Securities Practice Notes

Published by the National Securities and Capital Markets Group

Fall 2009

In This Issue

Capital Raising Under the New Registration Regime

State of the Securities Union

Knowing your "Know Your Product" Obligation

Be Ready for IFRS

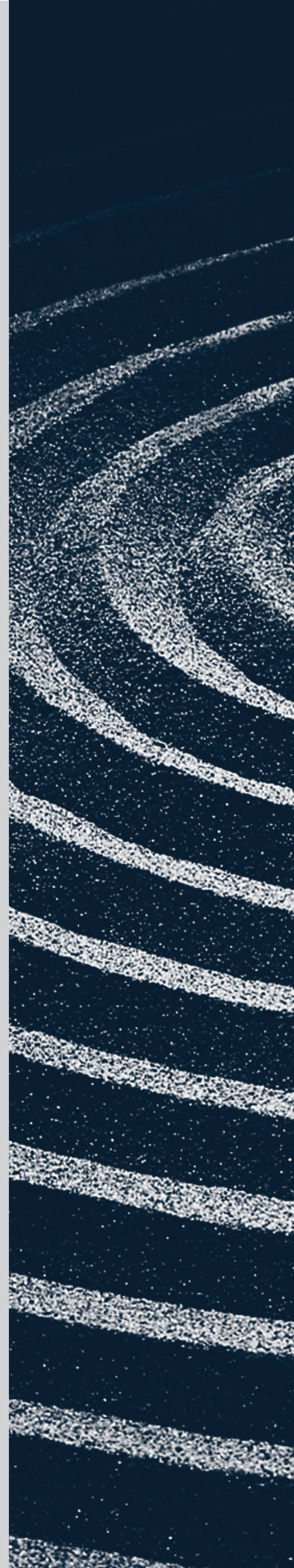
Security Holder Approval Required by TSX for More Public Company Acquisitions

What's Happening Around Miller Thomson?

F. David Rounthwaite, Managing Editor, Ontario
Dwight D. Dee, Managing Editor, British Columbia
Virginia Huang, Contributing Editor, Ontario
David Sevalrud, Contributing Editor, Alberta
David Johnston, Contributing Editor, Québec

MILLER THOMSON LLP

Barristers & Solicitors
Patent & Trade-Mark Agents



Capital Raising Under the New Registration Regime

On July 17, 2009, National Instrument 31-103 *Registration Requirements and Exemptions* ("**NI 31-103**") was published with an effective date of September 28, 2009. NI 31-103 significantly revises securities registration regulation, and will affect certain capital raising activities throughout Canada.

A key concept in NI 31-103 is that of the "business trigger" for trading registration. As a general rule, anyone who trades or advises in securities for a business purpose is subject to the registration requirement. This is a change from the current "trade trigger" regime that applies to securities dealers whereby the features of any particular trade determine whether registration is needed. Under the "business trigger" regime, regulators will look at the type of activity and whether it is carried out for a business purpose to determine if an individual or a firm must register. In determining if the activity is for a business purpose, regulators have indicated that the following factors will be relevant:

- engaging in activities similar to a registrant;
- intermediating trades or acting as a market maker;
- directly or indirectly carrying on the activity with repetition, regularity or continuity;
- being, or expected to be, remunerated or compensated;
- directly or indirectly soliciting.

The new registration rules require certain firms and persons who formerly were not required to register to become registered. The new registration rules will have an impact, in particular, on firms involved in venture capital and private equity investing.

Regulators have stated that venture capital and private equity investing are distinguished from other forms of investing by the role played by venture capital and private equity management companies ("**VCs**") and have indicated that the registration requirement will not extend to VCs whose scope of activities is limited. VCs typically raise money under prospectus exemptions. Investors rely on the VC's expertise in selecting and managing the investments and commit their money for some period of time. In return, the VC receives a management fee or "carried" interest in the profits generated from the investments. They do not receive compensation specifically for raising capital or commission for trading in securities. For VCs, there is no requirement for the VC to register, so long as the raising of money from investors and the investing of that money are occasional and uncompensated activities.

