MEMBER REGULATION

INVESTMENT DEALERS ASSOCIATION OF CANADA

notice

ASSOCIATION CANADIENNE DES COURTIERS EN VALEURS MOBILIÈRES

ATTENTION:
Ultimate Designated Persons
Chief Financial Officers
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Please distribute internally to:
Corporate Finance
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Update of Compliance Interpretation Bulletin C-61

Guidelines for Compliance with IDA By-law 29.13

PRE-MARKETING OF DISTRIBUTIONS

These guidelines are intended to assist Members in interpreting and complying with IDA By-law 29.13 (the "By-law"). Refer also to Canadian Securities Administrators' Notice "Pre-marketing activities in the context of Bought Deals", which is attached.

1. **Convertible Securities**

   The definition of equity security in the By-law includes securities convertible into equity securities. A security is deemed to be convertible into an equity security if it includes a right or option to purchase, convert or exchange or otherwise acquire any equity security. With respect to certain redeemable or retractable preferred shares, the issuer has the right to pay the redemption price (when it redeems preferred shares) or the retraction price (when the holder exercises his right to have the shares redeemed) by issuing equity shares at a discount to market price rather than paying the redemption or retraction price in cash. These features are known as soft redemptions and retractions.

   Preferred shares that include a soft redemption or retraction feature should not be considered equity securities for the purposes of the By-law. Although the issuer has an option to issue equity shares at a discount to market price to meet the conditions in respect of redeemable or retractable preferred shares, except in extenuating circumstances, the issuer will opt to pay the redemption price or the retraction price in cash to avoid paying a higher cost of capital than would be dictated by the market. Accordingly, preferred shares with soft retraction and redemption features resemble debt securities and should be considered as such in respect of the By-law.

2. **Commencement of Distribution**

(a) DEFINITION – Commencement of distribution is defined in the By-law to mean the time when a Member has had distribution discussions with an issuer or selling security holder or another underwriter that has had discussions with an issuer or selling security holder which are of "sufficient specificity" that it is reasonable to expect the Member (alone or with another underwriter) to propose an underwriting of securities to the issuer or selling security holder. This provision is designed to ensure that confidential information concerning the issuer's intentions regarding a proposed financing are not conveyed to potential purchasers. Accordingly, while private discussions between Members and issuers would likely be caught by the definition, a public announcement by an issuer as to its financing intentions, such as a public meeting, at which a Member is present, would not generally be considered distribution discussions. Further, because in the normal course, a Member's discussions with an issuer would be followed quickly with an offer from the Member, a significant time delay between the discussions and the offer would generally indicate that the discussions were not "of sufficient specificity", or that the Member has determined that it will not pursue the distribution, and therefore such discussions would probably not constitute a commencement of distribution. If there are no distribution discussions and the issuer simply accepts an offer to underwrite a distribution from a Member, then the commencement of distribution occurs immediately upon acceptance of the offer. It may, of course, end virtually immediately with the issue of a news release.

(b) Commencement of distribution could occur at various times in the underwriting process for different Members and it will depend upon each Member's method of doing business as to when a distribution will commence. At the latest, it will have commenced at the time the offer to underwrite is made to the issuer.

Although the final decision to make the offer may be made by an underwriting committee of senior personnel of the member, it may well be that events are such that the distribution commenced before the committee's decision is made. For example, if personnel in the corporate finance department responsible for bringing proposed deals forward for approval believe that a proposed transaction is likely to be approved by the underwriting committee, their decision to recommend it could constitute commencement of distribution. When it occurs, there can be no further discussion with potential purchasers by persons with knowledge of the distribution discussions or by persons instructed by persons with knowledge.

(c) END OF RESTRICTIONS – There are three events in the By-law that open the door to a Member having communications with potential purchasers. One of them is when the issuer or selling security holder issues a news release under section 7.1 of National Instrument 44-101 announcing the signing of the underwriting agreement provided all the conditions in section 7.1 are met. Because some of the conditions in section 7.1 of National Instrument 44-101 relate to events that must happen after the news release is issued, this places a Member under some uncertainty that legitimate marketing may become

illegitimate pre-marketing if a condition is not met. This problem is exacerbated by the fact that a condition may be outside the control of the Member. As a result, this provision will not be interpreted adversely to the Member if the failure to meet the conditions was beyond the control of the Member.

