Notice

O.S.C. Policy 1.5 (formerly Draft Policy 3-47) entitled “Distributions of Securities Outside Ontario” primarily addresses the policy concern that securities distributed prospectus-free abroad not be illegally distributed or redistributed into Ontario to Ontario residents.

Policy 1.5 adopts a broad construction of the definitions of “trade” and “distribution” in the Securities Act (Ontario) (the “Act”) and states that in light of the breadth of these terms, a distribution of securities by an issuer outside Ontario may also be considered to be a distribution of securities in Ontario requiring compliance with the prospectus provisions of the Act or an exemption therefrom. The subject matter of Policy 1.5 is thus relevant both to distributions by issuers incorporated or continued under the laws of Ontario or whose head office is situate in Ontario (“Ontario issuers”) and to distributions by all other issuers (“non-Ontario issuers”) regardless of their connection, if any, with Ontario.

Policy 1.5 does not apply to issuers who satisfied the criteria for eligible reporting issuers set forth in O.S.C. Policy 5.6 entitled “Prompt Offering Qualification System” whether or not such issuers intended to effect distributions outside Ontario in accordance with Policy 5.6.

The Commission has received a considerable number of comments with respect to Policy 1.5. Some commentators have expressed the concern that Policy 1.5 will seriously interfere with the capital formation process for issuers effecting financings outside Ontario where it is manifest that there is no intention that the securities distributed abroad will find their way into Ontario and where no question arises of bringing the Ontario capital markets into disrepute.

The Commission is of the view that Policy 1.5 may have unduly interfered with legitimate distributions outside of Ontario. Therefore, as of the publication of this Bulletin, the Commission has repealed Policy 1.5. At the same time the Commission wants to make known its views on the application of the Act to distributions of securities outside of Ontario. The Commission is therefore publishing, in place and stead of Policy 1.5, the following Interpretation Note.

Distributions of Securities Outside Ontario

1. The Provisions of the Act
The basic prospectus requirement of the Act is contained in subsection 52(1) [53(1)] which provides, in part, as follows:

“No person or company shall trade in a security on his own account or on behalf of any other person or company,

(b) …...where such trade would be a distribution of such security,

unless a preliminary prospectus and a prospectus have been filed and receipts therefor obtained from the Director,” (emphasis added)

The term “trade” is defined in paragraph 1(1)42 [1(1)] of the Act, in part, as follows:

“ ‘trade’ … includes,

i. any sale or disposition of a security for valuable consideration, whether the terms of payment be on margin, instalment or otherwise, but does not include a purchase of a security or, except as provided in subparagraph iv, a transfer, pledge or encumbrance of securities for the purpose of giving collateral for a bona fide debt,

…..

v. any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of any of the foregoing;”

The term “distribution” is defined in paragraph 1(1)11 [1(1)] of the Act, in part, as follows:

“ ‘distribution’, where used in relation to trading and securities means,

i. a trade in securities of an issuer that have not been previously issued,

…..

iii. a trade in previously issued securities of an issuer from the holdings of any person, company or combination of persons or companies holding a sufficient number of any securities of that issuer to affect materially the control of that issuer, but any holding of any person, company or combination of persons or companies holding more than 20 per cent of the outstanding voting securities of an issuer shall, in the absence of evidence to the contrary, be deemed to affect materially the control of that issuer.

(emphasis added)

A “distribution” thus includes a sale by an issuer of its previously unissued securities to a purchaser, whether or not such purchaser is an underwriter of the securities. While a sale by an issuer to an underwriter acting as purchaser is exempt from the prospectus requirements of the Act by paragraph 71(1)(r) [72(1)(r)], the sale by the underwriter of such securities constitutes a distribution pursuant to subsection 71(6) [72(6)] of the Act.

The term “underwriter” is defined in paragraph 1(1)43 [1(1)] of the Act, in part, as follows:
“‘underwriter’ means a person or company who, as principal, agrees to purchase securities with a view to distribution or who, as agent, offers for sale or sells securities in connection with a distribution and includes a person or company who has a direct or indirect participation in any such distribution, but does not include, …”

2. Statement of Principle

In light of the outlined provisions of the Act, including the broad definition of “trade”, and depending on the connecting factors with Ontario, a distribution of securities outside Ontario by Ontario or non-Ontario issuers might also be considered to be a distribution of securities in Ontario requiring compliance with the prospectus provisions of the Act or a exemption therefrom.

