**Securities Regulation Notes**

Table of Contents

[Chapter 1: Context and Philosophy 2](#_Toc530666983)

[Introduction 2](#_Toc530666984)

[What are securities? 2](#_Toc530666985)

[Where & how securities are first sold? 3](#_Toc530666986)

[Where & how securities are subsequently traded? 3](#_Toc530666987)

[Purpose of securities regulation 3](#_Toc530666988)

[How are these objectives achieved? 4](#_Toc530666989)

[Structure of Securities Regulation in Canada 4](#_Toc530666990)

[Foundational concepts 4](#_Toc530666991)

[What is a security? 5](#_Toc530666992)

[*s.1(1)* security includes: 5](#_Toc530666993)

[(d) debt security: a bond, debenture, note or other evidence of indebtedness, share, stock, unit, unit certificate, participation certificate, certificate of share or interest, preorganization certification or subscription other than 6](#_Toc530666994)

[September 19, 2018 8](#_Toc530666995)

[What is a Trade? 12](#_Toc530666996)

[What is a Distribution? A trigger to file a prospectus: S61(1). 14](#_Toc530666997)

[September 26, 2018 14](#_Toc530666998)

[Chapter 7—The Prospectus 14](#_Toc530666999)

[Reporting Issuer 15](#_Toc530667000)

[When is a prospectus required? Almost always (S61), unless exempt by NI 45-106(\*pg) or S76 15](#_Toc530667001)

[Steps for filing prospectus 17](#_Toc530667002)

[October 3, 2018 18](#_Toc530667003)

[October 10, 2018 20](#_Toc530667004)

[October 24, 2018 21](#_Toc530667005)

[Secondary Trading of Cryptoassets 23](#_Toc530667006)

[November 7, 2018 27](#_Toc530667007)

[Derivatives 27](#_Toc530667008)

[November 14, 2018 31](#_Toc530667009)

[November 21, 2018 34](#_Toc530667010)

[Exam: 40](#_Toc530667011)

**Different approaches to regulation in general**

* Spectrum of regulation
  + Laissez faire <–> full government regulation (ie. income tax act)
* laissez faire
  + benefits
    - Lower costs
    - More innovation with financial instruments
    - Autonomy
    - More foreign investment
    - More efficient – less bureaucratic
  + Cons
    - Uncertainty
    - Not all investors are rational
    - Information asymmetry
    - Encourage fraud
    - More monopolies
* Government regulation
  + Benefits
    - Investor confidence
    - More protection
    - Information symmetry
    - Mitigating risk
    - Benefits collective interest vs. self interest ie. regulate environment
  + Cons
    - Bureaucracy – inefficiency
    - Accountability
    - Costly, unpredictable

# Chapter 1: Context and Philosophy

## Introduction

* Securities regulation: the regulation of capital markets
* Regulation of anyone who issues securities, or anyone acting as an intermediary to trade
* Primary Objectives of Securities regulation: Investor protection
  + gives investors information to make informed decisions
  + preventing dishonest actors out of market
* Second objective: Fostering fair and efficient capital markets
  + “Market integrity”: requires that information about issuers/investments are disseminated to the public at the same time
* Capital markets regulation has 3 components: securities regulation; banking regulation (fed jurisdiction, *Bank Act*); regulation of insurance products (prov jurisdiction)
  + Capital markets are markets for raising money through buying and selling equity and debt instruments.
  + There is no national regulator in Canada, but there is interest in creating one
  + Primary concern of banking regulators is solvency of banks (prudential regulation)
* Capital markets are one subset of Financial Markets as a whole

## What are securities?

**Types of securities**

* **(1) Debt securities:** company is borrowing money from investors – ex. bonds (secured), debentures (unsecured), commercial paper, government bonds. Features include: face value, maturity date, interest rate (also referred to as coupon rate)
  + bank loans are not securities
  + bonds are traded over the counter and are less relevant today than they used to be
  + debt has a higher priority than equity in that it is paid out first on bankruptcy
  + bondholders do not have a vote in the operation of the business
* **(2) Equity securities:** company is selling investors a right to share in its future profits; buying an ownership stake in the company
  + Share or stock – 3 fundamental rights: (1) right to share in profits through dividends (if declared, totally up to company); (2) right to share in residual profits upon liquidation/bankruptcy; (3) right to vote @ SH meetings. “Common” SHs are entitled to all 3, but “preferred” SHs have preferential rights to dividends/residual assets, but no right to vote.
  + A unit in a business trust or partnership (analogous to share of corporate)
  + note: Equity carries more risk than debt securities b/c possibility of no dividend and must pay debt obligations before a dividend is declared
* **(3) Derivative securities:** derive their value from another instrument or other underlying asset or variable. Purpose: used for hedging risks (zero-sum gain: one person profits, the other loses the equivalent amount) and speculation (of price changes)
  + Equity derivative is dependent on the projected future profits
  + “Futures Ks” are used to guard against increase in prices.
  + An “option” is a contract that entitles, but does not require, its holder either to buy or sell a particular security on a particular date at a specified price.
    - Underwritten options
    - Call (option to buy); put (option to sell)
  + “Swaps” are arrangements under which two parties agree to exchange particular cash flows over a fixed period of time.
  + “Short sale” works by securities loan K – borrowing security & selling it off in the market in anticipation that it will drop, buying it back, repaying loan and keeping profit for yourself.

### Where & how securities are first sold?

* First, sell in an exempt market (private placement) – issuer may sell securities to ppl known by its management, venture capitalists, or to other sophisticated investors, but not general public.
* Later, issuer may retain an underwriter to sell securities to the general public in an “initial public offering” (IPO) – issuer becomes a “reporting issuer” and therefore subject to a host of ongoing obligations under securities regulation.
  + Reporting issuer can still issue more securities in the exempt market after an IPO

### Where & how securities are subsequently traded?

* Traded among investors in the “secondary market” – between investors w/ no involvement by the issuer.
  + Securities sell higher in “deep” and “liquid” markets
  + “deep” markets: one in which many of the issuer’s securities are being traded
  + “liquid” markets: one in which there are many ready and willing buyers and sellers of the issuer’s securities
* Securities can be listed on stock exchanges, which provide considerable depth and liquidity.
* Certain securities (such as many derivatives, all corporate bonds & debentures) trade in “over-the-counter” markets.
* Institutional investors can arrange for private trades w/ other investors in the “upstairs market”.
* Also, a range of alternative trading systems (ATSs) exist.
* Major investors: banks, trust companies, credit unions, caisses populaires, insurance companies, pension funds and investment funds
  + Pension funds=largest buy side
* Retail investors = individual investors

## Purpose of securities regulation

* Unique features of securities markets have led to the disclosure-based approach – securities regulation seeks to ensure investors are aware of the risks to which they are exposed, rather than attempting to eliminate all risk.

1. **Investor Protection:** provides investors with protection from unfair, improper, or fraudulent practices – how? Through info disclosure!
2. **Capital Market Efficiency:** foster fair and efficient capital markets (market integrity), which involves striking a balance in that investor protection schemes cannot be so onerous as to deter corporations from using capital markets to raise funds
   1. Optimal financial resource allocation: capital markets help to allocate savings to businesses to put them to productive/socially optimal use
   2. Investors must be able to convert financial resources from one form to another easily and inexpensively
   3. There should be a consistent valuation framework—mandated by info disclosure
3. Other Goals
   1. **Address systematic risk:** which involves risk of breakdown among institutions & other market participants in a chain-like fashion that has the potential to affect the entire financial system negatively.
   2. **Public confidence:** to promote investor confidence and transparency in the capital markets

* The first 2 objectives are enshrined in Canadian securities legislation. The others can be viewed as a component of the primary objectives, but also requires separate treatment in the wake of the global financial crisis (GFC) and the 2011 *Reference re Securities Act* decision.

**Reference re Securities Act:** the proposed federal *Securities Act* was rejected as unconstitutional by the SCC, but the court held that systematic risk falls under federal jurisdiction.

### How are these objectives achieved?

* Canadian securities regulation uses 3 basic techniques:
  + registration of persons (traders, brokers): everyone who acts as a dealer, adviser or investment fund manager must register with the relevant commissions (main concern is knowledge of financial markets and solvency)
  + registration of issuers and securities: an issuer must qualify an acceptable prospectus with the commission for all securities being distributed to the public for the first time (main concern is transparency)
    - Continuous disclosure of all material info by issuers (information asymmetry)
  + anti fraud/market conduct measures: everyone in the securities industry must honour the anti fraud rules found in relevant legislation (insider trading, etc.)
* None of these methods attempt to eliminate risk altogether. They are trying to ensure that investors can fairly evaluate securities, they are fairly priced, have access to all relevant information in deciding whether or not to make investment

## Structure of Securities Regulation in Canada

* Despite attempts to harmonize system, no national regulator
  + Provinces and territories all have their own securities laws and regulators which are independent of the government
  + Securities regulators can issue fines and ban issuer from the market
* Other federal acts affect securities system
  + *Canada Business Corporations Act*: regulates conduct of federally incorporated companies
  + *Criminal Code*, *Competition Act, Investment Canada Act*
    - Courts can issue fines and jail sentences
* Administration
  + Each jurisdiction has its own administration agency
  + Canadian Securities Administrators: umbrella organization of all 13 Canadian regulators and the forum in which harmonization efforts occur
* **Administrative structure:** vary by jurisdiction, but most are two-tier (p.86):
  + The first level is the “official Commission” – consists of a tribunal; members called commissioners one of whom is designated as Chair; commissioners generate policy and make decisions in administrative enforcement proceedings
  + The second level is the staff, which runs the Commission’s day to day operations.

