorter, the period from the relevant financial year-end up to and including the time of announcement);
- if it reports only half-yearly, the period of two months immediately preceding the notification of its half-yearly report or, if shorter, the period from the relevant financial period end up to and including the time of the notification; and
- if the company reports on a quarterly basis like TSX-listed companies, the period of one month immediately preceding the announcement of the quarterly results (or, if shorter, the period from the relevant financial period-end up to and including the time of the announcement).

The LSE may permit the sale of securities by a director or applicable employee during a closed period only to alleviate a severe personal hardship. Nomads will generally insist that an AIM company adopt an insider-trading policy to comply with the above.

Insiders of AIM-listed companies are subject to the insider trading prohibitions under English law. Insider trading in the UK is a criminal offence.[104] Generally, it is illegal for anyone who purchase or sell or otherwise deal in securities of any public company with knowledge of price sensitive information relating to the securities of that company affecting that company that has not been publicly disclosed or published

[102] *Ontario Securities Act*, Section 76.
[103] *AIM Rules*, Rule 21.
[104] *Criminal Justice Act 1993*.

through the prescribed channels. It is also illegal for anyone to inform any other person of non-public price sensitive information. Therefore, personnel of a company with knowledge of confidential or price sensitive information about the company, or its subsidiaries, its joint ventures, or third parties in negotiations of material potential transactions, are prohibited from trading or dealing in securities of that company or of any such third party until the information has been fully disclosed.

c) Corporate Governance

General Governance Requirements

In Canada, public companies are subject to a number of corporate governance requirements that arise namely from National Instrument 58-201 – *Corporate Governance Guidelines* (the "Governance Policy"), National Policy 58-101 – *Disclosure of Corporate Governance* and Multilateral Instrument 52-110 – *Audit Committees.*

Amongst the salient requirements, listed issuers are required to describe in their management information circular certain aspect of their corporate governance practices. If those practices are not consistent with the Governance Policy, the disclosure must include an explanation of the practices the board has put in place. Although more modest disclosure requirements are imposed on TSXV-listed issuers, Tier 1 issuers must disclose their governance practices using the disclosure requirements that apply to TSX-listed issuers. The Governance Policy recommends best practices with respect to the role, independence and effectiveness of the board of directors, the nomination of directors, and executive compensation. In addition, if any issuer has a written code of business conduct and ethics, it must file a copy of the code and any amendments to it on SEDAR no later than the date on which its next financial statements must be filed under applicable securities laws.

Listed issuers are subject to audit committee composition and financial literacy requirements and disclosure obligations in respect of their audit committees in their AIF and management information circulars.[105] Note that audit committee composition requirements are slightly different for a TSXV-listed issuer. Audit committees are required to have a written charter that sets out their mandate and responsibilities.

[105] Multilateral Instrument 52-110 – *Audit Committees* ("MI 52-110"). All members of an audit committee must be independent and financially literate.

The AIM Rules do not specifically cover issues of corporate governance[106]. Unlike TSX- or TSXV-listed companies, AIM companies are not required to have audit, nominating or compensation committees of the board of directors. The AIM does not even require independent directors. However, companies will often ask their Nomad for advice on corporate governance or other issues that are not specifically covered in the AIM Rules. It is indeed one of the Nomad's duties to advise on what is appropriate from the perspective of corporate governance and what is necessary to protect the market's reputation.

The corporate governance arrangements of AIM companies have not been the subject of detailed studies. A notable exception is the work of Mallin and Ow-Yong[107] which is now somewhat dated. Their study of AIM companies based on admission documents revealed that corporate governance arrangements were affected by two factors: whether the Nomad was also the broker and whether the company raised new capital on admission. A salient finding of the study is that when one of these factors is present companies had "better" corporate governance arrangements. Specifically, a higher proportion of those companies had audit and compensation committees, and disclosed their corporate governance policies in their admission document. The results suggest that companies raising new capital improve their governance arrangements to get a better valuation. In this respect, they support the enabling approach to corporate governance. More puzzling is the fact that the Nomads appear to impose governance arrangements of "higher quality" where they also act as brokers. It is unclear why the Nomads would be stricter on this issue.

Despite the absence of specific corporate governance requirements, the AIM Rules require that AIM companies ensure that its directors accept full responsibility, collectively and individually, for its compliance with the rules; disclose without delay all information that needs to be disclosed in accordance with the Rules insofar as that information is known to the director or could with reasonable diligence be ascertained by the director; and seek advice from their Nomad regarding compliance with these rules whenever appropriate and take that advice into account[108].

Finally, note that the Quoted Company Alliance which represents small and medium-sized enterprises listed on AIM has recommended that AIM-listed companies provide disclosure of their corporate governance practices, even though the Combined Code does not apply to them.[109] This recommendation

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[106] The Combined Code on Corporate Governance does not apply to AIM companies.
[107] C. Mallin & K. Ow-Yong, "Corporate Governance in Small Companies – the Alternative Investment Market", (1998) 6 *Corporate Governance: An International Review* 224.
[108] *AIM Rules*, Rule 31.
[109] Quoted Companies Alliance, *Launch of QCA Corporate Governance Guidelines for AIM Listed Companies*, 13 July 2005.

purports to respond to requirements of institutional investors by setting the governance of AIM companies at a higher level. The guidelines cover similar issues as the Combined Code and as NP 58-201. They require that companies publish a corporate governance statement annually that describes how they achieve good governance.

Operations Subject to Shareholder Approval or Exchange Oversight

Canadian exchange rules impose various controls over certain operations conducted by listed companies to ensure the protection of investors. As seen below, AIM Rules do not provide for similar requirements.

TSX- and TSXV-listed issuers must obtain exchange approval for any transaction involving the issuance or potential issuance of securities[110]. The TSX generally requires security holder approval as a condition of acceptance if the transaction materially affects control of the listed issuer or if it provides consideration to insiders in aggregate of 10% or greater of the market capitalization of the listed issuer and has not been negotiated at arm's length[111]. The TSX also requires that security holder approval be obtained in connection with certain private placements of securities where the securities are issued below market price or are issued to insiders[112].

Changes in the capital structure of a listed issuer generally require the prior approval of the TSX or TSXV, as applicable, and in certain circumstances, security holder approval. Those changes include: any transaction involving securities issuances[113], such as a private placements or prospectus distributions[114]; issuance of securities as full or partial consideration for an acquisition of property[115]; stock consolidation[116]; security reclassification[117]; rights offerings[118]; security-based compensation arrangements[119]; and shareholder rights plans[120]. In addition, an issuer must inform the Exchange of any take-over bid or issuer bid on any of its securities and of any sales of its securities from a control block.

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[110] Section 602, TSX *Company Manual*; Section 5.1, TSXV Policy 3.2 – *Filing Requirements and Continuous Disclosure.*
[111] Section 604, TSX *Company Manual*.
[112] Section 607, TSX *Company Manual*.
[113] Sections 602 and 604 TSX *Company Manual*, Section 5.1, TSXV Policy 3.2 – *Filing Requirements and Continuous Disclosure.*
[114] Section 606, TSX *Company Manual*.
[115] Section 611, TSX *Company Manual*.
[116] Section 621, TSX *Company Manual*.
[117] Section 9, TSXV Policy 3.2 – *Filing Requirements and Continuous Disclosure.*
[118] Section 614, TSX *Company Manual*.
[119] Section 613, TSX *Company Manual*.
[120] Section 634, TSX *Company Manual.*

A TSXV-listed issuer must not agree to be party to a change of control or change in management or any transactions that may reasonably be expected to result in a change of control or change in management unless the agreement is approved by the TSXV[121]. Minority shareholder approval in connection with certain transactions is required under certain circumstances pursuant to Ontario Securities Commission Rule 61-501 – *Insider Bids, Issuer Bids, Business Combinations and Related-Party Transactions*. As mentioned above, in this case, issuers must provide additional information to investors to allow them to evaluate the operation they are called upon to approve.

Companies must also inform the Exchange when they declare a dividend as well as when they undertake charter amendments.[122] In this case, they must require having the amendment approved by the Exchange. Listed issuers must inform the Exchange using appropriate reporting forms of any change in the general company information, officers and directors, principal business, investors relation contact, etc.

Finally, TSXV-listed issuers must continue to meet minimum standards, called tier maintenance requirements, to remain listed on TSX Venture Exchange. These requirements relate to the company's financial situation, activity and shareholder distribution.

AIM Rules regulate less closely the operations described above. Shareholder approval is required when the company undertakes a reverse take-over, and a disposal that results in fundamental change in the business. AIM requires that it be informed of any notification of the timetable for any proposed action affecting the rights of the existing shareholders of an AIM-listed company.[123] Any amendments to the timetable proposed by the AIM-listed company, including amendment to the publication details of a notification, must be immediately disclosed to AIM.[124]

d) Costs of Maintaining a Listing

On AIM, listed companies must pay an annual fee of £4,180 ($8,360). A pro-rata annual fee is payable by new applicants, no later than three business days prior to admission to trading. In addition, the company must retain a Nomad throughout the year, and this requirement entails a cost of £30,000 to

[121] Section 6, TSXV Policy 3.2 – *Filing Requirements and Continuous Disclosure.*
[122] Section 428, 467, TSX *Company Manual*; Section 9, 11.2, TSXV Policy 3.2 – *Filing Requirements and Continuous Disclosure.*
[123] *AIM Rules*, Rule 24.
[124] *AIM Rules*, Rule 25.

£75,000 ($60,000 to $150,000) according to market participants consulted. Legal fees are arguably rather marginal given the role played by the Nomad.

The costs of maintaining a listing on Canadian exchanges is less straightforward because the fees vary with market capitalization. The following chart indicates the sustaining fees payable annually by all issuers for maintaining a listing on the TSX. Such fees are charged the first week of February and are charged on a pro-rata basis at the time of listing for those issuers that list on the exchange during the year.

Market Capitalization	**Base Fee**	**+ Variable Fee Rate**
Less than $100M	$10,000	0.0080%
$100M to $500M	$18,000	0.0075%
More than $500M	$48,000	0.0070%
Maximum	$80,000	

Additional listing fees will be charged if additional securities of the issuer are listed on the Exchange. Other fees may also be charged if the issuer proceeds with certain transactions requiring a filing with the TSX.