However, where a distribution of securities in effected outside of Ontario by Ontario or non-Ontario issuers and where reasonable steps are taken by the issuer, underwriter and other participants effecting such distribution to ensure that such securities come to rest outside of Ontario, the Commission takes the view that a prospectus is not required under the Act, nor is an exemption from the prospectus requirements necessary. Reasonable precaution and restrictions should be implemented by the issuer, underwriters and other participants in the distribution to ensure that the securities are not distributed, or redistributed, into Ontario or to Ontario residents and that such securities come to rest outside Ontario. Such precaution and restrictions should be designed to ensure that the entire distribution process results in the securities being held by or for the benefit of non-residents, as opposed to intermediaries in the distribution chain holding securities for resale to Ontario residents.

3. The Operation of the Principle

The number and nature of the restrictions that should be implemented, and precautions taken, in connection with the distribution of securities outside Ontario to ensure that such securities come to rest outside Ontario will, of necessity, vary with the circumstances surrounding each distribution.

In some financings, some of the following restrictions or precautions might be advisable:

(1) A restriction in the underwriting agreement against the underwriters selling the securities being offered to any Ontario resident;

(2) A similar restriction in the banking group or selling group agreements requiring banking group members or selling group members not to offer securities to Ontario residents;

(3) An “all-sold” certificate by the underwriters that they have not, to the best of their knowledge, sold any securities to Ontario residents;
(4) A statement provided in the confirmation slip sent by underwriters to purchasers of the offered securities that it is the underwriters’ understanding that the purchaser is not a resident of Ontario; or

(5) A provision in the transfer agency agreement between the transfer agent and the issuer requiring the transfer agent not to register securities in the name of any Ontario resident for a period of time (e.g. ninety days) from the date of closing.

In Eurobond or Eurodollar financings sufficient precaution will generally have been taken where:

(1) the offering circular contains a legend stating that the securities are not qualified for sale in Ontario or Canada and may not be offered or sold directly or indirectly in Ontario or Canada;

(2) the underwriters contractually agree that they will observe this restriction regarding the prohibition of offering in Ontario or Canada; and

(3) the securities to be distributed are initially issued in temporary form exchangeable for definitive securities 90 days after completion of the distribution upon certification that the definitive securities are not beneficially owned by Ontario or Canadian residents.

In other cases other factors will be relevant, including the class and nature of the securities being distributed, the attractiveness to Ontario investors of such securities, the likelihood that, absent such restrictions or precautions, the securities would come to rest in Ontario, whether a market for the class of securities being distributed or any other securities of the issuer already exists in Ontario, the likelihood of the development in the future of a market in Ontario for the securities being distributed, the way in which the distribution is proposed to be effected, the relationship between the capital markets of Ontario and the jurisdictions in which the securities are being distributed and the case of access of one to the other, whether or not the underwriters and other participants in the distribution are, or are affiliated with, investment dealers that conduct substantial activities in Ontario and the presence of the issuer in Ontario (whether through the conduct of business in Ontario, a number of shareholders resident in Ontario, the issuer being closely followed by Ontario investors or otherwise).

In cases of private placements outside of Ontario, where hold periods would have been applicable if the placement had taken place in Ontario, the Commission takes the view that the restrictions made or precautions taken to ensure that the securities come to rest outside Ontario need not be effective beyond the time for the hold period which would have applied had the placement been made in Ontario.

The onus is on the issuer, underwriters and other participants in the distribution to determine the number and nature of the restrictions to be implemented and precaution to be taken.
4. Ontario Registrants

Each Ontario registrant has the duty to take reasonable steps to ensure that trades in securities effected by or through such registrant do not involve trades of securities into Ontario or to Ontario residents without compliance with the prospectus requirements of the Act or in reliance on an exemption therefrom. More particularly, a registrant who sells, on behalf of one of his clients, securities in Ontario or who purchases securities outside Ontario must take reasonable steps to ensure that the transaction does not involve the distribution of securities not qualified in Ontario coming to rest in Ontario or with Ontario residents.

All Ontario registrants should establish standard procedures to prevent unlawful distributions of securities into Ontario and to ensure that the registrant meets its continuing responsibility to know both its clients and the securities being sold by or to its clients.

See also National Policy 20.

5. The Integrity of the Ontario Capital markets and the Jurisdiction of the O.S.C.

Needless to say, the Commission will not hesitate to intervene, to the extent of its powers, in distributions of securities outside of Ontario which negatively impact upon the integrity of Ontario capital markets.

Where the Commission becomes aware of distributions abroad by Ontario issuers that bring the reputation of Ontario’s capital markets into disrepute, the Commission is of the view that it has the jurisdiction, for the due administration of the Act and in order to preserve the integrity of the Ontario capital markets, to exercise its cease trade powers or to take other appropriate action against issuers, underwriters and other participants so distributing securities abroad.