# Foundational concepts

* The scope of securities regulation in Canada is based on 3 fundamental concepts:

1. Security – defined inclusively (not exhaustive, very broad definition)
2. Trade, and – defined inclusively
3. Distribution – defined exhaustively

* A transaction that involves a security, trade and distribution is subject to the full range of securities regulation.
  + Note – there are statutory and discretionary exemptions
* Definitions of security and trade are intentionally overbroad to ensure they catch every transaction the Commissions deem necessary to regulate, including new or unique formulations and structures – which prevents people from devising transactions to escape regulation 🡪 **“catch-then-exclude” strategy**

## What is a security?

* Two interpretations guide definition of securities:
  + A broad, flexible approach is appropriate since securities regulation is protective, not punitive.
  + And, courts will adopt substance over form. In other words, they focus on the general economic effects of the whole transaction rather than the specific technical details of any parts of it.

## s.1(1) security includes:

**(a) a document, instrument or writing “commonly known” as a security** – to ensure broad/flexible interpretation

* Broad, catch-all term: The issue is determining what is common knowledge
* Knowledge that is common among securities professionals (sophisticated analysts, securities lawyers), not laypersons: **Glenn (**; **Gelderman** (Quebec)
* The Quebec Securities Commission held that proof of common knowledge “must be based on an overwhelming set of facts and conclusive evidence”: **Geldermann**

**(b) a document evidencing title to, or an interest in, the capital, assets, property, profits, earnings or royalties of a person** – *reflects goal of protecting investing public* *in capital markets*

* **Basic test:** whether a “document” shows some form of investment or speculation
  + This includes property interest acquired for the purpose of making an investment, rather than buying a commodity to merely acquire an interest in property**.** The K will typically feature performance of a service by others that is meant to increase value of the property.
* **Case law: Whether the document shows a form of investment or speculation? Is there an expectation of return based on work of another?**
  + **\*Swain: Title doc for a ½** interest in a pair of breeding chinchillas was held to constitute a security b/c the vendor agreed to share w/ the purchaser the profits gained from breeding the chinchillas. Purchaser was making an investment, not buying a pet.
  + **\*Brigadoon: scotch whisky receipts** were held to be securities b/c they were bought & sold as an investment (hoping its value increased as it aged), not as inventory or for consumption (didn’t purchase w/ a view to take possession).
    - *Individuals purchased scotch stored in Brigadoon’s warehouse. It was aged for a number of years and then sold by Brigadoon on behalf of its owners to various blenders.*
  + **Raymond Lee:** **Control can help determine whether something is security or not**
    - *Company solicited people w/ inventions and would help ppl with their patent application + marketing in return for 20% interest in invention = NOT security, inventors still in complete control, primarily a transaction for patent processing, inventors did not regard as security*
  + **Re Sunfour Estates:** co-tenancy interests in undeveloped commercial real estate were NOT sec. Land only developed if purchasers agreed to. Profit depended on value of real estate, not efforts of 3rd pty, **purchasers** retained complete control of prop.
  + Actual document need not even exist! *Re Kustom Design Financial Services*
  + **Franchise agreement** may be a security either b/c it represents a “document evidencing...” or as an investment K. In either case, the amount of control the franchisee has over its investment will likely determine the issue. **Look @ the KEY elements of the agreement! \*Re Century 21**
* Think about: who has possession? Is there a separation of ownership & control? Is there profit sharing? **Arguably X is securities b/c the purchasers didn’t purchase [the good] w/ a view to take possession of it.** **They bought it as an investment, hoping its value would increase as it aged.**

**(c) a document evidencing an option, subscription or other interest in or to a security**

* **Option:** a K that entitles the buyer to either buy (“call” option) or sell (“put” option) a particular security at a particular date at a specified price.
* **Subscriptions** are sign-up forms for purchasing securities.
* **Rights:** granting existing security holders rights to purchase a specific number of additional securities for a specific price w/in a specific period.
* **Warrants:** right to purchase a specific number of equity securities at a specific price and during a specific time period.
* Any thing entitling one to a security in the future is a security (employee stock option for compensation)
* Interests in a security 🡪 derivatives

### (d) debt security: a bond, debenture, note or other evidence of indebtedness, share, stock, unit, unit certificate, participation certificate, certificate of share or interest, preorganization certification or subscription other than

(i) a **contract of insurance** issued by an insurer, and

(ii) an evidence of **deposit** issued by a savings institution

* Issue: distinguishing a debt security from a doc evidencing indebtedness that is not a security!
* in \***Gill**, the court applied the **Revs test** (from a U.S. case) under which there is a rebuttable presumption that certain types of notes (like receipts) are securities. There are 4 relevant factors: **1) motivation behind the transaction:** if seller wants to raise $ and buyer wants to profit from the returns the instrument is expected to generate – the instrument is likely a security; **2) intended distribution of the instrument:** if it is one in which there will be “common trading for speculation or investment”, it’s a security; **3) reasonable expectations of the investing public:** the more the public expects a security the more likely it’s a security; **4) existence of another regulatory regime:** if there is no other regulatory scheme that reduces the risk of the instrument, it’s likely a security.
  + Must look @ substance!
  + If listed in definition, then there is a presumption that it is a security – but the presumption can be rebutted

**The rest:**

(e) an agreement under which the interest of the purchaser is valued, for the purposes of conversion or surrender, by reference to the value of **a proportionate interest in a specified portfolio of assets**, but does not include a contract issued by an insurer that provides for payment at maturity of an amount not less than ¾ of the premiums paid by the purchaser for a benefit payable at maturity

* Units & shares of open-ended investment funds – ex. “mutual funds”

(f) an agreement providing that money received will be repaid or treated as a subscription to shares, stock, units or interests at the option of the recipient or of any other person

(g) a **profit sharing agreement or certificate**

(h) **a certificate of interest** in an oil, natural gas or mining lease, claim or royalty voting trust certificate

(i) an oil or natural gas royalty or lease or a fractional or other interest in either,

(j) a collateral trust certificate,

(k) an income or annuity contract, other than one made by an issuer

(l) **an investment contract** – catchall provision; *per* ***Pacific Coast*** *policy goal of the provision is protection of the public*

(m) a document evidencing an interest in a scholarship or educational plan or trust,

(n) an instrument that is a future contract or an option but is not an exchange contract

(o) a permit under the Oil and Gas Activities Act,

whether or not any of the above relate to an issuer, **but does not include an exchange contract**

(l) **an investment contract—not specifically defined in the act**

* **Issue: If a capital raising instrument does not specifically fit w/in the enumerated list in the Act, then determine whether it can be characterized as an investment K?**
* The leading Canadian case w/ respect to investment Ks is \***Pacific Coast**, where the SCC looked at US jurisprudence. Chief Justice Laskin dissented – he is against overly broad interpretation of investment Ks.
* **\*Howey (US): The test of whether there is an “investment contract” under the Securities Act is whether the scheme involves an investment of money in a** 1) **common enterprise** 2) **w/ profits to come solely from the efforts of others**; and, if that test be satisfied, it is immaterial whether the enterprise is speculative or nonspeculative, or whether there is a sale of property w/ or w/out intrinsic value.
  + Key quote: An investment K means a K, transaction, or scheme whereby a person invests money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party – it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed by the enterprise.
  + The SCC in **Pacific Coast** adopted a more realistic formulation of the word “solely” in the Howey test: whether **the efforts made by those other than the investor are the undeniably significant ones,** those essential managerial efforts which affect the failure or success of the enterprise. The court alsoheld that a “common enterprise” is an enterprise in which the fortunes of the investor are interwoven w/ and dependent upon the efforts and success of those seeking the investment or of third parties.
    - The commonality necessary for an investment K is that between the investor and the promoter, rather than between the investors themselves.
  + Expectation of profit

|  |  |
| --- | --- |
| **Pacific Coast** | F: purchasers bought bags of silver coins on margin (i.e. substantial party of the purchase price on credit). Majority of the purchases did not actually pay the full price (~35%) & closed their margin accounts by selling their bags back to Pacific (never actually physically possessed the bags) // issue: were the margin purchases investment Ks and therefore securities? // H: yes!   * Laskin dissenting: price of silver set by markets over which Pacific has no control |
| **Howey** | Howey sold real estate Ks for half of its citrus groves. The purchaser of the land could then lease it back to the service company, via a service K, which would tend to the land, harvest, pool, and market the produce. // I: was payment for land security? // H: investment Ks |
| **State of Hawaii** | Hawaii Market Center sold “founding” memberships to promoters who could earn money through selling additional memberships by referring others to shop at the store using the promoter’s buyer’s card. // I: do the memberships sold by HMC constitute a security? // H: scheme in question was a security   * Court said that the Howey test is too narrow & adopted the risk capital theory |