(d) END OF RESTRICTIONS – Although under the By-law there are three events that could trigger the end of restrictions on communications, note that dissemination of a news release announcing the distribution is necessary in order to ensure equal access to material information among market participants, and to meet concerns about tipping and trading based on undisclosed material information. It is a condition of section 7.1 of National Instrument 44-101 permitting the solicitation of expressions of interest in advance of filing a preliminary prospectus that a news release be issued and filed forthwith upon entering into an enforceable underwriting agreement. Therefore, a news release must be issued and disseminated before communications with potential purchasers of the issue may commence.

(e) MARKET STABILIZATION AND PRINCIPAL TRADING – Commencement of distribution under the By-law will generally occur at an earlier point in time than the restrictions on principal trading activities and trading of solicited orders by underwriters commence under OSC Rule 48-501, AMF Regulation Q-26 and UMIR 7.7. The latter commence on the later of the date two trading days prior to the day the offering price is determined and the date on which a Member reaches an agreement or understanding to participate in a distribution. Normally, this will be later than when discussions with an issuer or selling security holder are of sufficient specificity that it is reasonable to expect the Member to propose an underwriting.

Note that IDA By-law 29.13 also prohibits principal trading in securities that are the subject of distribution discussions if the trading is engaged in or directed by a person with knowledge of the distribution discussions. This prohibition applies for the same period of time as the restrictions on communications apply, and reflects the legal prohibition on "insider trading" by persons in possession of material non-public information. Principal trading for purposes of market stabilization under OSC Rule 48-501 and UMIR 7.7 is only permitted if it is otherwise legal – i.e., if the fact of the distribution and material information related to it have been publicly disclosed and disseminated to investors. The trading restrictions under OSC Rule 48-501 and UMIR 7.7 continue until the date the selling process ends and all stabilization arrangements are terminated

(f) DISSEMINATION OF NEWS RELEASE – The By-law provides that a news release is deemed to have been issued when it is disseminated in accordance with the policies of applicable stock exchanges. For listed securities, the news release must be disseminated in accordance with the Timely Disclosure Policies of The Toronto Stock Exchange or the TSX Venture Exchange, as applicable. The TSX's policy requires dissemination of a complete text news

release via a news distribution service with national dissemination to the financial industry.

3. **Exempt Distributions and Special Warrants**

Discussions between a Member and an issuer or selling security holder with respect to a proposed offering which will be exempt from the prospectus requirements of securities law are not regulated by the By-law. This includes the situation where an issuer and a Member have a demonstrable bona fide intention to effect an exempt distribution that is abandoned in favour of a prospectus offering. In such a case, however, from the time when it is reasonable for a Member to expect that a bona fide exempt distribution will be abandoned, any subsequent pre-marketing activities will be subject to the By-law.

The above interpretation applies to conventional private placements of securities where the securities are intended to be issued and held under the "closed system", including special warrant offerings by issuers not eligible to use the short form prospectus system. However, the pre-marketing restrictions in By-law 29.13 are intended to apply in the case of special warrant offerings by issuers if it is intended that the underlying securities are to be qualified by a short form prospectus. The IDA may grant an exemption from this provision if it is expected that there will be a significant delay before the preliminary short form prospectus is filed. A delay for the purpose of filing a notice under section 2.8 of National Instrument 44-101 and the translation of the documents to be incorporated by reference will not generally be considered to be a significant delay.

4. **Certificate**

Although the certificate is made “on behalf of” the Member and, generally speaking, the person signing is not doing so personally, circumstances may arise when the conduct of the person signing may be considered unbecoming or not in the public interest by an SRO or a matter of continued fitness for registration under securities law.

The certificate does permit delegation of the enquiry function (“or having caused to be made”) but presumably it should be to a senior executive who is an appropriate person to perform the enquiry.