Where the activities of an entity cannot be characterized as venture capital or private equity, and money is being raised under prospectus exemptions, the trading entity would be required to register as an exempt market dealer ("**EMD**") under NI 31-103. An EMD is a dealer that is permitted to trade in securities distributed under exemptions from prospectus requirements.

However, the entity may not have to register as an EMD if money is being raised solely from investors in Alberta, British Columbia, Manitoba, the Northwest Territories, Nunavut and the Yukon Territory. The securities authorities in those jurisdictions have each issued an order exempting individuals and firms from the requirement to register when the person trades in securities in reliance on the following prospectus exemptions in National Instrument 45-106 *Prospectus and Registration Exemptions*: accredited investor; family, friends and business associates; offering memorandum; and minimum amount investment.

To rely on this order, an entity must meet each of the following conditions:

- not be otherwise registered anywhere under any other securities legislation;
- not provide suitability advice leading to the trade;
- not otherwise provide financial services to the purchaser;
- not hold or have access to the purchaser's assets;
- provide a risk disclosure in prescribed form to the purchaser; and
- file an information report with the securities regulatory authority.

Subject to the above exemption, a firm which deals in securities, including prospectus exempt securities, will be required to register as a dealer. Firms previously engaged in capital raising activities on an exempt basis will likely register as an EMD. To obtain EMD registration, a number of terms and conditions must be satisfied. A firm must designate an ultimate designated person, being the chief executive officer or an individual acting in a similar capacity, who is responsible for supervising the activities of the firm directed towards ensuring and promoting compliance with securities legislation. A firm must also designate a chief compliance officer who is responsible for establishing and maintaining policies for compliance, monitoring and assessing compliance, reporting to the ultimate designated person and submitting an annual report for the purpose of assessing compliance. The chief compliance officer of an EMD must also pass a partners, directors and officers exam and either the Canadian Securities Course exam or the Exempt Market Products exam.

EMDs must meet conditions pertaining to working capital, bonding or insurance and repayment of certain subordinated debt. EMDs must observe conduct rules, including those relating to know-your-client and suitability obligations.

In addition to the requirements for the EMD, individuals who will be acting on behalf of the EMD in a sales capacity must be registered as a dealing representative. Registration as a dealing representative requires meeting certain proficiency requirements including passing either the Canadian Securities Course exam or the Exempt Market Products exam.

For firms required to register as an EMD, NI 31-103 provides a 12-month transition period from the effective date to become fully compliant with the requirements of the instrument.

Susan Han
Toronto
T. 416.595.8167
E. shan@millerthomson.com
and
Rhea Solis
Calgary
T. 403.298.2451
E. rsolis@millerthomson.com

State of the Securities Union

While Stephen Harper and Michael Ignatieff shadow boxed over the summer of 2009, an arguably more interesting story to watch was the series of developments taking place in national securities regulation.

In January 2009, the federal government issued the final report of the Expert Panel on Securities. Headed by former Conservative cabinet minister Tom Hockin, the Expert Panel on Securities Report contemplates a national securities commission that will fully replace the securities commissions of co-operating provinces. It also contemplates a new criminal law emphasis on securities infractions. In addition to the hugely controversial assumption of federal jurisdiction to the exclusion and diminution of provincial jurisdiction, the Expert Panel Report contains other features that have significantly heated the debate. One prime example is the “opt in” procedure under which federally-regulated corporations that have to date been regulated provincially with respect to securities matters would have the option to be regulated exclusively by the new national securities regulator to the total exclusion of the former provincial regulator. Features of the report such as this have been treated by Quebec and Alberta as highly confrontational and raised the question whether Ottawa would lose its nerve.