**Class Notes – September 12, 2018**

**Corporate Structure**

* Corporate law emerged to deal with the relationship between shareholders and the directors and officers of the company, which are two distinct entities
* Securities law does not regulate a company’s actions
* Securities law is concerned with the way in which the company issues securities and the information it discloses to shareholders and investors

Example: Starting a business

* Need to raise money 🡪 purpose for which securities are sold
  + Might go to bank – not a security
    - Bank will likely ask for collateral
    - Not governed by securities regulation
  + Government grant?
    - Not a security
* Raise more money after bank or bank doesn’t give you a loan? Incorporate company and sell shares privately
  + As soon as you distribute security, you are under securities jurisdiction
  + Must file prospectus as soon as you distribute security
    - If you make a misrepresentation in the prospectus, public or securities commission can bring action against you
  + Director must sign prospectus and they become liable. The person who signs is often a lawyer
  + Companies starting up would prefer not to disclose a prospectus because of the cost of filing a prospectus 🡪 there are exemptions that cover certain types of people that you sell to who don’t need a prospectus
    - Who?
      * Friends and family,
      * Company that wants to invest more than $150K,
      * accredited investors (with over $200k) (ex. venture capital firms),
      * offering memorandum exemption: disclosure document that it is shorter and more plain language and less content than a prospectus but you can sell to anyone and raise an unlimited amount of money
* When you want to become a reporting issuer, you will need to file a prospectus 🡪 become a public company in that you are now able to sell to the general public
  + Underwriter may become involved and buy the IPO – underwriter does due diligence on firm
    - Why go to an underwriter? They have clients who want to buy securities
    - They will either act as a go between and take a commission or a “bought deal” where they buy it at a certain price, which is lower than the price they are ultimately going to sell it at
  + After filing prospectus, you will have an IPO and the share price will likely jump once it goes onto the market, if there is excitement about the security
    - Sometimes all of the securities are spoken for before they hit the market – they continue to be traded in a secondary market
  + Advantages of listing on exchange:
    - Visibility of shares
    - Creates a price for shares – recognition of price
  + Requirements:
    - Comply with rules of exchange
    - Continuous disclosure
      * Evolved from being just financial/accounting statements, to showing management discussion and analysis
    - Annual meetings
    - Disclose “Controlled persons” – controlled persons are insiders and they must report what they are selling on CDAR (website)
* Once you are a reporting issuer, you can still issue securities under an exemption
  + “private placement” – large/institutional buyer after an IPO
  + Must report material facts, so a company would have to report this

# September 19, 2018

**Know your regulator: What is a securities commission?**

**What are its powers? How can you challenge it? What other regulatory entities operate in this space?**

**Act, Regulations and Rule**

* Acts and regulations must go through full legislative approval
  + Many legislators who comment on the acts and regulations are not well versed in financial matters
* Rules do not need to get legislative approval
  + However, they get public comment
  + Commissions can get 100-200 comment letters from people in the industry who understand the issues
  + In some ways, there is less oversight at a government level for rules, but more oversight in that the public is engaging in making these rules

**Definition of Security**

* Non-exhaustive
* S.1(1) of the Securities Act
* Remedial legislation – given a broad and purposive interpretation
* Sometimes a security can fit under various heads

***Securities Act*** **S1(1) “security”:**

(a) a document, instrument or writing commonly known as a security,

* Catch-all term
* The issue is determining what is common knowledge?
  + Not common knowledge to a person on a street
* Knowledge that is common among securities professionals (sophisticated analysts, securities lawyers), not laypersons: **Glenn**; **Gelderman**
* The Quebec Securities Commission held that proof of common knowledge “must be based on an overwhelming set of facts and conclusive evidence”: **Geldermann**

(b) a document **evidencing title to, or an interest** in, the capital, assets, property, profits, earnings or royalties **of a person** – *reflects goal of protecting investing public*

* seems to cover things that may not even be securities
  + ie. a deed to your house
* This includes property interest acquired for the purpose of making an investment, rather than buying a commodity to merely acquire an interest in property. **The investment or speculative purpose of the transaction is key.** The K will typically feature performance of a service by others that is meant to increase value of the property.
* **Whether the document shows a form of investment or speculation? Is there an expectation of return based on work of another?**
* **\*Swain: Title doc for a ½** interest in a pair of breeding chinchillas was held to constitute a security b/c the vendor agreed to share w/ the purchaser the profits gained from breeding the chinchillas. Purchaser was making an investment, not buying a pet.
* **\*Brigadoon: scotch whisky receipts** were held to be securities b/c they were bought & sold as an investment (hoping its value increased as it aged), not as inventory or for consumption (didn’t purchase w/ a view to take possession).
  + *Individuals purchased scotch stored in Brigadoon’s warehouse. It was aged for a number of years and then sold by Brigadoon on behalf of its owners to various blenders.*
  + Receipts showed an interest in whiskey—brokers were buying and selling receipts, without a view to taking possession of the whiskey receipt.
  + Document evidencing title to whiskey
  + Receipts could just as easily not be a security if the person intended to take possession of the whiskeys
* Same with interest in land
  + Ex. Mortgage – mortgage evidences an interest in a house until the debtor pays the creditor the amount of the loan
    - The mortgage in the hands of the bank is a security
    - The trade of a security is the sale of a security, not the purchase
* **Raymond Lee:** **Control of thing alleged to be a security can help determine whether something is security or not**
  + *co. solicited people w/ inventions and would help ppl with their patent application + marketing in return for 20% interest in invention = NOT security, inventors still in complete control!*
  + Agreement: patent market researcher receives an interest in 20% of the value in the invention if it ever went forward 🡪 did not entitle them to make any decision about the invention
    - More like a contingency deal
  + Found to be a service b/c
    - Inventors retained control of the invention
    - Intention of the inventors: did not think they were giving an interest in the invention
    - It was likely just a payment for his patent work
  + Biggest factor: inventors retained control of their invention and what the value of their invention would be – the inventors were not investing with the patent researcher, the invention was ultimately going to be what made money
* **Re Sunfour Estates:** co-tenancy interests in undeveloped commercial real estate were NOT sec. Land only developed if purchasers agreed to. Profit depended on value of real estate, not efforts of 3rd pty, **purchasers** retained complete control of prop.
* Actual document need not even exist!

(c) a document evidencing an **option, subscription** or other interest in or to a security

* **Option:** a K that entitles the buyer to either buy (“call” option) or sell (“put” option) a particular security at a particular date at a specified price.
* **Subscriptions** are sign-up forms for purchasing securities.
* **Rights:** granting existing securityholders rights to purchase a specific number of additional securities for a specific price w/in a specific period.
* **Warrants:** right to purchase a specific number of equity securities at a specific price and during a specific time period.
* anything entitling one to a security in the future is a security (employee stock option for compensation)
  + the point of a derivative is to acquire another security

(d) **debt security:** a bond, debenture, note or other **evidence of indebtedness**, share, stock, unit, unit certificate, participation certificate, certificate of share or interest, preorganization certification or subscription other than

* **i) a contract of insurance issued by an insurer, and**
* **ii) an evidence of deposit issued by a savings institution**
  + Why would these be excluded? Covered by other regimes and don’t want them to overlap
  + Ex. clients may not know there instrument is a security,
* Issue: distinguishing a debt security from a doc evidencing indebtedness that is not a security!
* in \***Gill**, borrowed money from a number of people. He did pay them back and they were just meant to be loans. SCC looked at the notation on the checks which said “investments”.
  + the court applied the **Revs test** (from a U.S. case) under which there is a rebuttable presumption that certain types of notes (like receipts) are securities.
    - There is a rebuttable presumption that something is a security if it is listed, but it can be rebutted with the following 4 factors: **1) motivation behind the transaction:** if seller wants to raise $ for business purposes and buyer wants to profit from the returns the instrument is expected to generate – the instrument is likely a security; **2) intended distribution of the instrument:** if it is one in which there will be “common trading for speculation or investment”, it’s a security; **3) reasonable expectations of the investing public:** the more the public expects a security the more likely it’s a security; **4) existence of another regulatory regime:** if there is no other regulatory scheme that reduces the risk of the instrument, it’s likely a security.
      * Must look @ substance!
  + Decision: none of the factors rebutted the presumption
* Alberta court of appeal has been dealing with something similar: R v Stephenson, Ont case: Ontario Securities commission v Tiffen
  + Alberta/Ontario Securities Commission was attempting to imprison someone trading in promissory notes
  + Issue: were the notes securities?
  + In the lower courts, the judges and commission had considered the Revs factors case—Appeal courts found that the Revs case did not apply and that the promissory note was clearly a security, there is no ambiguity in the act surrounding the words, and there are exemptions in the act. The legislature wanted a broad definition of securities but in certain circumstances, if you didn’t want the act to apply, the act has exemptions 🡪 no need for Revs factors in Alberta and Ontario for presumptions.

