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Proposed National Instrument 51-103: CSA Proposes to Simplify Venture Issuer Regulation

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On May 31, 2010, the Canadian Securities Administrators (the “CSA”) released a consultation paper detailing a proposal to overhaul the securities regulatory regime applicable to venture issuers (other than issuers that fall within the definition of “venture issuer” under securities legislation by virtue of issuing only debt or preferred shares). The proposal was intended to initiate a consultation with market participants with the goal of developing an approach to venture issuer regulation that better reflects the needs and expectations of venture issuer investors and makes regulatory compliance more manageable.

This initial proposal included some significant departures from the current governance and disclosure regime including: the consolidation of venture issuer governance and disclosure requirements into one national instrument; replacing interim MD&A and financial reports with a semi-annual report; streamlining annual disclosure into one core disclosure document; and modifying disclosure obligations for prospectuses and other offering documents. The proposal also intended to focus disclosure on information believed to be more relevant to venture issuers, such as annual biographical information about executive officers, comparative information regarding executive compensation and business development expenditures, and enhanced periodic reporting.

After a 14 month consultation process, the CSA has now published for comment rules and amendments that would introduce a new regulatory regime applicable to venture issuers.

Although there were different levels of support for each of the CSA's proposals, the consultations indicated strong overall support for pursuing a more tailored approach and for the development of a separate national instrument containing the main governance and disclosure obligations applicable to venture issuers.

The Proposed Rules

The CSA's proposed rules contain most of the significant aspects of the original proposal, while abandoning some of the more contentious ideas such as the introduction of a securities law standard of care and fiduciary duty applicable to directors and officers of venture issuers. The proposed rules are designed to eliminate certain disclosure obligations that may be of less value to venture issuer investors, provide supplemental disclosure thought to be more relevant, and make regulatory compliance more manageable.

Applicable securities laws define a "venture issuer" as a reporting issuer that does not have any of its securities listed or quoted on the Toronto Stock Exchange, an exchange registered as a "national securities exchange" under the *U.S. Securities and Exchange Act of 1934*, or a marketplace outside of Canada or the U.S. other than the AIM of the London Stock Exchange and the PLUS markets operated by PLUS Markets Group. The proposal would apply to all venture issuers other than debt-only issuers, preferred share-only issuers and issuers of securitized products – in other words the proposal is focused on public companies listed on a junior exchange. Debt-only, preferred share-only and issuers of securitized products would continue to be subject to the current venture issuer requirements if they meet the venture issuer definition in NI 51-102 *Continuous Disclosure Obligations*.

The principal features of the proposed rules are:

- **Consolidation of Venture Issuer Regulation:** Canada's current governance and disclosure regime already recognizes many important variations to

accommodate the differences between venture and senior issuers; however, these variations are scattered throughout the broader securities regulatory regime. The CSA's proposed rules would streamline and consolidate the main governance and disclosure requirements applicable to venture issuers into one new national instrument (NI 51-103 *Ongoing Governance and Disclosure Requirements for Venture Issuers*), providing venture issuers with one main reference point for securities compliance.

- **Annual Report:** The proposal introduces an annual report requirement that combines business, corporate governance and executive compensation disclosure, along with MD&A, annual financials and CEO/CFO certifications. The annual report would be the core disclosure document for venture issuers. It would also have the effect of broadening the concept of the CEO/CFO certifications, as the certifications would apply to all of the material in the annual report.
- **Mid-year Report:** In place of interim MD&A and financial reports, venture issuers would file a mid-year report that would include an interim financial report, the associated MD&A and CEO/CFO certifications.
- **Interim Filings:** The new rules would make interim MD&A and financial reports voluntary; however, if a venture issuer decided to file voluntary interim reports, it would be required to do so for a minimum of two years. This modification, and in particular the move away from the U.S. approach to quarterly filings, has been the most contentious aspect of the proposal. Although other respected jurisdictions (including the U.K. and Australia) have adopted semi-annual filings, there are concerns about diverging

from the U.S. practice; and those jurisdictions that have semi-annual filings do not differentiate between the senior and junior segments of the market.

- **Information Circular:** The proposed rules would streamline information circular disclosure to information directly pertaining to the matters to be acted upon at the meeting. This would include enhanced biographical information about directors and the relocation of corporate governance and executive compensation disclosure to the new annual report.
- **Business Acquisition Report (“BAR”):** BARs would be replaced with enhanced material change reporting, and the significance tests triggering financial statement disclosure would be increased from acquisitions that are 40% significant to acquisitions that are 100% significant.
- **Enhanced Material Change Reporting:** The proposal would broaden the scope of events caught by periodic reporting, including enhanced reporting of material related entity transactions and major acquisitions. Venture issuers will continue to have access to the confidential filing procedures for material change reports, except in respect of material related entity transactions.
- **Initial Public Offerings:** The disclosure required in a long-form prospectus would be conformed to the annual report disclosure. This would remove the requirement for business acquisition reports in connection with an offering (although financial statements would be required for reverse take-overs and acquisitions that are 100% significant), would eliminate three and nine month interim financial reports and associated MD&A, and would require only two years of audited annual financial statements.

- **Short-form Offerings:** Venture issuers would also be permitted to use their annual reports in place of an annual information form in order to qualify as short-form eligible under NI 44-101 *Short Form Prospectus Distributions*. As a result, venture issuers would essentially have the same access to the short form regime as senior issuers. This is an important feature of the proposed rules given the constraints venture issuers face in timing the market, the costs and time associated with preparing a long-form prospectus, and venture issuer reliance on capital market financing.

Venture issuers would also be subject to new substantive corporate governance requirements relating to conflicts of interest, related entity transactions and insider trading; with the proposed rules requiring that venture issuers will develop policies relating to these issues. Director and executive compensation disclosure would be more tailored and streamlined, including the introduction of a simplified compensation table. New audit committee composition requirements would be introduced that largely codify the current corporate law requirements. The proposed rules would not impact other core disclosure instruments including: NI 51-101 - *Standards of Disclosure for Oil and Gas Activities*; NI 43-101 *Standards of Disclosure for Mineral Projects*; NI 52-107 *Acceptable Accounting Principles and Auditing Standards*; NI 52-108 *Auditor Oversight*; and NI 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer*.

We recognize the importance of this development to the venture industry and the impact it could have on your business. We would be delighted to discuss these proposals further and to help you formulate any comments you may have for submission to the CSA. The comment period is open until October 27, 2011. Please feel free to contact [Bill Gilliland](#) at (403) 268-6826 or

[Dan Shea](#) at (403) 268-3060 at any time to further discuss this proposal.

Contact Us

For further information, please contact a member of our [National Securities | Corporate Finance Group](#).