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The First Concrete Step in the OSC's Exempt Market Reform Initiative: Introducing the Existing Security Holder Prospectus Exemption

On November 27, 2014,[1] the Ontario Securities Commission ("**OSC**") announced certain rule amendments[2] that will give effect to a new capital raising prospectus exemption (the "**Existing Security Holder Prospectus Exemption**") for reporting issuers listed on the Toronto Stock Exchange, the TSX Venture Exchange, the Canadian Securities Exchange and the Aequitas Neo Exchange[3] (the "**Exchanges**"). This new exemption is scheduled to come into effect on February 11, 2015.

The Amendments follow the OSC's review of the exempt market to examine whether there was a need for additional prospectus exemptions to facilitate capital raising, particularly for start-ups and small and medium-sized enterprises ("**SMEs**"), while protecting investors' interests. As a result of this review, the OSC published for comment, on March 20, 2014, four proposed prospectus exemptions and two proposed reports of exempt distribution, which included the Existing Security Holder Prospectus Exemption. The Amendments are the first concrete steps in the OSC's exempt market reform initiative.

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1 Ontario Securities Commission, Notice of Amendments to Ontario Securities Commission Rule 45-501, “Ontario Prospectus and Registration Exemptions” (27 November 2014) online: OSC <*http://www.osc.gov.on.ca*>.

2 Amendments to OSC Rule 45-501 *Ontario Prospectus and Registration Exemptions* (“**Rule 45-501**”), as well as certain policy changes to Companion Policy 45-501CP to Rule 45-501 (“**45-501CP**”) and consequential amendments to National Instrument 45-102 *Resale of Securities* (collectively, the “**Amendments**”).

3 With respect to the Aequitas Neo Exchange, upon the effective date of the recognition order for such exchange.

Consistent with the theme of enhancing an issuer's ability to raise capital, on November 27, 2014, the Canadian Securities Administrators also published a notice and request for comment on proposed amendments to the prospectus-exempt rights offering regime. Please see our commentary on this proposal *here*.

What is the Existing Security Holder Prospectus Exemption?

The Existing Security Holder Prospectus Exemption is a prospectus exemption for distributions to existing security holders by a reporting issuer (other than an investment fund) of its own securities. It provides investors who have acquired securities of a listed issuer with the opportunity to participate in primary offerings of that issuer. Offerings are limited to the class of equity securities listed on one of the Exchanges, or units consisting of the listed security and a warrant to acquire the same. Securities distributed under the Existing Security Holder Prospectus Exemption will be subject to a four month hold period, subject to certain other conditions being met. All distributions under the exemption will require the filing of a report of exempt distribution.[4]

Who is eligible for the Existing Security Holder Prospectus Exemption?

The Existing Security Holder Prospectus Exemption will be available to reporting issuers (other than investment funds) with equity securities listed on an Exchange, provided the reporting issuer has complied with its periodic and timely disclosure requirements.

What do reporting issuers need to know?

Reporting issuers wishing to use the Existing Security Holder Prospectus Exemption must make the offering available to all existing security holders who, as of the record date, hold a listed

[4] The report will be under Form 45-501F *Report of Exempt Distribution* which must be accompanied by payment of a $500 activity fee.

security of the same class and series as the listed security to be distributed under the exemption. This record date must be at least one day before the date on which the issuer issues an offering news release. A distribution may not result in dilution of greater than 100% in the number of outstanding securities of the same class.

Under the Amendments, reporting issuers are not required to provide an offering document, but must issue an offering news release disclosing in reasonable detail the proposed offering, including the use of proceeds arising from the offering. Offering materials must be filed no later than the day they are first provided to investors.

While there is no requirement for reporting issuers to allocate a *pro rata* portion of the offering to existing security holders, issuers should refer to 45-501CP to ensure fair and equal treatment of existing security holders.

Finally, the OSC has made it clear that it believes it would be "improper" for issuers to solicit investors to purchase shares in the secondary market in order to be able to rely on the Existing Security Holder Prospectus Exemption.

What do investors need to know?

Investors wishing to acquire securities under the Existing Security Holder Prospectus Exemption must confirm in writing to the issuer that they held (as of the record date), and continue to hold, the type of listed security being acquired. An investor will be limited to investing no more than an aggregate amount of $15,000 in an issuer under the exemption in any 12-month period, unless advice regarding the suitability of the investment has been obtained; if the investor is a Canadian resident, such advice must be from an investment dealer registered in the investor's jurisdiction.

Investors will have no statutory right of rescission or contractual rights against an issuer under the Existing Security Holder Prospectus Exemption. However, they are provided with rights of action in keeping with the secondary market civil liability provisions in Part XXIII.1 of the *Securities Act* (Ontario). Accordingly, investors will have rights of action for damages relating to misrepresentations in documents released on behalf of an issuer, misrepresentations in public oral statements by certain persons, and failure of an issuer to make timely disclosure.

Towards Harmonization with the CSA

In implementing the Existing Security Holder Prospectus Exemption, the OSC is harmonizing itself with the other Canadian jurisdictions, other than Newfoundland and Labrador, all of which have already adopted a similar exemption (the "**CSA Exemption**"). However, while the Existing Security Holder Prospectus Exemption is substantially similar to the CSA Exemption, the two are not identical. Notably, the CSA Exemption does not have a carve-out for investment funds, while in Ontario investment funds are excluded in keeping with the policy rationale of facilitating capital raising for SMEs. Also, unlike the CSA Exemption, the Existing Security Holder Prospectus Exemption requires that a distribution of listed securities or units by an issuer must not result in an increase of more than 100% of outstanding listed securities of the same class and series.

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a cautionary note

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