(e) an agreement under which the interest of the purchaser is valued, for the purposes of conversion or surrender, by reference to the value of **a proportionate interest in a specified portfolio of assets**, but does not include a contract issued by an insurer that provides for payment at maturity of an amount not less than ¾ of the premiums paid by the purchaser for a benefit payable at maturity

* Units & shares of open-ended investment funds – ex. “mutual funds”
* Mutual fund shares are constantly being revalued every day– unlike other investment funds where the redemption is set by what the fund says rather than the value of the fund itself. Redemption is at the discretion of the fund manager and may happen only once a year.
  + Liquidity of this other type of fund is uncertain – may not always be able to find a purchaser between redemption periods

(f) an agreement providing that money received will be repaid or treated as a subscription to shares, stock, units or interests at the option of the recipient or of any other person

(g) a **profit sharing agreement or certificate**

(h) **a certificate of interest** in an oil, natural gas or mining lease, claim or royalty voting trust certificate

(i) an oil or natural gas royalty or lease or a fractional or other interest in either,

(j) a collateral trust certificate,

(k) an income or annuity contract, other than one made by an issuer

(n) an instrument that is a future contract or an option but is not an exchange contract

* Exchange contract is unique to BC and a few other jurisdictions
  + Exchange contract is not a security but are derivatives
* This provision is for futures contracts or options that are not about interests in securities

(l) **an investment contract** – catchall provision; *per* ***Pacific Coast*** *policy goal of the provision is protection of the public*

* **If a capital raising instrument does not specifically fit w/in the enumerated list in the Act, then determine whether it can be characterized as an investment K?**
* The leading Canadian case w/ respect to investment Ks is \***Pacific Coast**, where the SCC looked at US jurisprudence. Chief Justice Laskin dissented – he is against overly broad interpretation of investment Ks.
* **SEC v. C. M. Joiner Leasing Corp**
  + Decision: investment contract
  + Analysis:
* **\*Howey (US) 1946: Common enterprise test**
  + Facts: investors bought units in a citrus grove development. Units did not entitle the investors to go pick fruit. The company would pick the fruit, then let the investor know how much they made based on how much fruit
  + Definition of investment K: “a contract transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party”: ***Howey*** (contracts for the sale of units in a citrus grove)
    - and, if that test be satisfied, it is immaterial whether the enterprise is speculative or nonspeculative, or whether there is a sale of property w/ or w/out intrinsic value.
  + Reasons: “These investors have no desire to occupy the land or to develop it themselves – they are attracted solely by the prospects of a return on their investment… The investors provide the capital and share in the earnings and profits. It follows that their interests involve investment contracts, regardless of the terminology use.”Substance over form: what is the intention of the party here?
* **HAWAII SUPREME COURT 1971:** Expanded *Howey* in this test: Risk capital test—***Hawaii Market Center***
  + **Facts:** essentially a pyramid scheme. Subsequent members who come in pay more for the product but can still sell it for higher. You are enriching the person above you and you will make money on subsequent sales. Retail store membership program to earn income if they recruited new members – no expectation of profit
  + Looked at Howey (common enterprise) test:
    - Invested money in a common enterprise and expected profits. The question was whether the profits from the lower members in the scheme would be solely from the efforts of others
      * NOT solely from the efforts of others, the upper member is involved so they had to look at a new test
  + Risk Capital Test:
    - 1. An offeree gives an initial value to the offeror.
    - 2. A portion of this initial value is subject to the risks of the enterprise.
    - 3. The furnishing of the initial value is induced by the offeror’s promises or representations that the offeree will gain some benefit over and above the initial value as a result of the enterprise’s operation.
    - 4. The offeree does not receive the right to exercise practical or actual control over the managerial decisions of the enterprise.
  + Decision: Investment contract
* Pacific Coast 1978
  + Facts: Buyers pay a portion of price for silver coins up front, plus a commission, and owe the rest to Pacific Coast. Buyers take possession of their silver once the full price is paid. Pacific Coast didn’t have inventory if all buyers paid in full at once. To hedge risk of people paying off their coins right away, Pacific Coast bought futures contracts for silver with the partly-paid debts. Most buyers never took possession of silver, but resold the bag back to Pacific (who had no obligation to buy, but their ads claimed they never fail to make market for customers). Customers would pay/receive difference between what they owed Pacific Coast and current market value of the silver coins. Pacific’s ads talked about inevitable increase in value. It was the era of stagflation. Pacific couldn’t dictate price of silver, but you could only sell your coins to them. Most of their business was speculating on the future price of silver.
    - Majority of the investment material described the instruments as investments and offered inevitable increase in the price of silver. Pacific coast did not file a prospectus for these securities. Pacific coast did not have the coins on hand—they had been acquiring futures contracts for silver in case a purchaser redeemed the instruments.
  + issue: were the margin purchases investment Ks and therefore securities? // H: yes!
    - Laskin dissenting: price of silver set by markets over which Pacific has no control
      * As long as exchange remained solvent, the people could redeem. Insolvency is not enough to make the investment risky
  + Ratio: **Pacific Coast** adopted a more realistic formulation of the word “solely” in the **Howey** test:
    - 1. Is there a common enterprise? This is where an investor advances money and the promoter has managerial control over the success of the enterprise.
      * “common enterprise” is an enterprise in which the fortunes of the investor are interwoven w/ and dependent upon the efforts and success of those seeking the investment or of third parties. The commonality necessary for an investment K is that between the investor and the promoter, rather than between the investors themselves.
    - 2. Are the profits to come solely from the efforts of others?
      * “Solely” is construed broadly whether **the efforts made by those other than the investor are the undeniably significant ones,** those essential managerial efforts which affect the failure or success of the enterprise
  + Analysis: Investors were putting themselves at risk by investing with the exchange b/c Pacific Coast did not actually have any coins and were merely entering futures contracts and hedging/speculating on the value of the coins.
* Examples:
  + Units in a citrus grove development (Howey)
  + Retail store membership program
  + Purchase of bags of silver coins on margin
  + Some franchises where the franchisor retains a huge degree of control relative to the franchisee
  + Real estate ventures

## What is a Trade?

* Once you have a security, how is a trade found?
* S1(1) “trade”:
  + (a) a disposition (**sale**) of a security for valuable consideration whether the terms of payment be on margin, installment or otherwise, but does not include a purchase of security or a transfer, pledge, mortgage, or other encumbrance of a security for the purpose of giving collateral for a debt
    - Trades only include sales. You are allowed to purchase without having to be registered
      * Why? Registration requirement for sellers is protecting the investor. The point of registration is for buyers. Registration would not add much to investor protection. The investor is the person who may be at an informational disadvantage
    - For valuable consideration: giving a security away is not a trade. The point of investor protection is to protect investors’ money. Giving something away does not engage investor monies.
  + (a.1) entering into a futures contract
    - Does not need a sale here b/c no one is presently buying a security – merely entering into a futures contract is a trade
    - Both parties are trading here
  + (b) entering into an option that is an exchange contract
  + (c) participation as a trader in a transaction in a security or exchange contract made on or through the facilities of an exchange or reported through the facilities of a quotation and trade reporting system
    - Capturing a broker who enters an order on an exchange to buy or sell = trading
    - Regulation wants to catch anything a broker does because they are acting as an intermediary. Want to have them registered to protect investor and to ensure that they are honest
  + (d) the receipt by a registrant of an order to buy or sell a security or exchange contract
    - when you are a registered trader or dealer, or advise a trader or dealer, both buy and sell orders are trades
  + (e) a transfer of beneficial ownership of a security to a transferee, pledgee, mortgagee or other encumbrancer under a realization on collateral given for a debt
    - transfer of a security so it is caught
  + (f) any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of any of the activities specified above
    - Catch-all: intention of this is that you want to catch people doing the actual trade AND the person who may be one step removed from the trade
    - ex. issuer has a finder who goes out and finds prospective purchasers and directs them to the issuers even though the finder does not sell or buy securities 🡪 without subheading f, this person would not be caught by the act though they may be the sole source of information for the buyer
    - How close to you have to be to the trade to “act in furtherance”— There must be some level of proximity between what you’ve done and the specific trade: depends on the facts and the particular securities commission. Commission may take a more broad or more narrow view.
* **S34: A person must not (a) trade in a security or exchange contract, (b) act as an adviser, (c) act as an investment fund manager, or (d) act as an underwriter, unless the person** is registered in accordance with the regulations and in the category prescribed for the purpose of the activity.
  + There are a number of exceptions: catch and release—catch the transaction and then determine whether an exemption applies
* **S34** and **NI 31-103** state that a trade triggers the requirement that a registered dealer be involved in the transaction and thus, it is important to determine whether a transaction qualifies as a trade or not. This will determine whether a transaction is subject to securities regulations.