The following chart indicates the sustaining fees payable annually by all issuers for maintaining a listing on the TSXV:

Market Capitalization	**Minimum**	**Maximum**	**Fee Calculation**
Less than $5 million	$3,500	$3,500	Flat fee
$5 million to $100 million	$3,500	$30,000	$3,500 + $100 for each $1,000,000 in market capitalization or part thereof above $5 million
More than $100 million	$15,000	$30,000	$15,000 + $100 for each $1,000,000 in market capitalization or part thereof above $100 million

Additional listing fees will be charged if additional securities of the issuer are listed on the Exchange. Filing and other fees may be charged if the issuer proceeds with certain transactions or operations requiring a filing and/or an approval of the Exchange.

A recent TSX Ipsos Reid Survey on the cost of maintaining a listing on the TSXV was about $57,000, excluding corporate overhead allocation.[125] The costs include commission and exchange fees, legal and accounting expenses, and shareholder communications and transfer agents. This makes the TSXV competitive with AIM in terms of the cost of maintaining a listing. Unfortunately, no similar data exists for the TSX.

[125] D. Gordon, *The Costs of Going Public and Staying Public*, Calgary, Canadian Listed Company Association, 2003.

Table 2: Comparison of Ongoing Obligations on Canadian Exchanges and AIM[126]

	TSX/TSXV	Overseas Companies on AIM[127]
Annual Information Forms/Annual Information Updates	If listed on TSX or TSXV and certain exchanges (not including AIM), company to file within 90 days of financial year end	N/A
Annual Financial Statements	If listed on TSX or TSXV and certain exchanges (not including AIM), company to file within 90 days of financial year end (or concurrently with filing of annual information form) If listed only on TSXV and AIM, company to file within 120 days of financial year end	Company to file within six months of financial year end – copies of Canadian filings suffice
Half-Yearly Financial Statements	N/A	Company to file within three months of financial period – copies of Canadian filings suffice
Quarterly Financial Statements	If listed on TSX or TSXV and certain exchanges (not including AIM), company to file within 45 days of interim period If listed only on TSXV and AIM, company to file within 60 days of interim period	N/A

[126] Adapted with permission from McCarthy Tétrault, *Comparison of Continuous Disclosure and Liability Rules Applicable to Canadian Companies Listed on the Toronto and London Stock Exchanges*, September 2005 (on file with the author).

[127] Overseas companies refer to companies incorporated outside the U.K., either cross-listed or solely listed on AIM. In general, AIM Rules do not make distinctions between domestic or overseas companies.

Comparison of Ongoing Obligations on Canadian Exchanges and AIM

	TSX/TSXV	Overseas Companies on AIM
Press Releases	Compare to immediately announce material changes/information	Company to immediately announce events that may/would likely lead to substantial movement in share price
Material Change Reports	Company to file material change report within 10 days	N/A
Insider Trading	Prohibition against trading with knowledge of undisclosed material facts or changes	Prohibition against trading with knowledge of undisclosed price sensitive information Prohibition against trading by directors for one month prior to release of quarterly financial statements and two months prior to release of annual financial statements
Significant Acquisitions Transactions	Company to file acquisition report within 75 days of acquisition unless exemption available	Company to file routine notification of transactions which exceed 10 per cent. of any specified class tests e.g. assets – reverse takeovers require special detailed disclosure
Communication with Shareholders	Company to send management information circular to legal and beneficial shareholders and file with Canadian regulators	Company to make Canadian documentation available to shareholders and send electronic copy of Canadian documentation to AIM

Comparison of Ongoing Obligations on Canadian Exchanges and AIM

	TSX/TSXV	Overseas Companies on AIM
Insider Reporting	Insider to file insider report within 10 calendar days of becoming an insider/changes to such position	Company to notify market as soon as issuer "becomes aware" of trading by directors
Early Warning Reports	Shareholder to immediately notify market when shareholdings reach 10 per cent. followed by an early warning report within two business days.	Company to notify market as soon as it becomes aware of any shareholder exceeding of falling below three per cent.
Share Compensation Arrangements	Shareholder approval virtually always required	N/A
Corporate Governance Matters	Company to file copy of any written code of business conduct and ethics of amendments no later than date on which next financial statements must be filed	N/A

iv. Summary

The preceding comparative analysis reveals three broad types of differences between the models used by AIM and Canadian stock exchanges to regulate their markets.

The first is the choice made by AIM in favour of a principles-based approach to govern admission. This choice contrasts with the classic rules-based approach used by Canadian exchanges. Despite this difference, the criteria on which companies' suitability for listing is assessed tend to be the same on AIM and Canadian exchanges. However, the principles-based approach gives greater latitude to adapt the suitability analysis to the particularities of companies seeking listing. Further, it is important to point out that companies seeking to list on AIM and on Canadian exchanges are subject to extensive disclosure obligations that deal with essentially the same matters. In other words, the principles-based approach does not translate into a lower level of disclosure for companies getting listed. Finally, in terms of costs, it is difficult to consider that the principles-based approach of AIM translates into significant savings that render it more attractive than Canadian exchanges. Indeed, the suitability analysis conducted by the Nomad is more detailed and idiosyncratic and therefore involves significant costs. With regard to disclosure, since AIM Rules mandate the communication of similar information to investors as Canadian exchanges, savings are at best marginal.

The second difference relates to the scope of ongoing obligations imposed on listed companies. AIM has less stringent periodic disclosure requirements than Canadian exchanges. Moreover, AIM has much lighter corporate governance requirements than Canadian exchanges. The lower level of ongoing obligations is arguably compensated by the Nomad who advises listed companies on disclosure and corporate governance. The Nomad can adapt the disclosure and governance practices of the companies to their particularities and the needs of investors. The result is a more tailored approach that may yield some economies for listed companies. It is important to stress that these economies are real only if the Nomad gets it right by selecting the disclosure and governance practices that investors value, while leaving the others aside. Otherwise, if companies have disclosure and governance practices of lower quality, investors will simply discount the value of the securities offered, leaving no net benefits. Still, the AIM approach calls into question the cost-effectiveness of the current disclosure and governance obligations imposed by Canadian securities regulation.

Finally, the corporate governance requirements of AIM are more lenient and flexible than those applicable to Canadian exchanges, which are inspired by the American model. This enables listed companies to avoid being subject to corporate governance requirements that are ill-suited to their characteristics and impose unnecessary compliance costs. It is interesting to note that American companies are seeking listing on AIM to avoid the requirements imposed by the *Sarbanes-Oxley Act*.[128]

[128] E. Brown, "London Calling", *Forbes*, 8 May 2006, p. 51; S. Stewart, "Towering London", *The Globe and Mail*, 18 April 2006.

6. Policy Implications: How Is the Alternative Investment Market Model Informative for Canadian Stock Exchanges?

i. Framing the Issue

a) The Importance of Stock Exchanges for the Competitiveness of Canadian Capital Markets

Stock exchanges perform three central functions in capital markets.[129] Firstly, they play a crucial role in providing liquidity to securities. Secondly, they have a screening function that assists investors in assessing the quality of companies and of the securities listed. Finally, they act as regulators by making rules that govern trading and companies' governance, as well as ensuring the enforcement of those rules.

The functions of stock exchanges are valuable for investors and issuers. Thus, stock exchanges are considered to be key market infrastructure entities.[130] As the IOSCO aptly summarizes:

> The fair and efficient functioning of an exchange is of significant benefit to the public. The efficiency of the secondary market in providing liquidity and accurate price discovery facilitates efficient raising of capital for commercial enterprises, benefiting both the wider corporate sector and the economy as a whole. The failure of an exchange to perform its regulatory functions properly will have a similarly wide impact.[131]

From this perspective, it is easy to understand that the presence of well-functioning exchanges is critical for the competitiveness of Canadian capital markets.

b) Competitive Pressures and the Regulatory Model of Canadian Stock Exchanges

Canadian stock exchanges operate in an increasingly competitive environment.[132] If they are unable to discharge their core functions effectively, Canadian exchanges risk losing market share as they will be

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[129] J.R. Macey & H. Kanda, "The Stock Exchange as a Firm: The Emergence of Close Substitutes for the New York Stock and Tokyo Exchanges", (1990) 75 *Cor. L. Rev.* 1007; A.M. Fleckner, "Stock Exchanges at the Crossroads", (2006) 74 *Fordham L. Rev*. 1.
[130] B.S. Black, The Legal and Institutional Pre-Conditions for Strong Securities Markets, (1999) *UCLA L Rev*. 781.
[131] International Organization of Securities Commissions, *Regulatory Issues Arising from Exchange Evolution*, Consultation Report of the Technical Committee, 2006, p. 6.
[132] C. Carpentier *et al.*, *Competition Among Securities Markets: Can the Canadian Market Survive?*, Cirano Scientific Series, 2004s-50; "Battle of the bourses", *The Economist*, 27 May 2006, p. 65

less attractive to companies. Specifically, companies will seek listings on more effective exchanges that will enable them to reduce their cost of capital. The departure of a significant number of companies could have some adverse impact for the reputation, operations and, ultimately, the viability of Canadian exchanges.

Although we are far from such a catastrophic scenario, the recent surge of listings on AIM by Canadian companies is puzzling. Some may question whether this is a signal of a dysfunction in the operations of Canadian exchanges. However, when we examine the views expressed by market participants about AIM, as well as empirical data, it is difficult to pinpoint a specific failure in the functions provided by the exchanges.[133] Still, the recent trend and relative success of AIM raises the issue as to whether AIM is doing something "right", and what Canadian exchanges should be thinking about doing in order to remain competitive. In this respect, the comparison made above indicates that there are differences in the regulatory models and trading systems. AIM relies on a decentralized principles-based approach whereas Canadian exchanges use a rules-based centralized approach to regulate companies. AIM is a quote-driven market where liquidity is provided by market-makers, whereas Canadian exchanges remain primarily auction-driven markets, supported by market-makers.