This year for several months nothing happened on the federal front. Then in June, the Minister of Finance launched the Transition Office “to establish the Canadian Securities regulator” with the former Chair of the British Columbia Securities Commission Douglas Hyndman as Chair and CEO. The major components of the Office’s mandate are to develop a federal Securities Act, to “be the key interlocutor” for provinces, territories and existing securities regulators in the transition process and to “lead the transition to a Canadian securities regulator”. The transition is a huge task and will not be accomplished quickly. At the date of writing, the Office had opened a temporary location in Toronto and Mr. Hyndman has announced that the provinces that have agreed to appoint a representative to a new advisory counsel to design the structure and details of a new national commission will be disclosed soon. Significantly, in his announcement, Mr. Hyndman stated that by appointing a representative to the advisory council, a province will not be committing to join a new regulator, but only to participate in the process of designing the model. Mr. Hyndman is targeting 2012 for a new national securities commission to be up and running.

Surprisingly, the major development on the provincial front in this issue may not be the various “we’ll see you in court” statements made by Quebec and Alberta, but in fact the successful launch of National Instrument 31-103, Registration Reform by the Canadian Securities Administrators. Registration reform, a massive undertaking has become a reality without the involvement of the federal government. While registration reform has been supported by Ontario, which also supports establishment of the Canadian securities regulator, some of its features in fact provide counter arguments to the federal position. For example, introducing the passport system for registration which permits registration in a principal jurisdiction to be effective in all other provinces or territories is arguably no less efficient than a national securities regulator doing the same thing. The significant advantage, of course, to the passport system is that jurisdictional controversy is avoided and Quebec and Alberta willingly participate. So, leaving aside the specific issue of registration reform itself, the way in which it has been brought about in and of itself means that national securities regulation as contemplated by the Expert Panel may be more remote than ever. Correspondingly, if the passport system and other jurisdictional integration features of registration reform fail or are perceived as dysfunctional, some further support for the concept of the national securities regulator may develop.

F. David Rounthwaite
Toronto
T. 416.595.8646
E. drounthwaite@millerthomson.com

Knowing your "Know Your Product" Obligation

CDO, ABCP, ETD, CDS, CLN[1]....how many of these abbreviations can you decipher? The global financial crisis has brought to light an alphabet soup of complex financial instruments and products. More important than just recognizing the names of these instruments is actually knowing how these derivative products work. One of the key responses of regulators in the wake of the financial crisis is a call for registrants to place a renewed emphasis on meeting their "know your product" ("**KYP**") duties under securities law.

Both the Industry Investment Regulatory Organization of Canada ("**IIROC**") and the Canadian Securities Administrators ("**CSA**") have published guidance on what standards a registrant must meet to determine whether a product is "suitable" for a client. On September 2, 2009, the CSA published CSA Staff Notice 33-315 *Suitability Obligation and Know Your Product* as a reminder of the importance of understanding an investment product before it is recommended to a client and to provide guidance on how to meet this obligation.

The "know your product" requirement applies to both firm and individual registrants. The rule applies to all investment products, regardless of whether they are sold under a prospectus. The CSA expects firms to have a process of review for new products, as well as those that have undergone significant changes. A firm must also have the skills and experience necessary to conduct a product review on its own. It may not recommend a product simply based on second-hand information provided by issuers, third parties, market participants, or by identifying similarities with other investment products. In evaluating products, registrants are expected to consider several key factors including:

General Structure – The overall complexity and transparency of an investment product must be determined, as well as its basis of return and any conflicts of interest that may arise due to its return structure. It is also important to identify any unique features that may introduce unusual risks.

Risks – The process must identify the risks that relate to the product, including liquidity risks, price volatility, risks relating to assets that may underlie derivatives or structured products, and any default risks. Inherent in this analysis, which should be obvious, is determining the likelihood that a client may lose all or some of his or her investment.

Costs – The process must also determine what an investment will cost a client. This includes identifying any sales charges, commissions, referral fees, early redemption fees, and other such charges. Embedded costs, such as bid-ask spreads, must also be identified.

Who are the Parties? – Perhaps one of the most critical aspects of the review process is knowing who is involved. Of course this includes knowing your client, but more importantly, the process must reveal the history and financial position of an issuer. It must also positively identify and evaluate the qualifications and reputation of any fund managers, portfolio managers, product manufactures, or guarantors that may be involved in a transaction.