**Notes on trade**

* Trades can occur in different jurisdictions
  + May be where the purchase happens or where the sale happens. SEE BELOW
* Greggory and Co vs Quebec Securities Commission
  + SCC held that Quebec had jurisdiction over a promoter in Quebec who had mailed out bulletins to investors outside of Quebec. Prospective investors outside of Quebec but Quebec had jurisdiction
* R v Mackenzie Securities Limited
  + Ontario broker who was telephoning people in Manitoba to get them to invest with him, Manitoba court determined that Manitoba had jurisdiction
* Effect: there can be concurrent proceedings
* Bennett and BC Securities Commission BCCA:
  + Court considered the fact that parallel proceedings were happening in Ontario (quasi criminal proceeding) at the same time that the BCSC was proceeding against Bennett administratively
    - Administratively: can only make orders under s.161 and 162: ban you, penalties, etc.
    - Quasi criminal: go to court, court can impose jail time or other restrictions
  + BCCA held: you have actually breached securities law in both commissions and you have decided to engage in cross jurisdictional trades and have implicated investors in both provinces 🡪 both provinces have jurisdiction and the mandate to proceed against you. TOUGH LUCK
    - Ratio: you can have parallel proceedings
* Alberta Securities commission has sanctioned both people who are trading within the jurisdiction to buyers outside the jurisdiction and vice versa, to sellers outside the jurisdiction selling to buyers in the jurisdiction

## What is a Distribution? A trigger to file a prospectus: S61(1).

* Distributions are a type of trade that triggers the prospectus process, which is why this characterization is important. The definition set out in S1(1) of the *SA* is exhaustive. It is important to note that while all distributions involve trades, not all trades qualify as distributions.
  + Absent an exemption, if you distribute securities, must file a prospectus
  + Issuers are always looking for exemptions to avoid cost of filing prospectus
* **S1(1) “distribution”:** 
  + **(a)** a trade in a security of an issuer that has not been previously issued
    - a NEW security
  + **(b)** a trade by or on behalf of an issuer in a previously issued security of that issuer that has been redeemed or purchased by or donated to that issuer
  + **(c)** a trade in a previously issued security of an issuer from the holdings of a control person
    - if you own 20% of the voting securities of an issuer, you are deemed to be a control person
    - if you trade these securities, it is a distribution
    - Why? This person has enough securities to affect control of the company
  + **(d)** a trade by or on behalf of an underwriter in a security that was acquired by the underwriter, acting as underwriter, before Feb 1 1987, if the security continues, on Feb 1 1987, to be owned by or on behalf of that underwriter so acting
  + **(e)** a trade **DEEMED to be a DISTRIBUTION:** **(i)** in an order made under S76 by the commission or the executive director or **(ii)** in the regulations
  + **(f)** a transaction or series of transactions involving further purchases and sales in the course of or incidental to a distribution (ie: if X sells shares to Y, then Y immediately sells those shares to A, B, C, then the sale from X to Y is a distribution)
  + **(g)** a prescribed class of trade of transaction
* **S1(1) “control person”: (a)** a person who has a sufficient number of voting rights attached to all outstanding voting securities of an issuer to **affect** **materially** the control of the issuer OR **(b)** each person in a group of people acting together according to an agreement that has a sufficient number of voting rights
  + **DEEMED CONTROL PERSON**: if one person or a group of persons holds 20% of the voting rights, unless there is evidence to the contrary

**Final Thoughts**

* Commission itself is board members. They act as board members who make regulation and also the board that enforces regulations
  + Make the rules, oversee compliance with rules and enforce the rules – lots of power
* Executive director can hire staff
* Securities law comes from provincial acts

# September 26, 2018

**Prospectuses**

* Purpose of prospectus: consumer protection
* Seeks to compel relevant disclosure from issuers
* Allows regulators to review prospectus and ensure that it meets the requirements of the legislation and does not raise public interest concerns
* Regulators are not judging the merits of the security (don’t care whether its safe/sound)
* Reflects a state of affairs at a particular time – a snapshot
* They are required if you are making an IPO, and also if you issue new securities
* Definitions of trade and security are broad so to capture lots of situations

# Chapter 7—The Prospectus

* Once there is a “security”, a “trade” and a “distribution”, and absent exemptions, a prospectus must be registered
* Should be capable of being read by investors generally and not only analysts and other trained persons
* Disclosure document only: Commissions only check for “full, true and plain disclosure of all material facts”
  + Do not conduct a merit review of the prospectus ie whether an investment is sound
* Must meet certain requirements, namely, NI 41-101 – not exhaustive, some jurisdictions have additional requirements

## Reporting Issuer

* Reporting issuers are subject to continuous disclosure requirements and insider trading restrictions

**Defined in BC Securities Act**

**s.1(1)** **"issuer"** means a person who

**(a)** has a security outstanding,

**(b**) is issuing a security, or

**(c)** proposes to issue a security;

**s.1(1)** **“reporting issuer”** means an issuer that

**(a)** has issued securities in respect of which

**(i)** a prospectus was filed and a receipt was issued,

**(ii)** a statement of material facts was filed and accepted, or

**(iii)** a securities exchange take-over bid circular was filed,

under a former enactment,

* Ignore for exam!

**(b)** has **filed a prospectus or statement of material facts** and the executive director has issued a **receipt** for it under this Act,

* Why? b/c issued securities to public and now under an obligation to update them.

**(c)** has any securities that have been at any time **listed and posted for trading on any exchange** **in British Columbia**, regardless of when the listing and posting for trading began,

* Company can make an offering in Ontario and list on TSX – once lists on TSX, reporting issuer in BC
* Any issuer that is trading on an exchange in Canada, reporting issuer – even if not filed a prospectus there

**(d)** is an issuer that has exchanged its securities with another issuer or with the holders of the securities of that other issuer in connection with an amalgamation, merger, reorganization, arrangement or similar transaction if **one of the parties to the amalgamation, merger, reorganization, arrangement or similar transaction was a reporting issuer at the time** of the amalgamation, merger, reorganization, arrangement or similar transaction,

* An entity is not a reporting issuer then combines with one, now it is a reporting issuer
* Private issuer merges w/ a public company, so now securities of a reporting issuer
* Listing company becomes wholly owned by private company by merger or plan of arrangement – b/c one of the parties is a reporting issuer, resulting company becomes a reporting issuer

**(e)** is designated as a reporting issuer in an order made under section 3.2,

* Deemed to be a reporting issuer by the commission
* If the regulator says so – why would the commissioner do this? Missed what he said! Sometimes issuers want to become reporting b/c then able to have shares that can trade freely,

**(e.1)** is a person that is within a prescribed class of persons, **or**

* Prof skipped

**(f)** has **filed a securities exchange take-over bid circular** under this Act for the acquisition of securities of a reporting issuer and has taken up and paid for securities subject to the bid in accordance with the circular,

* Will come back to this under take-over bids

**unless the commission orders under section 88 that the issuer has ceased to be a reporting issuer.**

## When is a prospectus required? Almost always (S61), unless exempt by NI 45-106(\*pg) or S76

* A prospectus provides investors with detailed information about the issuer so they can make informed valuation and investment decisions.
  + This requirement goes back to the overarching goal of securities regulation – to protect the capital market from those seeking to take advantage of investors.
  + Prospectuses are designed as an instrument to increase public confidence in public offerings and the capital market in general, and to enhance transparency of market transactions.
* The general requirements for the prospectus process are outlined in **NI 41-101.**

**In the BC Securities Act:**

* **S61:** **(1)** Unless exempted under this Act, a person must not **distribute** a security unless **(a)** a preliminary prospectus and a prospectus respecting the security have been filed with the executive director and **(b)** the executive director has issued receipts for the preliminary prospectus and prospectus.
  + **(2)** These must both be in the required form (hence why it is *required*…)
* **S76: (1)(a)** You can apply for discretionary exemption by the commission/executive director from the requirements as long as it isn’t prejudicial to the public interest.
* REQUIRED FOR: IPOs, subsequent public offerings, some secondary offerings (ie: resale by a control person **N1 45-102, S1(1) “distribution” (c)**)
* Executive director has different powers than the commission itself under the act. Commissino sets policy which the ED has to follow