Nevertheless, some may argue that the differences between AIM and Canadian exchanges are not preoccupying in that they simply reflect different strategies. The exchanges have different approaches because they cater to different types of companies. This argument loses its force in light of the data that show that AIM and the TSX attract companies of similar size and market capitalization. Thus, it appears relevant to examine whether AIM is doing something "right". Specifically, we will analyse whether the regulatory model used by AIM has some features that Canadian exchanges should consider importing in order to remain competitive. The assessment of the trading systems of AIM and of Canadian exchanges is beyond the scope of this report and will therefore be left aside.

c) A Cautionary Note on Second-tier Exchanges

The Alternative Investment Market is a specialized exchange that is part of the portfolio of the London Stock Exchange. When thinking about the lessons to be drawn from AIM for Canadian exchanges, a first question that may spring to mind is one of perspective: should we be considering the creation of a new

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[133] See Faegre & Benson, *American Springtime Blooms on AIM*, March 16, 2006 [online: http://www.faegre.co.uk/articles/article_1863.aspx]: "However the key to the success of AIM will not be found by scouring the rule books or by comparing regulatory climates".

stock exchange along the lines of AIM or, instead, an improvement of the operations of the existing exchanges?

The experience of European countries with junior stock exchanges, or second-tier markets, should serve as a cautionary note for those who may be thinking about the former option. Second-tier markets are essentially special segments that are created by stock exchanges in their equities markets with the objective of lowering regulatory and cost barriers to entry for smaller companies.[134]

Second-tier markets have been more popular in Europe where many stock exchanges have sought to establish special stock markets for smaller companies. The most notable European second-tier market initiatives have included the *Mercato Ristretto* in Italy, the *Second Marché* in France, the *Officiele Paralle Markt* (OPM) of the Amsterdam Stock Exchange, and, prior to AIM, the *Unlisted Securities Market* (USM) of the London Stock Exchange.[135] These second-tier markets, which were all under the management of the main markets, purported "to bring access to public securities markets nearer to the SMEs, providing lower costs of capital, the availability of equity capital in larger amounts, and the opportunity for exits for early stage investors."[136] The common approach adopted by the markets was to reduce cost barriers to entry by relaxing listing requirements.

Initially, European second-tier markets were considered to be a success as their implementation coincided with a very rapid growth in the number of new entrants.[137] The stock market collapse of 1987 and the following recession, however, marked the permanent decline of these markets.[138] Thus, the *Mercato Ristretto*, the *Second Marché*, the OPM, the USM, and other second-tier markets, have been a failure.[139] Without minimizing the impact of the events of 1987 and of the recession, commentators argue that the failure of the European junior stock markets was caused by more important structural deficiencies. Bannock stresses that since second-tier markets were under the same management as the main exchanges,

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[134] G. Bannock, *European Second-tier Markets for NTBFs*, London, Commission of the European Communities, 1994, p. 7.
[135] M. Anolli *et al*., "Second-tier Markets in Europe", in R. Buckland & E.W. Davis, Eds., *Finance for Growing Enterprises*, London, Routledge, 1996, p. 223; G. Bannock, *ibid.*, pp. 27-103. See also R. Buckland & E.W. Davis, *The Unlisted Securities Market,* London, Clarendon Press, 1989; G. Bannock & A. Doran, *Going Public — The Markets in Unlisted Securities,* London, Harper & Row, Publishers, 1987.
[136] G. Bannock, *ibid.*, p. 7.
[137] G. Bannock, *ibid.*, pp. 27-103.
[138] Commission des Communautés Européennes, Communications de la Commission, "Rapport concernant la faisabilité de la création d'un marché européen des capitaux pour les jeunes sociétés entrepreneuriales de croissance rapide", COM (95) 498 final p. 6.
[139] M. Anolli *et al*., *supra* note 134, p. 225-226; G. Bannock, *supra* note 134, pp. 103-107. See also "Europe's second markets; Small, but not yet beautiful", *The Economist*, January 25, 1995 at 80.

they were not actively promoted as "stock market managements [were] inevitably predominantly interested in the main market, which accounts for most of their income and prestige".[140] This lack of active promotion coupled with the relative similarities of listing requirements caused second-tier markets to be widely considered mere ante-chambers for the main markets.[141] Thus, issuers moved their listings to the main market as soon as practicable, with a depressing effect on volume and liquidity. Furthermore, because of their transitory nature, junior stock markets listed few high quality firms and thereby acquired a reputation of posting inferior securities.[142] Some commentators also stressed that the relative dearth of institutional investors as buyers of small firm securities may have played an important role in preventing the market from developing efficiently and effectively.[143] Undoubtedly, the lack of institutional investments in second-tier markets securities has dampened the development of efficient market infrastructures.

Admittedly, the recent success of AIM indicates that it is possible to create a vibrant second-tier market. Nonetheless, the number of high profile failures suggests that the creation of such a successful market requires a specific institutional setting. Given that the Venture Exchange and the Canadian Trading and Quotation System already cater to small companies, it does not seem to be advisable to consider creating an additional specialized stock exchange in Canada along the lines of AIM. Rather, it is more appropriate to examine whether there are some features of the existing regulatory regime of Canadian exchanges which could be improved, in light of AIM's experience.

ii. An Assessment of the Regulatory Model of the Alternative Investment Model

a) Competing Models to Regulate the Markets Operated

The comparative analysis of the Alternative Investment Market with Canadian exchanges reveals differences in the regulatory approach followed by each. The differences concern the regulatory techniques used, as well as the strategies used to implement regulation. The existence of those differences raises the question as to whether AIM relies on a regulatory approach that is "superior" to that used by Canadian exchanges.

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[140] G. Bannock, *ibid.*, p. 112.
[141] *Ibid.*; M.J. Robinson, *supra* note 23, p. 611.
[142] M.J. Robinson, *ibid.*
[143] *Ibid.*

Techniques to Regulate Admission: Rules versus Principles

It is tempting to qualify AIM as an exchange that relies on a principles-based approach to regulate companies. In contrast, Canadian exchanges can be seen as using a rules-based approach. While there are some merits to this distinction, it should not be overstated. The principles-based approach of AIM is primarily found in the regulation of admission where the Rules refer to a concept of suitability rather than to precise requirements. The ongoing obligations of listed companies are framed using a rules-based approach. Canadian stock exchanges regulate admission and ongoing obligations using a rules-based approach. However, there remain principles-based provisions throughout the rule-book, namely with respect to admission. Thus, the opposition between the rules-based and principles-based approach on Canadian exchanges and AIM is more striking with respect to admission than to ongoing obligations. For the latter, it is more a question of the weight of regulation, with AIM having a lighter approach than Canadian exchanges especially in the broad area of corporate governance. From this perspective, it seems that any discussion of the merits of those two regulatory techniques should be done in light of the admission of companies, rather than of the regulation of the market as a whole.

The standard theory with respect to the regulation of admission by stock exchanges appears to support the rules-based approach. At a general level, the theory holds that listing requirements are quality standards that can convey information to investors on firm value. By seeking to list on a stock exchange, a company asserts that it meets the initial listing standards, that it intends to satisfy the ongoing listing standards, and that it is committed to respecting the exchange's corporate governance standards.[144] Thus, a listing application can be taken as an important expression of managerial confidence in the business prospects of the firm.[145] The information that signals a stock exchange listing is valuable to investors because it is costly to replicate for low-quality issuers who cannot meet the requirements.

There are some additional merits to the rules-based approach. Rules operate *ex ante* and are therefore more transparent. For investors, transparency is beneficial in that they know precisely what criteria companies have met in order to get admitted for trading in the various segments of the market. Further, since they are standardized, listing requirements may convey a clearer message to investors about the

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[144] J. Afflek-Graves *et al*., "The Effect of the Trading System on the Underpricing of Initial Public Offerings", (1993) 22 *Fin. Mgmt*. 99 at 101.
[145] L.K.W. Ying *et al*., "Stock Exchange Listing and Securities Returns", (1977) 12 *J.F.Q.A.* 415 at 416-418. See also D.S. Dhaliwal, "Exchange-Listing Effects on a Firm's Cost of Capital", (1983) *J. Bus. Res.* 139; T. Grammatikos & G.J. Papaioannou, "The Informational Value of Listing on the NYSE", (1986) 21 *Fin. Rev.* 485.

quality of companies. For companies, transparency renders the application process more predictable. Assisted by their advisors, companies can readily identify whether they meet the listing requirements.

The most important drawback of rules is their rigidity. There is a risk that they create pointless rigidities that will prevent companies from being admitted, where they do not fit in the framework, or that will force them to incur additional costs to satisfy the requirements. The principles-based approach of AIM provides a flexibility which could be seen as attractive for Canadian markets by allowing regulation to be more responsive to the diverse needs of companies.

Whether the Canadian regime lacks flexibility to the point that a shift to a principles-based approach should be considered appears doubtful. The minimum listing standards for exchange listing in Canada are similar or lower than those for markets in developing countries.[146] Exchange authorities do have some discretion in the application of listing requirements, as they have pointed out. Moreover, the review of listing requirements indicates that Canadian Exchanges provides a rather flexible framework which allows smaller companies to get admitted for trading. For instance, the TSX permits listings by technology and industrial companies that have net tangible assets of $1Million (Tier 1) or even with no tangible assets (Tier 3). Finally, even if they exist to some extent, those rigidities are not the reasons why Canadian companies have listed on AIM, since most of them are also inter-listed on Canadian exchanges.

Besides, any consideration of the opportunity to shift to a principles-based approach demands that we factor in the latter's drawbacks. Three are noteworthy. The first is the reduction in the transparency of the admission process which can have adverse effects for investors and companies. Secondly, a principles-based approach implies the delegation of discretionary power to Exchange authorities with respect to the suitability of the companies seeking admission. This likely entails additional costs as more analysis is required to assess suitability. Moreover, as the experience of AIM shows, companies may not be comfortable with such discretion to the extent that they have less control over the admission process given the elusiveness of the criteria relied upon to make the assessment. Thirdly, shifting to a principles-based approach would mark a departure from the standard model used by most stock exchanges. Given the integration of North American capital markets, caution is warranted before implementing a regime that would break new ground. Indeed, it is necessary to consider what the reaction of American investors and regulators would be toward companies listed on a Canadian exchange governed by a principles-based approach with which they are not familiar.

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[146] C. Carpentier *et al.*, *Initial Public Offerings: Status, Flaws and Disfunctions*, Industry Canada, 2003, p. 43.