Legal Framework – Ascertaining the applicable legal and regulatory framework is also a critical aspect of the review process, because it affects both the general structure and risk portion of the review. By determining the frequency and comprehensiveness that is required by an issuer's disclosure documents, a firm can evaluate how accurate its general structure and risk analysis truly is. In other words, a firm should be confident that its review paints an accurate picture if it is based on information from an issuer that is required to make frequent and comprehensive disclosure, as opposed to a situation, such as the previous ABCP market, where little or no disclosure was required. This analysis also involves identifying exemptions that may exist as well as the legal characteristics of derivatives or structured products.

Policies and Procedures – All firms should also have written policies and procedures to ensure that they are satisfying the KYP requirement. This should include outlining the process of identifying investment products that require review and how to assess the suitability of the product for each client.

It is important to note that conducting a review and approving an investment product does not entirely satisfy the KYP requirement. Individual registrants must still be made to thoroughly understand the product before they can determine if it is suitable for a client. On March 23, 2009, IIROC released similar guidance for its members (IIROC Notice 09-0087 *Best Practices for Product Due Diligence*).

Dwight D. Dee
Vancouver
T. 604.643.1239
E. ddee@millerthomson.com
and
Keoni Norgren, *Articling Student*

Be Ready for IFRS

The Canadian Accounting Standards Board ("AcSB") will soon require public companies to adopt IFRS for financial reporting. IFRS are International Financial Reporting Standards, which are established by the International

1 *Collateral Debt Obligations (CDO); Asset Backed Commercial Paper (ABCP); Exchange Traded Derivatives (ETD); Credit Default Swaps (CDS); Credit Linked Notes (CLN);*

Accounting Standards Board ("**IASB**"), an independent standard-setting board, appointed and overseen by a geographically and professionally diverse group. Although the official changeover to IFRS is not required until January 1, 2011, public issuers must be prepared to produce IFRS compliant financial statements for the 2010 fiscal year for comparative purposes. The rigid rules that characterize Canadian generally accepted accounting principles will be replaced by the more flexible IFRS principles that are applied based on judgment and assumptions determined by the specific facts applicable to the issuer.

As companies become increasingly global, the adoption of IFRS allows investors to compare businesses using the same standards and allows businesses to create financial statements that should be interpreted consistently in the countries in which they operate.

The Canadian Securities Administrators ("**CSA**") has published a number of notices to assist issuers with the transition to IFRS.

Changes in an issuer's accounting policies that the issuer has adopted or expects to adopt after the end of its most recently completed financial year must be disclosed in management's discussion and analysis ("**MD&A**"). This disclosure must include (i) a description of the new accounting standard; (i) disclosure of methods of adoption permitted and the method the issuer expects to use; (iii) discussion of expected effects on the issuer's financial statements; and (iv) the potential effects on the issuer's business.

In CSA Staff Notice 52-320 *Disclosure of Expected Changes in Accounting Policies Relating to Changeover to International Financial Reporting Standards*, the CSA state that it recognizes that issuers may only be able to provide limited information regarding the changeover to IFRS in MD&A in the years leading up to the implementation of IFRS and provides guidance on the type of disclosure which should be made in an issuer's MD&A.

As a follow-up to CSA Concept Paper 52-402 *Possible Changes to Securities Rules Relating to International Financial Reporting Standards* released in February 2008, the CSA also released CSA Staff Notice 52-321 Early Adoption of International Financial Reporting Standards, Use of US GAAP and Reference to IFRS-IASB. CSA Staff confirmed that exemptive relief may be granted on a case-by-case basis to permit domestic issuers to prepare financial statements in accordance with IFRS for financial periods beginning before January 1, 2011. Issuers are expected to assess whether their staff, board of directors, audit committees, auditors, investors and other market participants are prepared for the change. CSA Staff also proposed that domestic issuers that are SEC registrants retain their current ability under National Instrument 52-107 Acceptable Accounting Principles, Auditing Standards and Reporting Currency ("**NI 52-107**") to use US GAAP. Finally, although the AcSB's strategic plan proposes importing IFRS into Canadian GAAP, CSA Staff stated its preference that securities rules require domestic issuers to prepare financial statements in accordance with IFRS after the changeover date, rather than Canadian GAAP.