|  |  |
| --- | --- |
| **Prospectus required** | The requirement for prospectus is set out in s. 61 of BCSA  **(1)** Unless exempted under this Act, a person **must not distribute a security unless**  **(a)** a **preliminary prospectus** and a **prospectus** respecting the security have been **filed** with the executive director, **and**  **(b)** the executive director has **issued receipts** for the preliminary prospectus and prospectus.   * Once filed both & received receipt, then can make distribution   **(2)** A preliminary prospectus and a prospectus must be in the required form.  ***A distribution is exempt from the prospectus requirement either by qualifying for an exemption under NI 45-106 or applying for discretionary exemption from regulator under s. 76 BCSA.*** |
| **Contents of prospectus**  **s.63 – full true and plain disclosure of all material facts** | Basic requirement for disclosure in a prospectus is full, true and plain disclosure of all material facts …  **(1)** A prospectus **must provide full, true and plain disclosure of all material facts** relating to the securities issued or proposed to be distributed.  Definition of full, true and plain given in ***Coventree***   * **Full:** means all the facts that are material; can’t pick & choose—good and bad; sufficient to permit investors make an informed investment decision * **True:** accurate, not misleading (either by using words or omitting words), no omission of material facts * **Plain:** wording needs to be understandable to an ordinary investor in plain language * **Material fact** is defined in s.1(1) using the market impact test – a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.   + Objective test   + At time fact is disclosed, would it have a significant effect?   **(2)** A **preliminary prospectus** must substantially comply with the requirements of this Act and the regulations respecting the content of a prospectus. |
| **Form & content of prospectus is prescribed in**  **NI 41-101** | Regulation of specific contents is set up in **NI 41-101**  **s.3.1(1)** Subject to subsections (2), (2.1) and (3), an issuer filing a prospectus **must file the prospectus in the form of Form 41-101F1.**  **(2)** An issuer that is an investment fund, other than a scholarship plan, filing a prospectus must file the prospectus in the form of Form 41-101F2.  **(2.1)** An issuer that is a scholarship plan filing a prospectus must file the prospectus in the form of Form 41-101F3.  **(3)** An issuer that is qualified to file a short form prospectus may file a short form prospectus.  Forms:   * General form: Base form is set out in **Form 41-101F1**   + Look @ the copy provided by prof * Specialized forms:   + Investment funds   + Exchange credit accounts |

## Steps for filing prospectus

**A prospectus is required for: IPOs; subsequent public offerings; some secondary offerings (ex. resale by control person) // Going public generally requires the preparation of a disclosure document called a prospectus containing all material information concerning the business and securities to be offered.**

Almost all filing is done electronically through SEDAR.

**Step #1:** **Secure services of an UW**

* Engage an UW to help w/ the marketing process
* Find syndicate of investors
* Negotiate underwriting agreement – negotiated by UW counsel
* Look @ UW arrangements heading

**Step #2:** **File a preliminary prospectus & obtaining a receipt** (p.226)

* Has to satisfy s.63 & form requirements in NI 41-101
* Contains all the same info as final prospectus except price of securities, price paid to underwriter, and auditor’s report. The preliminary prospectus **does not have to contain a price** for the securities as this will be set based on market conditions at the time of filing the final prospectus.
* Preliminary prospectus contains red herring language. Cover page must contain a note that the prospectus is not final, info in it may be amended, no securities may be sold before the final prospectus is receipted.
* Allows you to engage in preliminary marketing activities, and **after obtaining preliminary receipt to solicit expressions of interest.** The UWs fill a book, which is based on expressions of interest not binding commitments.
  + In reality, expressions of interest are like biz handshake. If back out of commitment, you will be blacklisted.
* Preliminary Preceipt usually issued automatically. Very cursory review to ensure certificates attached properly (issuers certificate and UW certificate); checks that the form of the prospectus is followed. There might be deficiencies in disclosure, but the staff won’t check at this point.
* **For an IPO** – there is no pricing info or how many shares
  + Won’t know how many units are being sold
  + i.e. if you’re doing best efforts, this gives a marketing tool for your syndicate to go to their networks to see how big an offering it can be and what price it can be. Can start taking offers from each syndicate.
  + Orders not legally binding orders – b/c need the final prospectus before they can be binding – b/c this is a distribution and can’t do w/out a prospectus (and need a final one for it)

**Step #3:** **Waiting period** / **review & comment**

**Waiting period:** the period of time between when the issuer receives a receipt from the Commission for its preliminary prospectus, and when it receives the receipt for its final prospectus (defined in NI 41-101). Majority of marketing activity happens at this stage.

* **not allowed to sell or accept an offer to buy** – doing so is called “gun-jumping”

**Activities permitted during the waiting period:**

* **Road show:** during the waiting period, **usually in the context of an IPO offering**, management & investment banks go on the road and meet w/ various institutional management (NI 41-101 part 13). There’s requirements on what docs can be presented – can’t present the prospectus, but can do a summary; there can be certain marketing materials, but have to be filed w/ the regulator.
  + Comparables is the only thing that can be in marketing but doesn’t have to be in prospectus
* **Green sheets:** summaries prepared by investment dealers, not intended for members of the public
* **Risk** is that you make a statement during the interim period that you can’t put in prospectus (b/c you can’t back it up), then you have to pull the offering.
* Lawyers usually send a **scare memo** – goes to the pple in the company who know about the offering that they can’t tell anyone about the offering. Restrict statements that are made to the public so they don’t hit the marketing restriction.

**Comment letters** might come from the regulator

* After the issuer resolves all comments, they will be cleared for final filing.
* Now, in a position to file final prospectus and **sign UW agreement** (which binds the UW to purchase the number of securities).
* s.78 talks about UWs being able to solicit expressions of interest during the waiting period.

**Step #4:** **File the final prospectus and obtaining a receipt** (p.232)

* First, sign the UW agreement, then file the prospectus right after. Issuers must submit a “blacklined” copy of the prospectus when submitting the final prospectus. A black-lined copy shows all of the changes made from the preliminary prospectus.
* The FP is an amended version of the PP and must contain final pricing information and audit reports. The executive director must issue a receipt for a FP filed, unless they consider it to be prejudicial to the public interest to do so (**S3(2)**) and must not refuse without giving the person who filed the FP an opportunity to be heard (**S65(3)**).
* Issuer can get a final receipt once all deficiencies are resolved. Commission does not have to issue if they are not of the view that it is in the public’s interest. Situations where a receipt won’t be issued:
* Adequacy of financial resources; insolvency concerns
  + Follow-up offering – want to raise equity b/c insolvent // commission won’t issue a receipt b/c working capital deficient
* Use provision is not specific enough – if the biz plan has lots of alternatives, but nothing specific – then blind pool & commission won’t issue receipt for blind pool type company
  + Exception: filing for capital pool company
* If the capital structure is flawed/unfair – has to do w/ the issuance of too many shares too cheaply to the management or promoter of the company
* If there is not going to be a public market for the securities
* If the offering looks too promotion. i.e. looks too good to be true.
* Concern about misrepresentation
* Commissioner concerned that issuer’s pre-public SH’s have entered the escrow requirements in NI 46-201
* If it’s a questionable biz (i.e. payday loans)

# October 3, 2018

**Elon Musk Case Study**

* What did he do?
  + Tweeted to 22 million followers that he was taking Tesla private at $420/share which was greater than what it was trading at at the time ($370), and that he had funding secured.
  + He did not have funding secured and he had not had a meeting with Tesla about this statement
* **Quirks**
  + He was on a radio show smoking pot and there is some opinion that he tweeted to impress his girlfriend. Perhaps people were taking him with a grain of salt?
* SEC brought charges against him for securities fraud. Why?
  + His twitter was announced to be an official source of information for Tesla
  + He did not have financing in place and the board did not know about it. There were far more uncertainties than what he disclosed.
  + The result of this is that he could have been permanently banned from participating in the market or being a director for a public company
  + They sought to remove him as a board of director and ban him from any investment activity from Tesla
* SEC went to Tesla to settle with him and Musk – initially, he said to the board “if you settle, I quit”. The next day, Musk said he would settle but it was on worse terms.
  + $40 million dollar penalty – ½ by Musk and ½ by Tesla 🡪 disgorge money to investors who lost due to the volatility of Tesla
  + He had to step down as chair but can remain as CEO – Tesla required to put 2 new independent chairmen on their board. Independent chairmen are NOT a part of management
    - They wanted to keep him on the operations side
* Tesla had no mechanism for knowing what Musk was going to disclose
  + They had to put processes in place to control his communication
* SEC thought it would be better for investors to not give him a complete ban b/c people are emotionally invested in him and he is viewed as the visionary of the company – if you took him out, would Tesla be as successful? It could severely harm the
* What was the harm? The tweet was misleading
  + The harm was that his statement could drive the price up
    - The price initially went up, and once the SEC filed charges, the share price dropped to $260.
  + Once the information came out, there was significant volatility to the share price
  + Market integrity: Tesla had given notice to the public that Elon Musk’s twitter account was a way to announce material changes. It created uncertainty in market integrity because he did not back up his statements
* Is a twitter account an appropriate forum for material changes?
  + Pros:
    - Efficient way to get information out and get to people more/faster than if it were posted on SEDAR
  + Cons:
    - Immediate ability to communicate people
    - Less information than SEDAR
    - Risk of misrepresentation b/c it does not include everything it needs
* **Whats the point? To the extent that you have someone representing your company for material changes, the company should ensure that they understand and respect their obligations** 
  + **Regulators have significant power to intervene if individuals do not comply with requirements**
* **Was this a good result?**
  + **For Tesla: probably, b/c they got to keep Musk where he serves it best yet they get a chance to see what happens if the board is more independent**
  + **SEC: prompt response, showed they were serious**
* **Is there a danger to using social media for continuous disclosure? YES**
* Fraud v misrepresentation
  + Fraud = outright lie
  + Misrepresentation