Outsourcing Regulatory Functions

A second distinguishing characteristic of AIM is its outsourcing of the responsibility for regulating companies to the Nomad. From the outset, it must be acknowledged that such outsourcing is not *per se* limited to a principles-based model. However, to the extent that it is costlier to operate than a rules-based model, a principles-based model may require some form of outsourcing to remain competitive. Still, there is no reason to think that under a rules-based model Exchange authorities cannot outsource the assessment of applicants, or the supervision of listed companies, to a third party. For instance, Canadian exchanges could outsource the assessment of whether companies comply with listing requirements to professionals, such as investment dealers and corporate lawyers, by giving a new life to the sponsorship requirements. In the aftermarket, sponsors could have the obligation to continue to monitor the companies' compliance with exchange rules. Outsourcing these functions could generate economies for Canadian exchanges, which could enable them to concentrate their resources on enforcement or other priorities.

Leaving aside the choice between a principles-based and a rules-based approach, outsourcing makes sense only to the extent that it leads to more cost-effective regulation. At first glance, some may consider that decentralizing the regulation of applicants and listed companies with a Nomad-like market participant could be an option that would reduce regulatory costs in Canada through added competition. To assess this claim, it is necessary to analyse the extent to which a Nomad system could be implemented in Canada and generate significant economies. This question is discussed in the next section.

b) The Attractions and Challenges of the Nominated Advisor System

The Potential Contributions of the Nominated Advisor

The Nomad is the hallmark of AIM's regulatory regime. It performs different functions in lieu of exchange authorities. More importantly, it may do so more cost-effectively than the latter.

The Nomad as a Gatekeeper: Certification and Monitoring

The Nomad acts as a gatekeeper for the admission of companies on AIM by assessing their suitability and vouching for them. The suitability assessment performed by the Nomad replaces the detailed listing requirements and injects some flexibility in the admission process. The ability of the Nomad to act as a

substitute to detailed listing requirements is seen as one of its main advantages by many market participants.

The Nomad performs another gatekeeping service, as a Sherpa, by overseeing the compliance of companies with AIM Rules following their admission. Following admission, the Nomad also acts as a substitute for the detailed ongoing obligations that apply to companies listed on Canadian exchanges. Recall that the Canadian corporate governance regime provides more stringent requirements than the AIM regime. Disclosure obligations are also more extensive on Canadian exchanges than on AIM. In addition, public corporations in Canada are subject to corporate governance requirements that are more demanding. In fact, anecdotal evidence obtained from the consultation of market participants suggests that the more flexible rules of AIM render it attractive.

Through its regular contact with companies, the Nomad can contribute to enhance the quality of disclosure, as well as corporate governance in general, and thereby reduce the potential for investor abuses.[147] For instance, the Nomad may insist that the company adopt an insider trading policy or implement certain corporate governance "best practices" recommended by the Combined Code.[148]

The Nomad system may thus appear to provide an alternative mechanism to protect investors in a more cost-effective way. This function is arguably unique in capital markets. Other reputational intermediaries do not have such close ties with issuers, nor do they have the responsibility of enforcing exchange rules. The ability of the Nomad to act as a substitute to more detailed corporate governance requirements is certainly appealing. Many have criticised the governance requirements imposed on public corporations in Canada in the wake of recent corporate scandals. In the course of this research, market participants have questioned the compliance costs they generate, especially for smaller corporations. Others have cast doubt on their relevance.

Without calling into question the provision of these gatekeeping services by the Nomad, some qualifications are warranted. The suitability assessment and monitoring made by the Nomad is part of a principles-based approach that has its drawbacks, as mentioned above. In addition, the certification and monitoring functions are decentralized as they are discharged by each Nomad on the basis of its own perception of what makes a company suitable for AIM or what are "good corporate governance practices". There will necessarily be variations in the analysis and interventions made by the Nomads, and

[147] C. Mallin & K. Ow-Yong, *supra* note 107.
[148] *Ibid*.

these variations will increase with the number of Nomads. Thus, one limit to the certification provided by the Nomad resides in the lower level of standardization compared with Canadian exchanges where the centralization of the evaluation process fosters a more uniform interpretation of the requirements. This problem is compounded by the fact that companies are not required to disclose their corporate governance practices nor compare them with a given benchmark such as the Combined Code. This renders the comparison and analysis of the corporate governance of listed companies more costly for investors and reduces the disciplinary pressure resulting from their assessment.[149]

Also, the value of the certification and monitoring provided by the Nomad primarily rests on the Nomad's reputation. When a Nomad vouches for a company by declaring that it is suitable, it places its reputational capital at risk. The signal that investors derive from a company's being qualified as suitable for AIM rests indirectly on their assessment of the Nomad's reputation. Following admission, the reputation of the Nomad retained by the company will influence investors' perception of its corporate governance quality. While it is a powerful mechanism, reputation has its own limits, limits which may eventually undermine the value of the certification provided by the Nomad.

Finally, it must be emphasized that the vast majority of Canadian companies listed on AIM are inter-listed on the TSX or TSXV. For certification, this means that there is certainly some free-riding on the part of the Nomads as screening has already been made by Canadian exchanges given that they take to AIM companies that have satisfied listing requirements that attest to their quality. With regard to monitoring, inter-listed companies have already submitted themselves to arguably more stringent corporate governance requirements in Canada.[150] Listing on AIM does not exempt them from the corporate governance requirements they face as Canadian issuers. Stated differently, it is currently difficult to argue that Canadian companies seek listing on AIM to avoid stringent corporate governance requirements and benefit from a cost-effective substitute for those requirements with the Nomad system.

The Nomad as a Sponsor

The Nomad has a sponsorship role on AIM that may contribute to enhance the visibility of companies and firm value. In general, companies are brought to the market by firms that act as both Nomad and broker.

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[149] See S. Rousseau, "Canadian Corporate Governance Reform: In Search of Regulatory Role for Corporate Law", in J. Sarra, Ed., *Corporate Governance in Global Capital Markets*, Vancouver, U.B.C. Press, 2003, pp. 16-21.
[150] Besides, it is important to emphasize that venture issuers do benefit from certain exemptions related to the application of corporate governance requirements.

This combination arguably gives clout to the broker where it markets the companies. Furthermore, since the Nomad remains associated with the companies following admission on AIM, the brokers may have indirect incentives to act as a sponsor in the aftermarket. Indeed, it is important for the Nomad's reputation to appear as bringing to the market companies that are "suitable" for AIM, i.e., that are – and remain – successful. To attain this objective, brokers may devolve greater efforts promoting the securities to investors following companies' admission, for instance through their institutional and retail networks, and maintaining continuous analyst coverage.

A Critical Look at the Nominated Advisor Model*:* Agency Problems Affecting Nominated Advisors

Nomads act on behalf of both issuers and exchange authorities. From an economic perspective, the relationship that exists between a Nomad and issuers or the exchange authorities can be qualified as being one of agency. It is well known that the interaction between agents and their principals gives rise to potential agency problems.[151] Those problems result from differences in the goals of agents and those of their principals, and from the existence of information asymmetries between the two, and may lead to various adverse effects for issuers, exchange authorities and, ultimately, investors.

A first problem relates to the Nomad-exchange authorities axis. Under the current model, issuers pay Nomads to assess whether they are suitable for AIM. They are paid by companies following their admission to AIM to act as their Sherpa. Some question whether the practice of issuers paying the Nomads for the suitability analysis creates a potential conflict of interest. Specifically, they argue that under such circumstances, the Nomad may be tempted to be complacent when analyzing companies' suitability for AIM given that they derive revenues from this analysis, as well as from acting for the companies in the aftermarket. Further, Nomad will not want to be seen as being too harsh when judging suitability in order to attract future business. Recently, the London Stock Exchange launched a review of the regulation of AIM that provides support for this concern. Indeed, it appears that the Exchange "has begun quiet consultations with a number of AIM brokers after it became concerned that some Nomads were taking fees for bringing their client to market and then failing to supervise their subsequent activities".[152]

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[151] See the seminal work of M.C. Jensen & W.H. Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure", (1976) 3 *J. Fin. Econ.* 305.
[152] E. Simpkins, "Brokers up in arms at LSE move on Nomads", *Telegraph*, 23 April 2006 (on line at http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2006/04/23/cnlse23.xml).

Although this problem is fairly easy to state theoretically, it is more difficult to assess the extent to which it actually materializes in the form of abuses in the market. Indeed, so far, AIM has not been rocked by scandals calling into question the role of the Nomads. Still, the recent surge in the number of recognized Nomads may render this problem more acute for reasons discussed below.

A second problem relates to the Nomad-company axis. Given that the Nomads' activities depend on their recognition by exchange authorities, they may be conservative when assessing the suitability of applicants. Specifically, they may bar companies that they judge too risky from entering in order to protect themselves from liability or sanctions from exchange authorities. Thus, some companies may not be able to access AIM and benefit from its services. Admittedly, this risk should not be overstated given that there are now close to one hundred recognized Nomads that will each have different tastes for risk. A related critique is that Nomads may be fairly intrusive in the operations of the companies in order to discharge their responsibilities, and protect themselves. Management may lose some of its discretion with respect to their companies' compliance with AIM Rules.

To the extent that they exist, both problems have potential consequences for investors. The first problem will harm investors when they misread the quality of AIM-listed securities. The second will affect investors by limiting their investment opportunities in that it prevents companies from entering the market.

A Critical Look at the Nominated Advisor Model: Legal and Market-Based Constraints Influencing the Behaviour of the Nominated Advisors

As many have noted, the reputation of a Nomad is its most valuable asset. Even if every Nomad must be recognized by exchange authorities, the value of the services provided by a Nomad depends essentially on its reputation for accuracy, independence, and integrity. If a Nomad has a reputation for erratic or biased analysis, investors will discount the value of its suitability analysis. If investors doubt the accuracy or independence of the suitability analysis of a particular Nomad, issuers will, in turn, avoid soliciting the services of the latter and seek a more credible Nomad to signal their quality and suitability. Thus, a Nomad with a poor reputation will not be in business very long.

Because of its value, the reputation built by Nomads provides an economic incentive to behave diligently and ethically, even in the absence of regulation. To build and maintain their reputations, Nomads should be expected to put a concerted effort into providing high quality services since the superior value of their

analysis will not go unnoticed by market participants, who will be willing to pay for them. As far as worries over Nomad independence, the fact the fees derived from a given company form a relatively small portion of their total revenues, Nomads should not be willing to risk damaging their reputation to please a particular company.

