

**Ontario Securities Commission**

**Policy 51-604**

**Unofficial consolidation current to 2011-01-01.**

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**POLICY 51-604**

***DEFENCE FOR MISREPRESENTATIONS IN FORWARD-LOOKING INFORMATION***

**Contents**

**Part I Introduction**

Background

**Part II Defence for Misrepresentations in Forward-Looking Information**

Legislative scheme

Animating Principles

Risk factor disclosure

Assumption disclosure

Reasonable Basis

**Part III Defence for Misrepresentations in Oral Statements Containing Forward-Looking Information**

Legislative Scheme

A more flexible approach

**Part IV Duty to Update**

## **PART I INTRODUCTION**

### **Background**

**1.1 (1)** Ontario securities law provides public issuers, directors, officers and other parties with a defence from statutory civil liability for misrepresentations in forward-looking information. The defence for misrepresentations in forward-looking information was first introduced into Ontario securities law in December 2002 and came into force on December 31, 2005 as part of the introduction of a statutory civil liability regime in favour of secondary market investors.<sup>1</sup> A similar defence exists in those parts of the *Securities Act* that provide a statutory right of action for damages for misrepresentations in primary market offering documents.<sup>2</sup> The defence contained in the *Securities Act* is based on draft legislation that the Commission, together with certain members of the Canadian Securities Administrators, proposed for public comment.

**(2)** Ontario securities law defines forward-looking information as disclosure about possible events, conditions or financial performance that is based on assumptions about future economic conditions and courses of action.<sup>3</sup> Forward-looking information includes, but is not limited to, future-oriented financial information with respect to prospective results of operations, financial position and/or cash flows that is presented as either a forecast or a projection. Earnings guidance is an example of forward-looking information. MD&A may also contain forward-looking information.

**(3)** Forward-looking information is, by its very nature, information that carries with it a level of uncertainty. There is a concern that attaching statutory civil liability to information that contains inherent uncertainties will discourage issuers from disclosing or providing forward-looking information. Such a "disclosure chill" would not be desirable. Understanding management's assessment of the future prospects and potential of a company is valuable to shareholders and prospective investors. Indeed, some forward-looking information, for example in the form of MD&A, is required. The policy objective behind the defence applicable to forwarding-looking information is to facilitate responsible and balanced disclosure about an issuer's anticipated future prospects.

**(4)** This policy statement expresses the Commission's views on some of the policy considerations underlying the defence for misrepresentations in forward-looking information and explains how the Commission approaches the interpretation of certain aspects of the defence. It is being issued under subsection 143.8(1)(b) of the *Securities Act*.

This policy statement represents the views of the Commission which do not have the force of law. These views are also not legal advice and should not be relied on as such.

We expect that disclosure practices in this area will vary among issuers and will evolve over time.

## **PART II DEFENCE FOR MISREPRESENTATIONS IN FORWARD-LOOKING INFORMATION**

### **Legislative scheme**

**2.1** Written and oral forward-looking information is protected from statutory civil liability if:

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<sup>1</sup> See paragraphs (9), (9.1), (9.2) and (10) of section 138.4 of the *Securities Act*.

<sup>2</sup> See section 132.1 of the *Securities Act*.

<sup>3</sup> See subsection 1(1) of the *Securities Act*.

- (a) the document or public oral statement contains:
  - (i) reasonable cautionary language identifying the forward-looking information as such (the "identifier");
  - (ii) reasonable cautionary language identifying material factors that could cause actual results to differ materially from a conclusion, forecast or projection in the forward-looking information ("risk factors"); and
  - (iii) a statement of the material factors or assumptions that were applied in drawing a conclusion or in making a forecast or projection set out in the forward-looking information ("assumptions");
- (b) the identifier and disclosure of risk factors and assumptions appear proximate to the forward-looking information; and
- (c) the person or company had a reasonable basis for drawing the conclusions or making the forecast or projection.<sup>4</sup>

## Animating Principles

**2.2** The principles animating the defence for forward-looking information include:

- (a) an investor who reads a disclosure document or listens to an oral statement containing forward-looking information should be able to readily:
  - (i) understand that forward-looking information is being provided in the document or statement;
  - (ii) identify the forward-looking information; and
  - (iii) inform himself or herself of the material assumptions underlying the forward-looking information and the material risk factors associated with a particular conclusion, forecast or projection; and
- (b) effective disclosure is based on clarity of presentation and simplicity of language and style.

The "proximate" requirement

**2.3 (1)** Concerns have been expressed that the word "proximate" may be interpreted so as to require immediate juxtaposition of information in every instance. If this were the case, each statement of forward-looking information would need to be individually identified as such and all of the material risk factors and assumptions applicable to the statement immediately included, irrespective of the fact that these risk factors and assumptions may apply to various statements of forward-looking information in the same disclosure. The Commission does not interpret the "proximate" requirement to require immediate juxtaposition.

**(2)** MD&A, for example, frequently has threads of forward-looking information throughout. These threads of forward-looking information may be subject to common assumptions and risk factors. Breaking the flow of the discussion to indicate each time that a particular statement is forward-looking and to identify in a meaningful way the factors that could affect its outcome introduces complexity in presentation that could frustrate an investor's ability to readily follow the MD&A discussion and appreciate the nature of the forward-looking information. A reader may be better served by a single broader reference prefacing or following, as appropriate, the MD&A identifying and setting out the applicable assumptions and risk factors. The Commission believes that such placement should generally satisfy the "proximate" requirement of the defence.