**Continuous Disclosure Obligations**

* Continuous disclosure is a newer concept
  + Why? Concern for retail investor b/c institutional investors were better placed to understand what was going on with issuers
  + Information symmetry is good for consumers and issuers
    - Consumers are more inclined to buy and it is easier to price
    - Issuers get a more liquid market
* Only reporting issuers have an obligation for continuous disclosure
* **NI 51-102** governs continuous disclosure
  + Commonly used and updated
  + Relatively easy to follow
* **BCSA s.85** A reporting issuer must, in accordance with the regulations,
  + **(a)** provide prescribed **periodic disclosure** about its business and affairs,
  + **(b)** provide disclosure of a **material change**, and
  + **(c)** provide other prescribed disclosure.
    - Any other situations set out in the regulations
* S.85 of the act BCSC creates periodic disclosure requirements which give reference to NI-51-102
* NI 51-102:
* NI 51-102CP
* NI 54-101
  + Communication with beneficial owners of securities of a reporting issuer
* NI 58-101
* NP 58-201
* ***Discretionary Exemption:*** under **BCSA 91**, the regulator may grant a discretionary exemption to insiders where it would not be prejudicial to the public interest to do so; insiders may apply for a discretionary exemption.
* 51-102—Part V management’s discussion and analysis
  + To provide a narrative to financial statements
  + The numbers tell a certain story, but the management’s discussion and analysis bring the numbers to life and fill in the blanks
  + 51-102F1 Part 1(a): describes the point of managements discussion and analysis
  + 51-102 4A.2 and 3: **Disclosure of Forward-looking Info (NI 51-102):**
    - Have to highlight to people that forward looking information is there and that the future does not follow the past. The issuer has to meaningfully explain forward looking info and show what information the forward looking info is based upon
      * **4A.2(b):** cautions users of forward-looking information that actual results may vary from the forward-looking information and identifies material risk factors that could cause actual results to differ materially from the forward-looking information;
* **51-102 Part 9**
  + **Proxy**

**Exempt Market**

* Less trading, harder to trade, much different environment
* Exemptions exist from prospectus requirements b/c theres an understanding that theres a time at the beginning of a company where it has simply not materialized yet
* Easier and cheaper to raise money
* Rights offering

# October 10, 2018

**Disclosure Review**

* Regulators have a spectrum of ways they can address non-compliance with rules
  + Two sides of the spectrum:
    - 1) provide guidance to issuers who are not complying with securities law
      * this may be the case where issuers are trying to comply but not getting it
    - 2) require compliance/refiling/enforcement action for not complying with securities law
      * This is for issuers who may be purposefully not complying with securities law
* Compliance staff at Commission has several options when they get disclosure that does not comply with requirements:
  + 1) require issuer to make a news statement ot make the disclosure accurate
  + 2) get issuer to refile
  + 3) they can put out guides for issuers to better comply 🡪 staff reviews
* Staff Reviews come out of compliance reviews which are summaries of trends in disclosure of certain industries
* **Ex. Staff Review of Reporting Issuers in the Cannabis Industry** 
  + Ex. Problems in cannabis industry: management discussion and analysis – not enough info there to understand financial information
  + Problems in forward looking information
  + 74% of cannabis issuers in the US did not provide sufficient disclosure about the risks related to their US operations to satisfy the disclosure expectations

Fiduciary duty imposed on registrants

* Happened in England, Australia
* Big debate in Canada about a similar fiduciary duty
* Should there be a similar duty? Would it achieve the objective?

Fact pattern

* Disclosure of material conflict—is that enough?
* Tension b/t disclosure alone and an actual avoidance of the problem
  + Disclosure might be enough for sophisticated clients but not enough for unsophisticated clients
* Canada: there is a value in retail investors to go to a dealer and get advice, and is there a way beyond a full fiduciary duty to still preserve retail investors
* There is a concern throughout the acts that retail investors do not adequately understand certain investments and their details and that the acts do not fully protect retail investors from conflicts of interest
* When regulators sought to enforce NI 31-103 13.4, they realized that reasonable steps were only necessary to identify conflicts of interest and disclose them, and not to avoid the conflicts of interest
* Regulators have suggested:
  + Expressly stating in the rule that you must avoid conflicts of interest
* There is also a view that conflicts are inherent in firms trading on behalf of clients and impossible to completely avoid
  + Are firms even able to comply with fiduciary obligations?
* Is there a different way?
  + Proposal: Respond to conflicts in the best interests of your clients
* The concern with a full fiduciary duty for firms was that this would significantly increase costs for firms; less inclined to service smaller cleints
  + This is what happened in the UK: number of advisors went down and there was a consolidation of clients, and a pushing out of small clients
* In Canada, there was for a long time and still is, alongside question of whether there should be fiduciary duty on firms, and whether there should be a fiduciary duty on banks
  + Banks own a lot of mutual fund companies, so regulating against mutual funds affects banks
  + Banks are exempted from “suitability” requirements – they have an exemption for purchasing mutual funds
  + If you buy the same mutual fund share independent of the bank, they would get it cheaper?
  + Banks get trailer fees if they sell securities to an investor which are a percentage of the client’s holdings – dealers are making $100,000s off of trailer fees, which has nothing to do with them providing services to their clients. They don’t have to make a suitabililty requirement ie. saying to get into the no trailer security
  + There are class actinos against banks and regulations are attempting to respond to this conflict of interest
  + The conflict is that the trailer fee would be the dividend if the investor bought the security independent of th bank and the bank not advising them to not invest with them b/c they make money off of the client holding the security – WOW
  + Regulators are attempting to respond to this🡪 this is an example where a retail investor would be reasonable enough to determine that they should not be in the investment from the bank
  + Why? The best interest of the client would be to be in the security with no trailer fees

# October 24, 2018

Cryptocurrency

* What category of security does it fall under?
  + Varieties of ways in which a crypto asset will be a security (n)
  + “Futures contract” (c)
  + “security” (n)

Blockchain and how it works

* What is the blockchain (Distributed ledger technology)?
  + Essentially a central ledger of transactions – tracks value
  + It is decentralized and there is no intermediary
    - The trust that is placed in the system is in the ledger, not some intermediary entity
  + It is public
  + Ledger of stored information stored across a network of participants – new information is recorded on the ledger and the reliability of the blockchain relies on the entire network
* Has many different applications but today we are talking about cryptocurrency blockchains
* Cryptocurrency is just an entry on a blockchain
  + Perceived value of token has to do with trust in the validity of the blockchain it is based on and expectation of future value
  + Compared with other central bank currnecies: our faith in the CAD or USD is based on the central bank or the government, but with crypto, there is no central bank and it is independent of the government
    - Irony: Central Banks looking to use blockchain technology
* B/c digital currency is just a piece of data, it can take on any aspect of property (they can look like shares, currency, etc.)
  + They can look similar to investments governed by Securities law
  + Securities Law refers to them as cryptoassets

ICOs

* ICO: selling coins because you want to raise funds for a project that has not yet been completed
  + Starts to look more like a typical investment in a business (ie. startup) or an IPO
* This caused BCSCn to issue notices that there are securities law implications for ICOs

Investor Protection

* B/c of volatility of crypto, lack of transparency, and potential for fraud, the BCSCn is concerned with crypto
  + Lots of people just looking to cash in on an idea like Bitcoin
* BCSCn looks at the structure of the coin and whether it looks like an investment
  + If they resemble a security, they are captured by BCSCn

**Pacific Coast investment contract test**

Facts: Dealt with a company that offered and sold bags of silver coins.

Issue:

Decision: Positive on all 4 aspects of test as investment contract

Ratio: Pacific Coin test

* 1) Was there an investment of money?
* 2) Was there intention to profit?
* 3) Was there a common enterprise?
  + must be commonality b/w investor and the promotor (vertical), need not be commonality b/w investors themselves (horizontal)
* 4) Were the profits to come solely from the efforts of others?