Despite its role in shaping Nomads' behavior, reputation has some limits. It remains a noisy indicator in that it may not be easy for investors to discern the reputation of Nomads. Investors are only privy to Nomads' efforts indirectly through the performance of the companies that they take to the market. Thus, investors may attribute the same reputational effect to companies that fail for different reasons such as fraud, bad luck or inaccurate screening by the Nomad. Further, information that could help investors assess the reputation and quality of Nomads is not readily available. This could become problematic with the recent surge in the number of Nomads.

In addition to reputation, there are two legal constraints that can act as a check on the Nomad. The first is supervision by regulatory authorities. Currently, Exchange authorities monitor the Nomad on an ongoing basis. They conduct an annual review of the Nomad's activities. Exchange authorities may also visit Nomads during the year on a more informal basis.[153] Where the Exchange considers that a Nomad is in breach of its responsibilities or has failed to act with care and skill, or has impaired the reputation and integrity of AIM, it may impose sanctions such as censure, removal from registration, and publication of the action taken. For instance, the London Stock Exchange recently launched an investigation into the activities of a number of Nomads "that have been involved with companies suspected of misleading the market and causing investors to lose money".[154] As many have noted, the monitoring by exchange authorities arguably plays a disciplinary role that supplements reputational sanctions given that if the Nomad loses its registration, it is automatically forced out of business. It appears that, in the past, at least one yearly review has led to three Nomads being disciplined and one being excluded from AIM.[155] Nonetheless, the results of the monitoring are unfortunately not transparent for investors as exchange authorities disclose little information on its results, including enforcement actions. The opacity of the oversight activities hampers the ability of investors to use this information to assess the reputation of the Nomads. Besides, monitoring of Nomads by exchange authorities is not without cost. If the risk of abuses becomes too important, the net benefits of outsourcing could prove to be limited.

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[153] C. Mallin & K. Ow-Yong, *supra* note 107.
[154] E. Simpkins, *supra* note 152.
[155] C. Mallin & K. Ow-Yong, *supra* note 107, 231.

Secondly, the civil liability of the Nomad may supplement reputational sanctions. From a contractual perspective, the Nomad can be held liable toward the investors who purchase the securities distributed by companies as part of their admission. Since companies rarely use the prospectus process to issue securities on AIM, the liability of the Nomad would stem from the subscription agreement or "placing letter" used. However, the standard practice is for placing letters to contain disclaimers that purport to absolve the Nomad and broker from any liability. More generally, it would be possible for investors to bring common law actions against the Nomad based on misrepresentation or fraud. It appears that such actions would be rare in the U.K. in the context of AIM. Specifically, even though there is class-action legislation in place, class actions are rare in the U.K. because the threshold for certification is quite high.[156] Overall, the liability of the Nomads is merely theoretical and can not be seen as having a strong disciplinary effect on their behavior.

c) Should the Nomad System Be Implemented in the Canadian Market?

In light of the preceding discussion, is the implementation of a Nomad system in Canada an option that should be considered by Canadian exchanges in order to enhance their competitiveness? The benefits of a Nomad system have been identified above. They include the potential improvement of the accessibility of Canadian markets for smaller issuers, as well as a reduction in compliance costs. While those benefits cannot be dismissed, they should not be overstated as emphasized previously. Further, some restraint is warranted when looking at the recent success of AIM with Canadian companies. More importantly, even admitting that the Nomad system of AIM is beneficial in the U.K., it is far from certain that this would be the case in the Canadian context because of institutional differences.

A first concern residing with the implementation of a Nomad system in Canada relates to the fact that this model would run across the grain of the approach followed by North American stock exchanges to regulate their markets. Stated differently, it may not be compatible with the goal of harmonization that has been identified as important for the implementation effective securities regulation.[157] The goal of harmonization is far from being merely theoretical as it underscores the importance for securities regulation to avoid creating impediments to companies making multi-jurisdictional offerings.[158] The implementation of a Nomad system in Canada requires thinking about the consequences of setting up a model that is unknown in North America, both from regulators and investors. Would regulators continue

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[156] R. Brant *et al.*, "AIM: Gateway to European Capital Markets", *Lexpert*, January 2006.
[157] Five-Year Review Committee, *Final Report – Reviewing the Securities Act (Ontario),* 2003, p. 34.
[158] *Ibid.*, p. 43.

to give the same treatment to companies listed on an exchange relying on such an alternative system?[159] Would investors price the securities of companies listed on such an exchange similarly or would they require a discount?[160] Alternatively would institutional investors pressure companies to implement protections considered to be standard in North America, despite the elimination of those protections from the exchange's rules?

Another source of concern is whether the Nomad system would work effectively in the Canadian context. As underlined above, there are some pitfalls to be avoided for the Nomad system to deliver its benefits. So far, the particularities of the U.K. legal and institutional setting have contributed to the success of the Nomad system. In Canada, the existence or development of similar conditions is questionable. Following the implementation of the Nomad system, there would be very few Canadian market professionals with a Nomad experience or with a proven track-record. Thus, there would be a transitory period where reputation would not be very effective, either as a signal for investors or as a check on the new Nomads. Although this difficulty could eventually be overcome, this period would be marked by uncertainty and could disrupt the smooth operations of capital markets.

A more vexing issue in the long run would be the impact of the liability risk on the viability of the Nomad system in Canada. Canadian capital markets are probably marked by a higher risk of litigation than the United Kingdom's. In this respect, the closeness with the U.S. and the presence of American institutional investors are probably relevant factors. Additionally, class actions are easier to launch in Canada than in the U.K., and, indeed, have started to appear more frequently.[161] Thus, in Canada, Nomads would be subject to a higher risk of liability for their assessment of the suitability of companies, and for their advice on compliance with ongoing obligations, especially continuous disclosure obligations. Greater liability threats would affect the interest of market participants in becoming Nomads. It would also influence the Nomads' assessment and monitoring of companies. Specifically, they could be more conservative in their suitability analysis and more demanding in their oversight functions. Alternatively, they could require greater remuneration and stronger indemnification protections from companies in order to offset the risk

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[159] For instance, when the Sarbanes-Oxley Act was adopted in the U.S., it was argued that it was necessary for Canadian regulators to follow suit in order to ensure that Canadian companies continue to have access to capital outside the country. See, e.g., D. Brown, "Investor Confidence: A Critical Asset", Remarks at the Corporate Reporting Awards, 2002 (on line at http://www.osc.gov.on.ca/About/Speeches/sp_20021205_db_critical-asset.jsp); C. Nicholls, *The Canadian Response to Sarbanes-Oxley*, Capital Markets Institute, Toronto, 2003, p. 11.

[160] Research conducted by J. Board *et al.*, *supra* note 9, indicates that investors do not see AIM as inherently more risky than the Official list.

[161] See C. Piché, "Quebec: The Canadian Jurisdiction of Choice for Class Actions?", (2005) 26 *Class Action Reports* 559.

they incur, thereby rendering their services expensive.

It could be argued that investment dealers would be willing to take on this risk nonetheless to the extent that a Nomad system would mark the return of relationship investment banking. In such a framework, investment bankers would have a better understanding of the issuers' business, enabling them to manage liability risk more effectively. However, it is far from certain that relationship investment banking is desirable in Canada. Recent empirical research shows that relationship banking already exists in that issuers typically maintain close relations with one investment bank.[162] It appears that issuers do so in order to avoid information leakage to their product-market competitors. Because of this concern, the ability of issuers to choose an underwriter is significantly constrained. Issuers cannot easily replace an existing bank with another, and competition remains limited. These findings have important implications when thinking about the Nomad system. By leading to even stronger ties between issuers and investment banks, the Nomad model is likely to reduce further the ability of issuers to substitute away from an existing relationship. This could result in less competition in the investment banking industry in Canada, a worrisome prospect given the high level of concentration that already exists in this industry.[163]

In particular, introducing a Nomad system in Canada would further strengthen the power of investment banks. It would do so by giving them an additional power derived from their regulatory role. At a general level, increasing further the market power of investment dealers is not desirable given that competition is a key ingredient of a dynamic and innovative capital market. More specifically, the low level of competition coupled with the regulatory power of investment bankers acting as Nomads creates a significant risk of regulatory capture.[164] Indeed, capture of the regulatory process is more probable where concentration is high.[165] If regulatory capture were to occur, the regulation outsourced to the Nomads would become subservient to the needs of the Canadian investment banking industry, rather than responsive to the public interest. Without dismissing the possibility that the position of investment banks acting as Nomads is contestable – and that they remain subject to competitive pressures – the prospect of new players remains elusive given that reputation constitutes an important barrier to entry.

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[162] J. Asker & A. Ljungqvist, "Sharing Underwriters with Rivals: Implications for Competition in Investment Banking", 22 May 2006 (on line at http://ssrn.com/abstract=868677).
[163] McKinsey & Co., *The Changing Landscape for Canadian Financial Services*, Ottawa, Task Force on the Future of the Canadian Financial Services, 1998, p. 34; Canada, Department of Finance, *Canada's Securities Industry*, 2002 (on line at: http://www.fin.gc.ca/toce/2002/cansec_e.html).
[164] For a similar preoccupation, see C. Carpentier & J.-M. Suret, "The Canadian and American Financial Systems: Competition and Regulation", (2003) 29 *Can. Pub. Pol.* 431.
[165] G. Becker, "A Theory of Competition among Pressure Groups for Political Influence", (1983) 98 *Quart. J. Econ.* 371.

Finally, it is important not to lose sight of the Canadian exchanges' competitive position at the international level. As seen previously, the TSX does attract listings from foreign companies. The attractiveness of the TSX stems from its current attributes, i.e. its reputation, its regulatory regime and its trading system. Since all of these attributes are priced, foreign companies choose the TSX on the basis of its ability to enhance their value. The implementation of a Nomad system would do away with the screening and monitoring functions of stock exchanges. Whether a Nomad system would be a close substitute of those functions is debatable given the concerns highlighted above. Thus, investors would have more difficulty assessing the quality of issuers. Companies could face a higher cost of capital as they will have to compensate investors for the additional risk perceived.[166] In this light, caution is warranted when thinking about replacing the current regime with a Nomad system.