In CSA Staff Notice 52-324 *Issues Relating to Changeover to International Financial Reporting Standards*, CSA Staff indicated that it will provide relief from the existing requirement in NI 52-107 for financial statements to be prepared in accordance with the same accounting principles for all periods presented in the financial statements. CSA Staff also recognized that domestic issuers may face difficulties in meeting the filing deadline for their first interim financial statements beginning on or after January 1, 2011. The CSA is considering methods to assist issuers with these challenges, including extending filing deadline for first interim filings for a period beginning on or after January 1, 2011.

Prior to the mandatory implementation of IFRS, companies should start or continue to educate boards and audit committees about the new standards. Certifying officers will also need to consider whether adequate internal control over financial reporting, and disclosure controls and procedures are in place to address IFRS conversion challenges.

The complexity and cost of converting to IFRS vary on a case-by-case basis, and although private companies are not required to adopt IFRS they may consider adopting IFRS in certain circumstances. For example, if a private company is considering going public in the future, is a subsidiary of a public company, has global operations, or has competitors that use IFRS, adopting IFRS may make sense.

Virginia Huang
Toronto
T. 416.595.2987
E. vhuang@millerthomson.com

Security Holder Approval Required by TSX for More Public Company Acquisitions

On September 25, 2009, the Toronto Stock Exchange ("**TSX**") announced that it received approval from the Ontario Securities Commission to amend its rules governing public company acquisitions in the TSX Company Manual (the "**Manual**").

Subsection 611(c) of the Manual requires security holder approval for the issuance of securities as full or partial consideration for an acquisition where the number of securities exceeds 25% of the issued and outstanding securities of the listed issuer on a non-diluted basis.

However, currently there is an exemption under subsection 611(d) of the Manual, which eliminates this requirement where the listed issuer is acquiring a public company. Subsection 611(d) will be deleted from the Manual and TSX listed issuers must obtain security holder approval for both private and public company acquisitions that will result in the issuance of 25% or more of their issued and outstanding securities on a non-diluted basis.

This amendment was the result of requests for comments published by TSX on October 12, 2007 and April 3, 2009. Originally, TSX proposed that security holder approval be required for the issuance of securities in payment of the purchase price for an acquisition of a public company which exceeds 50% of the number of issued and outstanding securities of the listed issuer. However, an overwhelming majority of commenters submitted that the threshold dilution level should be lower than 50%.

Section 603 of the Manual preserves TSX's discretion to impose or exempt issuers from requirements in the Manual in appropriate circumstances. However, in its Notice of Approval, TSX notes that any exercise of its discretion should be limited where a bright line test applies and that it will not exercise its discretion to alter its rules, other than in extraordinary circumstances or where the rules do not apply to the circumstances.

The amendment will become effective November 24, 2009 ("**Effective Date**"), and will not have retroactive effect. Any transaction of which TSX has been notified in writing prior to the Effective Date, whether or not TSX has already granted conditional approval, will be unaffected.

Jay M. Hoffman
Toronto
T. 416.595.8508
E. jhoffman@millerthomson.com
and
Virginia Huang
Toronto
T. 416.595.2987
E. vhuang@millerthomson.com

What's Happening Around Miller Thomson ?

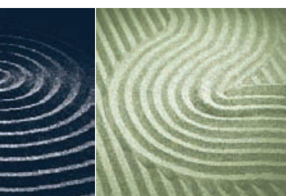
Seven new lawyers have joined our Securities and Capital Markets group in Toronto: **Ormonde Benson**, **Carl Calandra**, **Susan Han**, **David Judson**, **Jennifer Oosterbaan**, **David Rounthwaite** and **David Woolford**.

