

Freely Trading Securities Without a Prospectus

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For many smaller Canadian public companies, the current short-form prospectus regime can be prohibitive from a cost perspective, and some investment dealers have less interest in smaller offerings. The Canadian Securities Administrators (“CSA”) has proposed a new prospectus exemption (the “Exemption”) for reporting issuers listed on a recognized stock exchange in Canada, which is intended to serve as an alternative to the commonly used short-form prospectus regime. The proposed Exemption aims to both reduce the cost and regulatory burden associated with accessing the public markets, while facilitating enhanced retail investor participation in securities offerings and maintaining appropriate protections for those investors.

Who Can Qualify?

In order to rely on the Exemption, an issuer must:

- have securities listed on a recognized Canadian stock exchange;
- have been a reporting issuer for at least 12 months in at least one jurisdiction in Canada immediately prior to announcing the offering of securities in reliance on the Exemption;
- have an up-to-date continuous disclosure record;
- have active business operations (an issuer whose operations have ceased or whose principal asset is cash, cash equivalents or its exchange listing will not qualify);
- prepare and file a short offering document on SEDAR, on the issuer’s website and with the relevant securities commission(s) prior to soliciting any purchasers and no later than three business days after the date of the form;
- announce the offering by press release before soliciting an offer to purchase the securities, which must state that the offering document is accessible on SEDAR and on the issuer’s website; and
- cease distribution no later than the 45th day after issuing the news release.

Capital Raising Conditions

The Exemption would permit an eligible issuer to raise up to the greater of \$5 million or 10% of the issuer’s market capitalization, to a maximum of \$10 million, during a 12-month period immediately before announcing the offering. In addition, distributions of securities made under the Exemption during the 12-month period may not result in more than 100% shareholder dilution or, in the case of debt, 100% of the principal amount.

Notably, the securities can be issued to any type of investor and would be freely tradeable on issuance, similar to securities issued under a short-form prospectus; provided however, only listed equity securities or securities convertible into equity securities are eligible to be issued. Subscription receipts may be issued so long as shareholder approval of the transaction is not required. In their request for comments, the CSA has solicited public comments regarding whether convertible debt should be included as an equity security.

The Exemption is not permitted to be used if the issuer intends to use the proceeds of the offering for a significant acquisition or a restructuring transaction, whereby additional financial statements would be

required under the prospectus rules. If an issuer is intending to raise capital to finance a significant acquisition or a restructuring transaction by distributing securities to retail investors, the issuer would be required to use the prospectus regime in order to ensure potential purchasers have full, true and plain disclosure of all material facts related to the intended use of proceeds.

Similar to a private placement, an issuer that has relied on the Exemption will be required to file a report of exempt distribution within 10 days of closing, however, detailed confidential information on the purchasers will not be required (Schedule 1).

Offering Document and Secondary Market Liability

An issuer intending to rely on the Exemption will be required to prepare and file with the CSA a brief offering document describing, among other things, any new developments in the issuer's business, the issuer's financial condition, the use of proceeds and how proceeds from any offering in the previous 12 months were used. The document must also include a certification that both the offering document and the issuer's 12-month continuous disclosure record contain no misrepresentations.

While the CSA will not review the offering document as it would in the case of a prospectus, the offering document will be considered a "core" document under the secondary market civil liability regime, and the issuer will still attract secondary market civil liability if the offering document or the issuer's continuous disclosure record contains a misrepresentation. In addition, purchasers will have the right to rescind a purchase of securities within 180 days of the purchase. The CSA is soliciting comments as to the appropriateness of the secondary market liability regime and whether full prospectus liability may be a more appropriate incentive to issuers to provide adequate disclosure.

Key Considerations

Although the Exemption is subject to change as a result of feedback received from stakeholders during the comment period spanning until October 26, 2021, the following practical implications can be drawn if the Exemption is adopted in its current form:

- **Greater cost efficiencies.** Issuers can expect to realize cost efficiencies as there would be no requirement for an investment dealer to facilitate the purchase and sale of securities, and no prospectus will need to be prepared, filed and cleared with the applicable securities commission(s);
- **Greater access to capital.** Smaller issuers would have easier access to the capital markets and a broader group of investors given that any type of purchaser can rely upon the exemption without the need to satisfy certain identity-based criteria, such as financial thresholds or relationships. Given that securities issued in reliance on the Exemption will be freely tradable, this would likely be an attractive option for investors;
- **Freely trading securities.** Given how costly it is to conduct a prospectus offering, smaller issuers may complete more private placements in reliance on the Exemption as they will still be able to issue freely tradable securities without the significant costs associated with a prospectus offering; and
- **Enhanced disclosure and potential risk.** Smaller issuers would have a greater incentive to maintain an up-to-date continuous disclosure record given that it is a requirement for relying on the Exemption and exposes issuers to added potential liability. Purchasers under the Exemption would have civil remedies in the event of a misrepresentation and contractual rights of rescission.
- **Impact on prospectus offerings.** The Exemption has the potential to erode the prospectus market for raises under \$10 million.

The Capital Markets Group at Aird & Berlis LLP is ready to assist with any matter or question related to securities legislation. If you require any assistance with the foregoing, please contact us.

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