If a Nomad system is not an interesting option for Canada does this mean that the status quo is satisfactory? Criticism of the current regime suggests that there is room for improvement. Two avenues would merit consideration. First, the exchanges should review their listing requirements in order to determine whether additional flexibility can be instilled in the admission process, through a greater reliance on principles-based requirements for instance, without jeopardizing its screening function.[167] In parallel, they should seek to further coordinate their continuous disclosure requirements with those set forth by securities regulation. At present, issuers are faced with two disclosure standards. Under securities laws, they must disclose "material change", whereas following National Policy 51-201 and the TSX and TSXV policies, they must disclose "material information"[168]. These different standards create much confusion as many have noted.[169] In light of the new civil liability regime for deficient timely disclosure, it seems more apposite than ever that legislators and regulators adopt a unified standard to circumscribe issuers' obligations.[170]

Second, interest in the Nomad system brings to the forefront the adequacy of the Canadian response to the

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[166] The research of Board *et al.*, *supra* note 9, shows that in the U.K. investors do not consider AIM companies to be more risky. We cannot assume that those results would automatically translate in the Canadian legal and institutional setting.
[167] For a similar suggestion in the U.S., see J.R. Macey & M. O'Hara, "The Economics of Stock Exchange Listing Fees and Listing Requirements", (2002) 11 *J. Fin. Intermediation* 297, 307.
[168] *Ontario Securities Act*, s. 75; National Policy 51-201, *Disclosure Standards*, s. 4.1, 4.2; TSX *Company Manual*, s. 408; TSXV Policy 3.3 – *Timely Disclosure*.
[169] Ontario, Five Year Review Committee, *Final Report: Reviewing the Securities Act (Ontario)*, Toronto, Queen's Printer, 2003, p. 142; *Interim Report of the Toronto Stock Exchange Committee on Corporate Disclosure, Toward Improved Disclosure*, (1996) 19 O.S.C.B. 8, 77.
[170] J.D. Fraiberg & R. Yalden, "*Kerr v. Danier Leather Inc.*: Disclosure, Deference and the Duty to Update Forward-Looking Information", (2006) 43 *Can. Bus. L.J.* 101, 112.

Sarbanes-Oxley Act. Canadian regulators have crafted a response to the American reforms with a piecemeal approach, using a series of rules and instruments. Although regulators have attempted to enact requirements that are more tailored to the particularities of the Canadian market, the current regime continues to draw criticism because of the costs it involves, especially for smaller issuers.

d) Recommendations

Recommendation #1: Canadian stock exchanges and regulators should abstain from transplanting the Nomad system, and related features, of the AIM model in Canada.

Recommendation #2: Consideration should be given by Canadian stock exchanges to enhancing their attractiveness through improvements to the admission process.

Recommendation #3: Consideration should be given by Canadian stock exchanges to exploring solutions to make their continuous disclosure requirements more responsive to the needs of capital markets participants, including further harmonizing them with securities regulation.

Recommendation #4: To address the concerns related to the costs of corporate governance requirements, Canadian regulators should consider reviewing the cost-effectiveness of the existing corporate governance regime, with a special view at smaller issuers' interests.

iii. The Alternative Investment Market and the Liquidity of Canadian Companies' Securities

Liquidity plays a significant role in the decision to list securities on a stock exchange. Liquidity is valuable to investors who are willing to pay more to buy liquid securities. Conversely, investors require a premium for the trading costs they bear when holding securities that trade in a less liquid market. Thus liquidity ultimately influences companies' cost of capital and their ability to raise funds.

Given the importance of liquidity for the financing of companies, it is not surprising that this factor is naturally seen as a primary factor influencing listing – and inter-listing – decisions. Indeed, the most important economic function of a secondary market remains after all to create liquidity. It is tempting to argue, therefore, that Canadian companies seek to list on AIM in order to increase the liquidity of their securities. Determining whether listing on AIM enhances the liquidity of the securities of Canadian companies is an empirical question that is beyond the scope of this report. In a companion report, Board

et al. find that AIM trading represents a significant share of total trading in inter-listed securities, amounting sometimes over 50%.[171] Further, their study reveals that inter-listed securities have seen more rapid growth in trading volumes than the market or the resources sector as a whole. They conclude that AIM "has added additional business in its own right and stimulated greater interest in the domestic market".[172]

From a legal perspective, there is one aspect of the regulatory regime that is noteworthy when thinking about the role of AIM in providing liquidity. This aspect concerns hold periods which are enacted by securities regulation as part of the closed system.

The closed system refers to a set of rules governing securities distribution that purport to ensure the effectiveness of the prospectus regime. In a nutshell, under the closed system, all distributions of securities have to be made with a prospectus unless an exemption is available. Where securities are distributed using an exemption, they can only be traded subsequently using an exemption. If an exemption is not available, trades are prohibited unless either a prospectus is filed and receipted or certain conditions governing resale are met. In other words, "securities issued pursuant to a prospectus exemption become part of the "closed system" and are restricted from entering the secondary market."[173] The upshot of the closed system is that securities issued under an exemption tend to be rather illiquid so long as they remain in it.

The closed system provides a way out for securities issued pursuant to an exemption. The *Multilateral Instrument 45-102 Resale of Securities* (MI 45-102) establishes a framework to allow securities issued under an exemption to become freely tradable on the secondary market. The framework is based on two central concepts: the seasoning period and the hold period. The former refers to the period during which the company has been a reporting issuer, and the latter to the period during which the securities acquired under an exemption have been held. According to MI 45-102, securities distributed under an exemption can be traded outside of the closed system where a seasoning period of four months has elapsed and, in certain circumstances, where a hold period of four months has been satisfied.

MI 45-102 provides an exemption from this general framework that interests AIM. Securities issued under an exemption are not subject to seasoning- and hold periods where the following conditions are

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[171] J. Board *et al.*, *supra* note 9.
[172] *Ibid.* p. 67.
[173] Ontario, Five Year Review Committee, *supra* note 168, p. 134.

met: the issuer was not a reporting issuer in Canada at the time of the distribution; the securities were distributed mostly to investors that are not residents of Canada; and the trade for which the exemption is granted is made through an exchange outside of Canada. In light of this exemption, a Canadian company that is not yet a reporting issuer can structure a private placement with investors in the United Kingdom in a way that will ensure that the securities issued will immediately be freely tradable. It suffices for the company to limit the number of Canadian private placees and to arrange for the securities issued to be listed on an exchange.

Alternatively, it would be possible to argue that restrictions on the sale of privately placed securities do not apply to investors who are located in another jurisdiction, provided that they do not trade in the Canadian market. Indeed, it is debatable whether securities regulation can impose extraterritorial obligations on foreign investors who do not have a clear and direct connection with Canadian markets. AIM steps in here by providing Canadian companies with a market on which it is feasible to list securities issued under a private placement, given its more flexible listing requirements. Further, there are no resale restrictions for securities privately placed in the U.K.

Under this framework, a Canadian company that is a reporting issuer can issue securities via a private placement in the U.K. and have those securities freely tradable on AIM while those issued in Canada will be subject to hold periods. The role of AIM in providing liquidity to privately placed securities is not merely theoretical. It has been mentioned as an interesting advantage of AIM by market participants to whom we have spoken.

The ability to issue freely tradable securities in a private placement arguably reduces the cost of capital for companies since investors are willing to pay a premium for liquidity. From this perspective, AIM may be attractive in that it offers an original source of liquidity for securities issued by Canadian companies under an exemption.[174]

The discrepancy in regulatory treatment calls into question the relevance of hold periods. Three rationales are traditionally put forward to justify them. Firstly, they are meant to prevent "back-door underwriting", that is, the use of exemptions to distribute securities for immediate resale so as to avoid the obligations imposed by the prospectus regime. Secondly, hold periods purport to ensure that investors buying

[174] See J.G. MacIntosh, *Legal and Institutional Barriers to Financing Innovative Enterprise in Canada*, Kingston, School of Policy Studies, Queen's University, 1994, pp. 110-111 (noting the existence of regulatory arbitrage on the part of Canadian issuers seeking to escape hold periods by issuing securities in Europe).

privately placed securities have access to sufficient information from the issuer prior to the transaction. Finally, the hold periods serve as a safeguard against the exploitation of privileged information on the part of private placees that could harm other investors.

As the Five-Year Review Committee stressed, these rationales no longer make sense for reporting issuers.[175] The risk of back-door underwriting is probably overstated. To do so, an issuer needs to find an exempt purchaser willing to acquire the securities and thereby play the unofficial role of underwriter. According to MacIntosh, this possibility is remote: "In my view, institutional and other exempt buyers who hope to continue participating in the capital markets will simply have too little to gain, and too much reputational capital at stake to engage in such evasion of the securities legislation."[176] At any rate, even if such a risk exists, it could be dealt with in a more targeted fashion, either by using the definition of underwriter or through distribution. With the second rationale, the extent of continuous disclosure obligations coupled with the new civil liability regime have considerably narrowed the gap in the quality and scope of disclosure between the primary and secondary markets. Furthermore, investors buying privately placed securities from reporting issuers will have access to the information disclosed in the prospectus. The extensive disclosure obligations imposed on issuers further reduce the risk that private placees will exploit privileged information, and insider trading liability already exists to deter such wrongdoing. From this perspective, while resale restrictions make sense for non-reporting issuers, the case for such restrictions is weaker for a reporting issuer. It appears that it is time to eliminate hold periods for reporting issuers however regulatory safeguards should still be implemented to curtail the risk of back-door underwriting.[177]

<u>Recommendation #5</u>: To improve the liquidity of securities issued under a private placement, securities regulators should consider eliminating hold periods for securities of reporting issuers.

[175] Ontario, Five Year Review Committee, *supra* note 168, pp. 138-139.
[176] J.G. MacIntosh, *supra* note 173, p. 107.
[177] Ontario, Five Year Review Committee, *supra* note 168, pp. 138-139.

7. Conclusion

Stock exchanges are key market infrastructure entities. The existence of well-functioning stock exchanges is an important determinant of the competitiveness of Canadian capital markets. In this respect, the attractiveness of AIM is intriguing for policy-makers interested in the competitiveness of Canadian securities markets.

This study has firstly sought to gain a better understanding of AIM's success in attracting investors and issuers, including more recently a number of Canadian public companies. What emerges from the research is a complex picture where market- and legal-based factors play out to explain the attractiveness of AIM for Canadian companies. Amongst those factors, the particularities of the London market have significant weight. Still the alternative regulatory regime of AIM facilitates the ability of Canadian companies to tap into this market.