The Miller Thomson National Securities and Capital Markets group co-hosted breakfast seminars in Toronto and Vancouver on the implementation of registration reform through the introduction of National Instrument 31-103 Registration Requirements and Exemptions. The seminars were jointly hosted with Deloitte and AON and included speakers from IIROC. **Barbara Doherty**, **Susan Han** and **Dwight Dee** were among the presenters. Please check our website for details on an upcoming Montréal session.

Greg P. Shannon, **Darren Smits** and **Rhea Solis** spoke at the Calgary Chamber of Commerce on the new National Instrument 31-103 Registration Requirements and Exemptions.

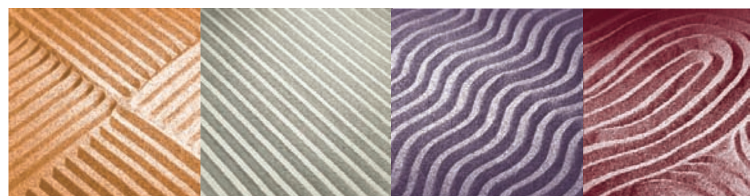
David Sevalrud and **Greg P. Shannon** co-hosted with PricewaterhouseCoopers a reception for the Institute of Corporate Directors at our Calgary office.

David Woolford spoke on the topic of "Financing Videogame Products" at the Finance Forum at the Vortex 2009 Competition in Toronto.



MILLER THOMSON LLP

Barristers & Solicitors
Patent & Trade-Mark Agents



Securities Practitioners:

Names and contact details for Miller Thomson Securities Practitioners can be found at www.millerthomson.com or by contacting the National Securities and Capital Markets Group Chair Jay M. Hoffman at 416.595.8508

Locations:

TORONTO

40 King Street West, Suite 5800
Scotia Plaza P.O. Box 1011
Toronto, ON, Canada M5H 3S1
T: 416.595.8500
F: 416.595.8695

VANCOUVER

1000-840 Howe Street
Vancouver, BC, Canada V6Z 2M1
T: 604.687.2242
F: 604.643.1200

CALGARY

3000, 700 - 9th Avenue S.W.
Calgary, AB, Canada T2P 3V4
T: 430.298.2400
F: 403.262.0007

EDMONTON

1055 - 102 Street
Edmonton, AB, Canada T5J 4G8
T: 780.429.1751
F: 780.424.5866

LONDON

255 Queens Avenue, Suite 2010
London, ON, Canada N6A 5R8
T: 519.931.3500
F: 519.858.8511

KITCHENER-WATERLOO

295 Hagey Blvd., Suite 300
Accelerator Building
Waterloo, ON, Canada N2L 6R5
T: 519.579.3660
F: 519.743.2540

GUELPH

100 Stone Road West, Suite 301
AgriCentre
Guelph, ON, Canada N1G 5L3
T: 519.822.4680
F: 519.822.1583

MARKHAM

600 - 60 Columbia Way
Markham, ON, Canada L3R 0C9
T: 905.415.6700
F: 905.415.6777

MONTRÉAL

1155 René-Lévesque Blvd. West
CIBC Tower
Montréal, QC, Canada H3B 3S6
T: 514.875.5210
F: 514.875.4308

Note:

This newsletter is provided as an information service to our clients and is a summary of current legal issues. These articles are not meant as legal opinions and readers are cautioned not to act on information provided in this newsletter without seeking specific legal advice with respect to their unique circumstances. Miller Thomson LLP uses your contact information to send you information on legal topics that may be of interest to you. It does not share your personal information outside the firm, except with subcontractors who have agreed to abide by its privacy policy and other rules.

© Miller Thomson LLP, 2009 All Rights Reserved. All Intellectual Property Rights including copyright in this publication are owned by Miller Thomson LLP. This publication may be reproduced and distributed the form or content. Any other form of reproduction or distribution requires the prior written consent of Miller Thomson LLP which may be requested from the editor at newsletters@millerthomson.com.