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<sup>4</sup> See subsection 138.4(9) of the *Securities Act*.

**(3)** There may be situations where particular assumptions and risk factors apply equally to multiple instances of forward-looking information in a single document. In the Commission's view, the use of cross-referencing in a manner that supports user friendliness and the principles animating the defence is consistent with the "proximate" requirement of the defence. We recognise that practices with respect to the use and extent of cross-referencing will vary among issuers depending on the circumstances and the nature of the particular disclosure.

**(4)** In the Commission's view, the animating principles underlying the defence suggest that, as a general principle, the more closely-tied a particular risk factor or assumption is to a particular conclusion, forecast or projection, the more "proximate" it should be to the forward-looking information. For example, where the disclosure of risk factors and assumptions is particularly tied to a forward-looking statement but does not immediately precede or follow the forward-looking statement, it may be necessary to provide a cross-reference or footnote that ties the risk factor or assumption to the specific conclusion, forecast or projection.

## **Risk factor disclosure**

**2.4 (1)** The defence for misrepresentations in forward-looking information requires the material factors that could cause actual results to differ materially from a conclusion, forecast or projection in the forward-looking information to be identified ("risk factors"). The risk factors identified in the cautionary language should be relevant to the conclusion, forecast or projection and should not be boilerplate in nature.

**(2)** The use of the word "material" underscores, in the Commission's view, that the cautionary statements should identify significant and reasonably foreseeable factors that could reasonably cause results to differ materially from those projected in the forward-looking statement. We do not believe that the defence should be interpreted as requiring an issuer to anticipate and discuss everything that could conceivably cause results to differ. It follows that failure to include the particular factor that ultimately causes the forward-looking statement not to materialize as predicted should not necessarily mean that the defence is not available. The defence does not, in the Commission's view, require companies to warn of every risk factor that, with the benefit of hindsight, ultimately could or might cause the forward-looking information not to come true. Similarly, the failure to include disclosure of the particular assumption that ultimately causes the forward-looking statement not to materialize as predicted should not necessarily mean that the defence is not available.

## **Assumption disclosure**

**2.5** The defence for misrepresentations in forward-looking information requires a statement to be included of the material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection set out in the forward-looking information. The requirement for a statement of the material factors or assumptions that were applied requires, in the Commission's view, the factors or assumptions to be relevant to the conclusion, forecast or projection. The use of the word "material" underscores, in the Commission's view, that the defence does not require an exhaustive statement of every factor or assumption applied – a materiality standard applies.

## **Reasonable Basis**

**2.6** In order to benefit from the defence, a company must have a reasonable basis for drawing the conclusion or making the forecast or projection set out in the forward-looking information. When interpreting "reasonable basis", we believe that relevant factors would generally include the reasonableness of the assumptions applied in drawing the conclusion or

making the forecast or projection; and the inquiries made and the process followed in preparing and reviewing the forward-looking information.

### **PART III DEFENCE FOR MISREPRESENTATIONS IN ORAL STATEMENTS CONTAINING FORWARD-LOOKING INFORMATION**

#### **Legislative Scheme**

**3.1** The *Securities Act* provides that in the case of a public oral statement containing forward-looking information, a person or company is deemed to have satisfied the requirements of the defence in paragraph 1 of subsection 138.4(9) (which are discussed in Part II of this Policy) if the person making the public oral statement states that:

- (a) the oral statement contains forward-looking information;
- (b) actual results could differ materially from a conclusion, forecast or projection in the oral forward-looking information;
- (c) certain material factors or assumptions were applied in drawing the conclusions or making the forecasts or projections included in the oral forward-looking information; and
- (d) additional information about the applicable risk factors and assumptions are contained in a "readily available" document and identifies that document.<sup>5</sup>

For purposes of the defence, a document filed with the Commission or otherwise generally disclosed is deemed to be "readily available".<sup>6</sup>

#### **A more flexible approach**

**3.2 (1)** The *Securities Act* recognizes that it may be unwieldy to make oral disclosures containing forward-looking information that satisfy all of the requirements of the defence contained in subsection 138.4(9). Instead, the *Securities Act* provides for a more flexible approach for oral statements containing forward-looking information that facilitates these types of oral communications by an issuer while still providing the information that would have been received if the forward-looking information had been contained in a written disclosure document.

**(2)** The deeming provision in subsection 138.4 (9.1) specifically refers to the requirements of the defence being satisfied in the case of public oral statements when the person making the public oral statement makes the required cautionary statements. In the Commission's view, subsection 138.4 (9.1) should not be interpreted as exhaustive; the requirements of the defence may be satisfied in appropriate circumstances by one person making the required cautionary statements on behalf of another person who is making the forward-looking statement. The animating principles underlying the defence support a pragmatic interpretation.

### **PART IV DUTY TO UPDATE**

**4.1** We do not interpret the defence for misrepresentations in forward-looking information as imposing upon any person or company a duty to update forward-looking information beyond any duty imposed under Ontario securities law or otherwise.

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<sup>5</sup> See subsection 138.4(9.1) of the *Securities Act*.

<sup>6</sup> See subsection 138.4(9.2) of the *Securities Act*.