Given the relevance of the regulatory dimension, the study also explored whether the AIM model is informative for the assessing approach followed by Canadian stock exchanges. Specifically, the study examined whether or not AIM is doing something "right" that Canadian exchanges should also be thinking about doing in order to remain competitive. If they are unable to discharge their core functions effectively, Canadian exchanges risk losing market share as they will be less attractive to companies.

The study finds two salient differences in the regulatory models used by AIM and Canadian exchanges. The first pertains to the choice made by AIM in favour of a principles-based approach to govern admission, in contrast with the rules-based approach used by Canadian exchanges. The second relates to the scope of ongoing obligations imposed on listed companies. Ongoing disclosure and corporate governance requirements are lighter on AIM than on Canadian exchanges. Overall, on AIM, it is the Nomad who substitutes for the more detailed listing requirements and more rigorous ongoing obligations of Canadian exchanges.

From this perspective, any attempt to import some elements of AIM's regulatory model to Canada must include the transplantation of the Nomad system. In this respect, the study shows that implementing a Nomad system in Canada could prove a complex and risky task. In fact, it is highly debatable whether an effective Nomad system could develop in Canada. For this reason, the study does not recommend that policy-makers seek to transplant the Nomad system and related features of the AIM model in Canada. Improvements in the competitiveness of Canadian stock exchanges should be sought by enhancing the

flexibility of their admission process, and by making their continuous disclosure requirements more responsive to the needs of capital markets participants, including further harmonizing them with securities regulation. It also seems apposite to undertake a revision of the costs of the mandatory corporate governance requirements imposed by securities regulation, and assess whether there are effective substitutes for those requirements on Canadian markets. Finally, a revision of hold periods could enable Canadian exchanges to generate greater liquidity to companies' securities, and thereby increase their attractiveness.

Appendix 1: TSX: Financial and Technical Requirements Applicable to Industrial (General) Issuers

Financial Requirements	Senior Companies	R&D Companies	Companies Forecasting Profitability	Profitable Companies	Technology Companies
Earnings or Revenue	Pre-tax earnings from ongoing operations of at least **$300,000** in the fiscal year immediately preceding the application		Evidence of pre-tax earnings from ongoing operations for the current or the next fiscal year of at least **$200,000**	Pre-tax earnings from ongoing operations of **$200,000** in the fiscal year immediately preceding the application	
Cash Flow	Pre-tax cash flow of **$700,000** in the fiscal year immediately preceding the application and an average pre-tax cash flow of **$500,000** for the 2 past fiscal years		Evidence of pre-cash tax flow for the current or next fiscal year of at least **$500,000**	Pre-tax cash flow of **$500,000** in the fiscal year immediately preceding the application	
Net Tangible Assets	**$7,500,000**		**$7,500,000**		
Adequate Working Capital and Capital Structure	Working capital to carry on the business and an appropriate capital structure	Adequate funds to cover all planned research and development expenditures, capital expenditures and general and administrative expenses for at least 2 years	Working capital to carry on the business and an appropriate capital structure	Working capital to carry on the business and an appropriate capital structure	Adequate funds to cover all planned development expenditures, capital expenditures and general and administrative expenses for 1 year
Cash in Treasury		Minimum of **$12,000,000** in treasury, the majority of which has been raised by the issuance of securities qualified for distribution by a prospectus			Minimum of **$10,000,000** in treasury, the majority of which has been raised by the issuance of securities qualified for distribution by a prospectus
Products and Services		Minimum of two-year operating history that includes research and development activities and evidence that the company has the technical expertise and resources to advance the company's research and development program(s)			Products or services at an advanced stage of development or commercialization supported by historical revenues or contracts for future sales from the company's main business

Appendix 2: TSX: Financial and Technical Requirements Applicable to Mining Issuers

Financial Requirements	Senior Companies	Producing Mining Companies	Mineral Exploration and Development Companies
Profitability	Pre-tax profitability from ongoing operations in the fiscal year immediately preceding the listing application		
Cash Flow	Pre-tax cash flow of **$700,000** in the fiscal year immediately preceding the application and an average pre-tax cash flow of **$500,000** for the 2 past fiscal years		
Net Tangible Assets	**$7,500,000**	**$4,000,000**	**$3,000,000**
Reserves	Proven and probable reserves to provide a mine life of at least 3 years calculated by an independent qualified person	Proven and probable reserves to provide a mine life of at least 3 years calculated by an independent qualified person, together with evidence indicating a reasonable likelihood of future profitability supported by a feasibility study or documented historical production and financial performance	
Adequate Working Capital and Capital Structure	Adequate working capital to carry on the business and an appropriate capital structure	Sufficient funds to bring the mine into commercial production, adequate working capital to fund all budgeted capital expenditures and carry on the business and an appropriate capital structure	Sufficient funds to complete the planned programme of exploration and/or development on the company's properties, to meet estimated general and administrative costs, anticipated property payment and capital expenditures for at least 18 months Working capital of at least **$2,000,000** and an appropriate capital structure
Products and Services		Must either (i) be in production or (ii) have made a production decision on the qualifying project or mine	And advanced-stage exploration property , detailed in a report by an independent qualified person A planned work program of exploration and/or development of at least $750,000 that will sufficiently advance the property and that is recommended by an independent qualified person

Appendix 3: TSX: Financial and Technical Requirements Applicable to Oil and Gas Issuers

Financial Requirements	Senior Oil and Gas Companies	Oil & Gas Exploration and Development Companies
Profitability	Pre-tax profitability from ongoing operations in the fiscal year immediately preceding the listing application	
Cash Flow	Pre-tax cash flow of **$700,000** in the fiscal year immediately preceding the application and an average pre-tax cash flow of **$500,000** for the 2 past fiscal years	
Reserves	Proven developed reserves of **$7,500,000**	Proven developed reserves of **$3,000,000** and a clearly defined programme which can reasonably be expected to increase reserves
Adequate Working Capital and Capital Structure	Adequate working capital to carry on the business and an appropriate capital structure	Adequate funds to execute the programme and cover all other capital expenditures as well as general , administrative, and debt service expenses for a period of 18 months with an allowance for contingencies and an appropriate capital structure

Appendix 4: List of Documents to be Submitted to the TSX in Connection with a Listing Application

- two fully executed copies of the listing application;
- the Listing Agreement;
- certified copies of all charter documents;
- one copy of each of the annual reports for the past three years (if they were issued);
- two copies of the applicant's most recent audited financial statements signed by two directors of the applicant on behalf of the board;
- one copy of every stock option or security purchase plan and any other agreement under which security may be issued;
- a copy of every material contract referred to in the listing application;
- copies of any agreements under which securities are held in escrow, pool or under a similar arrangement; a certificate from the trustee certifying that the trustee is holding the securities; and a list of the registered holders of the securities;
- a letter from the trust company that acts as transfer agent in the City of Toronto stating that it has been duly appointed as transfer agent for the applicant and is in position to make transfers and make prompt delivery of security certificates;
- a letter from the registrar indicating that it is acting as registrar in the City of Toronto;
- a current list of security holders, certified by the transfer agent or registrar to be true and correct;
- evidence of any registration or qualification of the applicant or its securities with the Ontario Securities Commission or a corresponding body in the jurisdiction where it was incorporated or primarily carries on business. One copy of each prospectus, if it was filed within the previous 24 months satisfies this requirement;
- a legal opinion from the applicant's legal counsel setting out that: (i) the applicant is a valid and subsisting company; (ii) the securities for which listing is applied have been legally created; and (iii) the securities, which have been allotted and issued as set out in the listing application, are validly issued as fully paid and non-assessable;
- a specimen certificate, printed by a bank note company approved by the TSX, imprinted with a CUSIP number, for each class of securities to be listed;
- an unqualified letter from the Canadian Depositary for Securities Limited confirming the CUSIP number assigned to the securities;
- a cheque payable to the TSX for the amount of the application fee;

- personal information forms (PIFs), sworn before a Commissioner of Oaths, completed by each individual who at the time of listing is (i) an officer or director of the applicant; or (ii) beneficially own or control, directly or indirectly, securities carrying more that 10% of the voting rights attached to all outstanding securities of the applicant. Each PIF must be accompanied by an original executed Consent for Disclosure of Criminal Record Information;
- statutory declarations completed by two officers; and
- a sponsorship letter signed by a director of a TSX participating organization if the applicant is a non-exempt company.

Appendix 5: TSXV: Minimum Listing Requirements for Tier 1 Issuers

Minimum Listing Requirements	**Mining Issuers**	**Oil and Gas Issuers**	**Technology or Industrial Issuers**	**Research and Development Issuers**	**Real Estate or Investment Issuers**
Net Tangible Assets	**$2,000,000**		Category 1: **$1,000,000** Category 2: **$5,000,000**	**$5,000,000**	**$5,000,000**
Property or Reserves	Material interest in a Tier 1 Property	**$2,000,000** proven reserves, based on constant dollar pricing assumptions, discounted at 15%			
Prior Expenditures		Nil		A minimum of $1,000,000 in prior R&D costs	
Recommended Work Program				Research and development work program of at least **$1,000,000**	
Working Capital and Financial Resources	Adequate working capital and financial resources which include adequate funds to conduct the recommended work program, cover G&A expenses for 18 months, property payments to keep Tier 1 Property and Exploration "Principal Properties" in good standing and **$100,000** of unallocated funds.	Adequate working Capital and financial resources to carry out the business, with a minimum of **$500,000** in working capital	Categories 1 and 3: Adequate working capital and financial resources to carry on the business for 18 months Category 2: adequate working capital and financial resources to carry out the program outlined in the business plan for 18 months and **$100,000** of unallocated funds	Adequate working capital and financial resources to	Adequate working capital and financial resources for 18 months
Earnings or Revenue	Nil		Category 1**: $100,000** pre-tax earnings in last fiscal year or in last two of three years		
Distribution, Market Capitalization and Float	**$1,000,000 held by Public Shareholders** **1,000,000 free trading public shares** **200 Public Shareholders with a board lot and no resale restrictions** **10% Public Float** **20% of issued and outstanding shares in the hands of Public Shareholders**				

Appendix 5: TSXV: Minimum Listing Requirements for Tier 1 Issuers (cont'd)

Other Criteria			Category 2: Management plan outlining the development of the business for 24 months and demonstrating reasonable expectations of earnings within 24 months		Publicly disclosed investment and strategy policy which includes the issuer's investment strategies and criteria; diversification requirements; conflict of interest provisions; and contractual rights of access to books and records of the investees For Investment issuers: 50% of available funds allocated to a minimum of 2 specific investments; board must be comprised of individuals with adequate backgrounds and expertise with respect to making investment decisions

Appendix 6: TSXV: Minimum Listing Requirements for Tier 2 Issuers

Minimum Listing Requirements	**Mining Issuers**	**Oil and Gas Issuers**	**Technology or Industrial Issuers**	**Research and Development Issuers**	**Real Estate or investment Issuers**
Net Tangible Assets			Category 1: **$500,000** Category 2: **$750,000** Category 3: **$750,000**	**$750,000**	**$2,000,000**
Property or Reserves	Hold a Significant Interest in a Qualifying Property or at the discretion of the TSXV, hold rights to earn a Significant Interest in the Qualifying Property	Category 1: **$500,000** proven producing reserves, based on constant dollar pricing assumptions, discounted at 15% Category 2: proven (producing or non producing) and probable reserves with present value of $750,000 based on constant dollar pricing assumptions, discounted at 15%			
Prior Expenditures	**$100,000** spent in exploration and development on the Qualifying Property in the last 3 years or sufficient expenditures incurred such that the property is a Tier 1 Property	Nil	Category 3: **$250,000** prior expenditures related to of the product or technology to be commercialized pursuant to the business plan for 12 months	A minimum of **$500,000** in prior R&D costs	

Appendix 6: TSXV: Minimum Listing Requirements for Tier 2 Issuers (cont'd)

Recommended Work Program	Geological report recommending a minimum of **$200,000** non-contingent work program on the Qualifying Property	Category 2: Geological report recommending a minimum development program of **$300,000** Category 3: Satisfactorily diversified exploration program recommended by a Geological Report + at least **$1,500,000** allocated to joint venture other recommended exploration program		Research and development work program of at least **$500,000**	
Working Capital and Financial Resources	Adequate working capital and financial resources which include adequate funds to conduct the recommended work program, cover G&A expenses for 12 months, property payments to keep Qualifying Property and Exploration "Principal Properties" in good standing for at least 12 months and $100,000 of unallocated funds.	Category 1: Adequate working Capital and financial resources for 12 months Category 2: Adequate working capital and financial resources which include sufficient funds to complete any joint venture exploration program, cover G&A expenses for 12 months and $100,000 of unallocated funds Category 3: Adequate working capital and financial resources which include sufficient funds to complete recommended work program, cover G&A expenses for 12 months and $100,000 of unallocated funds	Category 1 : Adequate working capital and financial resources to carry on the business for 12 months Categories 2 and 3: Adequate working capital and financial resources to carry out the program outlined in the business plan for 12 months (incl. 12 months G& A expenses) and $100,000 of unallocated funds	Adequate working capital and financial resources to conduct the recommended R&D work program, to cover G&A expenses for at least 12 months + $100,000 in allocated funds	Adequate working capital and financial resources for 12 months

Appendix 6: TSXV: Minimum Listing Requirements for Tier 2 Issuers (cont'd)

Earnings or Revenue			Category 1: $50,000 pre-tax earnings in last fiscal year or in last two of three years Category 2: $250,000 operating revenue in the last 12 months		
Distribution, Market Capitalization and Float	**$500,000 held by Public Shareholders** **500,000 free trading public shares** **200 Public Shareholders with a board lot and no resale restrictions** **10% Public Float** **20% of issued and outstanding shares in the hands of Public Shareholders**				
Other Criteria		Category 1: Geological report recommending further development or production	Categories 2 and 3: Management plan outlining the development of the business for 24 months and demonstrating reasonable expectations of earnings within 24 months Category 3: sufficient testing of technology to demonstrate commercial viability + working prototype of any industrial product		Publicly disclosed investment and strategy policy which includes the issuer's investment strategies and criteria; diversification requirements; conflict of interest provisions; and contractual rights of access to books and records of the investees For Investment issuers: 50% of available funds allocated to a minimum of 2 specific investments; board must be comprised of individuals with adequate backgrounds and expertise with respect to making investment decisions

<u>Appendix 7:</u> TSXV: Listing Procedures – Documents to be Filed

Initial Submission

The applicant issuer must file with the TSXV:

- a letter requesting conditional acceptance of the listing of common shares that:

(i) specifies the applicable industry and category for which the Issuer is applying for listing; (ii) a summary explanation as to how the Issuer has met each of the applicable Minimum Listing Requirements; (iii) indicates the number and class of the Issuer's shares to be issued and outstanding at the time of listing and if convertible or exchangeable securities will be issued and outstanding at the time of listing, indicating the number and type of shares reserved for issuance on exercise or conversion; (iv) where applicable, identifies any required waiver or exemptive relief application made or to be made pursuant to applicable Securities Laws; and (v) identifies three choices for a stock symbol;

- a copy of the preliminary prospectus (if the application is made concurrently with a prospectus offering) and if the application is not being made pursuant to a prospectus offering, a draft listing application (Form 2B)[178];
- if required, a preliminary sponsor report;
- if the application is not made concurrently with a prospectus offering, a certified list of all shareholders from the Issuer's transfer agent and registrar together with: (i) a report from each depository specifying the number of securities of each class of the issuer registered in the name of the depository held by each intermediary; and (ii) a list of beneficial shareholders provided by each intermediary holding greater than 10% of the issuer's shares calculated as of the date of the certified list of shareholders or other register of securities;
- if the application is made concurrently with a prospectus offering, a list of all outstanding securities of the issuer, including the date of issuance, the number and type issued and the issue price; if the issuer has more than 50 shareholders, and, unless otherwise directed by the Exchange, details of holdings need only be provided for non arms length parties;

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[178] The Listing Application must provide prospectus level disclosure unless the issuer has been a reporting issuer in Canada or been subject to equivalent continuous disclosure requirements in a foreign jurisdiction for at least one year and its continuous disclosure record is available or will be made available on SEDAR. The Listing Application must also include the Issuer's audited financial statements for the last financial year, and any such other statements the Exchange may require. If the Issuer's securities have been listed or quoted, the Issuer must file with the Exchange those financial statements filed in the last year with the applicable exchange, quotation system and regulator pursuant to that listing or quotation.

- a duly executed Personal Information Form (Form 2A) or, if applicable, a duly executed Declaration from each director, senior officer, promoter and other insider of the issuer; if any of these persons is not an individual, a PIF or, if applicable, Declaration from each director, senior officer and each control person of that person;
- copies of all material contracts;
- draft copies of all material agreements which the issuer expects to enter into before or contemporaneously with the listing;
- if applicable, a valuation or appraisal report prepared by a qualified individual in accordance with industry standards;
- a copy of the documents by which the issuer was incorporated or created and, if the issuer is incorporated outside of Canada or the United States, a legal opinion confirming that the Issuer is validly incorporated or created and the securities for which listing is applied have been legally created;
- if the issuer's principal properties or assets are located outside Canada or the United States, the Exchange will generally require a title opinion or other appropriate confirmation of title in a form acceptable to the Exchange;
- confirmation that the issuer has reserved its name with the Exchange in accordance with section 1.2 of Policy 5.8 - Name Change, Share Consolidations and Splits;
- if the issuer is a Mining Issuer or an Oil and Gas Issuer, a geological report for each of the Issuer's principal properties which must include recommendations for exploration and/or development work. Mining issuer reports must be prepared in accordance with National Instrument 43-101 and Form 43-101F1;
- if the issuer is an Industrial or Technology Issuer that has not yet generated net income from its business in the amount referred to in Policy 2.1 - Minimum Listing Requirements, a comprehensive business plan;
- if the issuer is a Research and Development Issuer, a discussion of the research and development conducted to date and a comprehensive recommended research and development work program; and
- the applicable minimum listing fee which shall be non-refundable.

Final Documentation

Following conditional acceptance of listing, the TSXV must receive the following final documentation:

- if the application is made concurrently with a prospectus offering, the final application consists of two originally executed Statutory Declarations (Form 2C) attached to the final Prospectus completed by each of two authorized directors or officers of the issuer dated within three business days of the date they are submitted to the Exchange confirming the prospectus disclosure. In the event of a material change between the date of the prospectus and the Statutory Declaration, a comprehensive material change report supplementing the prospectus disclosure must be incorporated into the Statutory Declaration;
- if the application for is not made concurrently with a prospectus offering, two originally executed copies of the final Listing Application (Form 2B) dated within three business days of the date they are submitted to the Exchange;
- a duly executed Listing Agreement (Form 2D) filed in paper form;
- if required, a duly executed copy of the final Sponsor Report;
- if applicable, a consent letter from each auditor, accountant, engineer, appraiser, lawyer or other person or party whose report, appraisal, opinion or statement is disclosed or summarized or incorporated by reference into the listing application or supporting documents;
- all material agreements not previously provided to the Exchange;
- a specimen share certificate imprinted with the applicable ISIN or CUSIP number which complies with Policy 3.1 - Directors, Officers and Corporate Governance and in the case of a generic certificate, the specimen certificate must be accompanied by a letter from the transfer agent confirming that the generic certificate complies with the requirements of the Security Transfer Association of Canada;
- if the application is made concurrently with a prospectus offering, a Distribution Summary Statement (Form 2E) prepared by a member firm acting as, or on behalf of, the issuer's agent;
- a letter from the issuer's transfer agent and registrar confirming that it has been duly appointed, and an undertaking to provide the Exchange with a copy of each treasury order of the issuer within five business days after any issuance of listed shares;

- a letter from the issuer's escrow agent confirming that it has been duly appointed as escrow agent and specifying the number and type of shares on deposit with the escrow agent to be held in escrow pursuant to the terms of each escrow agreement and the names of shareholders on behalf of whom it is holding any escrowed securities;
- a certificate of the applicable government authority or legal opinion that the issuer is in good standing under or not in default of applicable corporate law;
- for non IPO transactions, a certificate of the applicable Securities Commission(s) or legal opinion that the issuer is a reporting issuer in good standing and not in default in each jurisdiction in which it is a reporting issuer; and
- the balance of the applicable listing fee.

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