Note: interesting with reference to crypto – resembles crypto in some ways

**Notice 46-307: BCSCn test for Crypto**

* BCSCn released a notice (46-307) that said that the pacific coin test is the test to use for crypto
* Comment on whitepapers: whitepapers describe fundraising goal, the business, the project, and how many coins the business well retain. Although whitepapers are disclosure to investors, if you are doing an ICO than you need to file a prospectus.
* Desired behavior: educate issuers who may not be aware of securities law and warn that coin issuers cannot just use language to avoid securities law
* Regulatory sandbox: group that’s been formed Country wide to allow coin issuers to talk to regulators
  + The year after the notice, lots of people came into sandbox to determine if their instrument was a security or not
* Uniqueness of Sandbox:
  + Points of contact with commission in other areas of law are limited to more formal context
  + Sandbox allows for an informal interaction b/t businesses who aren’t sure if they are subject to securities law (or the lawyers of the businesses) and the BCSCn

Staff Notice 46-308

* Responds to all of the inquiries received in Canada about Utility Tokens – deeper dive into the pacific coin test
* Provided examples of situations and possible implications and recognized the kind of businesses that have been seen to date in Canada wrt crypto
  + There is a lot of innovation in this space and a lot of people trying to make the perfect token that is not a security
  + In contrast, there are people who want to be within Securities Law ambit b/c it increases confidence and it is a benefit to be regulated
* Examples of situations: all comes down to the structure of each token
  + 1) The proposed function of the token is to use software or an online platform or application, or to purchase goods and services, but the software, online platform or application or goods and services do not exist, are not yet available or are still in development.
    - Possible implications: This could indicate that the purchaser is not purchasing the tokens for their immediate utility, but because of an expectation of profit, which will depend on the issuer's ability to complete the development of the software, online platform or application or to offer the goods and services. Although some purchasers may be purchasing the token for the utility function, many purchasers may be purchasing the token in order to sell it on a cryptoasset trading platform or otherwise in the secondary market.
    - If you’re gonna issue a token on the basis of something you haven’t developed yet, most likely the pacific coin test will be met

|  |  |
| --- | --- |
| * + 2) The tokens are not immediately delivered to purchasers. |  |

* + - Probably take the fact that delayed receival means that you will not be using it for immediate utility but it is for expectation of profit
    - could also indicate a common enterprise exists because of the purchaser's reliance on management to deliver the tokens.
  + 8) Tokens have a fixed value on the platform that does not automatically increase over time, or change based on non-commercial factors.
    - This may reduce the purchaser's expectation of profit if tokens are continually available from the platform at a fixed value.
      * This would go a long way in making the argument in side stepping the investment contract test
  + 13) Tokens are distributed to users for free.
    - Does not pass first prong of test: investment of money

Difference b/t first and second notice

* Potential harm had become more clear by second notice
* First notice showed lower level of understanding
* Innovation can be good – but it is not good in and of itself
* Balance for regulators: b/t innovation and capturing activity w/ securities regulation
  + Example of need to regulate: Mt.Gox getting hacked and millions of dollars lost. Why was this exchange not regulated like a normal equity exchange?

## Secondary Trading of Cryptoassets

* June 2018 CSA notice: caution urged for Canadians investing with crypto-asset trading platforms
* There are over 20 Cryptoasset trading platforms domiciled in BC alone
* Cryptoasset trading platforms are a trading facility that allow for buying and selling of cryptoassets
  + Platform itself will buy tokens or it will match buyers and sellers
* To the extent that something trading on a platform is a security, there are rules that apply to the trading platform
  + S.24 of BCSA says that anyone who resembles an exchange must register as an exchange
  + If a platform facilitates the trading of crypto assets or interests in crypto assets that are securities or derivatives, that platform is required to comply with securities legislation.
* Investors should be cautious when dealing with any crypto-asset trading platform because key investor protections may not be in place
  + We want investors to understand that just because a platform may advertise itself as an exchange, that does not mean the platform is complying with applicable securities regulations
  + If it is not, investors should not expect to receive the same protections that are built into the securities regulatory framework applicable to exchanges or dealers, and should therefore be cautious

NI 21-101: Marketplace Operation

* "marketplace",
  + (a) in every jurisdiction other than Ontario, means
    - (i) an exchange,
    - (ii) a quotation and trade reporting system,
    - **(iii) a person or company not included in clause (i) or (ii) that** 
      * **(A) constitutes, maintains or provides a market or facility for bringing together buyers and sellers of securities,**
      * **(B) brings together the orders for securities of multiple buyers and sellers, and**
      * **(C) uses established, non-discretionary methods under which the orders interact with each other, and the buyers and sellers entering the orders agree to the terms of a trade, or**
    - (iv) a dealer that executes a trade of an exchange-traded security outside of a marketplace, but does not include an inter-dealer bond broker, and
  + (b) in Ontario has the meaning set out in subsection 1(1) of the Securities Act (Ontario);
* History of (iii) was to make space for alternative trading systems
* No definition of exchange in BCSA
* Definitions of security, marketplace, trades, etc. are live b/c new innovations occur that may not fit into the established definitions
  + Tension between conservativeness and innovation
* Question is how to regulate cryptoasset trading platforms?
  + Certain jurisdictions have created a new standalone framework for cryptoasset trading platforms
    - Issue: what if some of what is traded is a security but a lot of it is not?

NYAG report

* The OAG sought voluntary participation, expecting that platforms would embrace the opportunity to provide the public with much-needed clarity regarding basic practices and functionality
  + Most did. Nine of the thirteen platforms participated in the Initiative
* Four platforms – Binance Limited, Gate.io (operated by Gate Technology Incorporated), Huobi Global Limited, and Kraken (operated by Payward, Inc.) – claimed they do not allow trading from New York and declined to participate. The OAG investigated whether those platforms accepted trades from within New York State. Based on this investigation, the OAG referred Binance, Gate.io, and Kraken to the Department of Financial Services for potential violation of New York’s virtual currency regulations.
* By highlighting these weaknesses, as well as other considerations important to consumers, the OAG hopes to educate customers, and to encourage the virtual asset marketplace to adopt policies that ensure the integrity of transactions
* Commentary:
  + Voluntary questionnaire but failure to participate led to a securities investigation for 4 cryptoasset trading platforms
  + There is a vacuum in the space of cryptoasset trading platforms
  + Theme throughout the report that suggests that cryptoasset trading platforms should self regulate before they have to interfere
* Underlying purpose of report
  + Protect investors
  + Push industry to develop standards to regulate themselves

**NYAG Report: difference b/t traditional exchanges and cryptoasset trading platforms**

* Understanding the general structure of the traditional securities marketplace is helpful for understanding how virtual asset trading platforms are different, and why that matters to customers
  + The traditional “public” stock exchanges (e.g., the New York Stock Exchange or Nasdaq) must submit information regarding virtually all important aspects of their operations to the Securities and Exchange Commission (“SEC”) for review prior to implementation
  + Similarly, alternative trading systems (“ATS”) – of which there are several dozen in the United States – are private stock trading venues operated by a broker-dealer. ATSs are subject to extensive disclosure obligations regarding their ownership, operation, and rules.
* Those disclosures are designed to allow traders to understand the material aspects of how the ATSs operate.
* As an additional safeguard, everyday investors access traditional stock trading venues through a registered broker-dealer (or via personal investment advisor) whose business it is to understand the often-complicated nature of trading in order to effectively act on behalf of their clients.1
  + Cryptoasset platforms allow for direct access by anyone unlike most exchanges where there is an intermediary (broker) acting on your behalf
* In contrast, virtual asset trading platforms are not currently registered as trading venues under federal securities laws. Further, customers access virtual asset trading platforms directly, submitting orders themselves
* Trading platforms claim that the ability to freely access their venues benefits customers.
  + This freedom, however, requires everyday customers to understand not only how each trading platform operates as a venue of exchange (and to understand the differences among platforms), but also to make judgments about how to monitor quickly-moving prices, select appropriate order types, place trades, and accurately monitor performance, **without guidance from a professional** with knowledge and experience.

**NYAG Report: Surveillance**

* Traditional exchanges have extensive surveillance mechanisms to monitor for market manipulation and other abuses possible in the industry
* The cryptoasset trading platform industry has yet to implement serious market surveillance capacities, akin to those of traditional trading venues, to detect and punish suspicious trading activity.
  + A platform cannot take action to protect customers from market manipulation and other abuses if it is not aware of those practices in the first place

**NYAG: conflicts of interest and proprietary trading**

* Important issue that will be challenging to address: a lot of the trading platforms we are seeing, fill the orders of the clients and do their own proprietary trading on their venue. Form of a potential conflict of interest
  + Ex. if you are seeking to buy and no one is able to sell at the moment, the trading desk of the platform may take the other side of the trade and make a market for the buyer
  + This is a potential for a conflict of interest
* Such activity is common in the traditional securities marketplace, particularly in broker-operated alternative trading systems (ATSs), but it requires significant commitment to customer protections and transparency to remain in compliance with applicable laws.
  + Trading platforms that engage in proprietary trading on their own venues uniformly told the OAG that their trading desks had no informational or other trading advantage over customers.
* The OAG found that significant variation exists in the amount of trading activity attributable to those platform operators. Circle reported that it accounted for less than one percent of the executed volume on its platform Poloniex during the most recent time period reviewed. BitFlyer USA indicated that its own activity accounted for approximately ten percent of the executed volume on its platform. Another, Coinbase, disclosed that almost twenty percent of executed volume on its platform was attributable to its own trading.
* Risks
  + Such high levels of proprietary trading raise serious questions about the risks customers face on those platforms. As a general principle, when a significant percentage of the volume in one or more assets on a venue is attributable to one source, customers face the risk that the availability of liquidity in those assets could change, without notice and at any time, including when liquidity is needed most – namely, in times of market volatility or rapid price movement

Financial Stability Board

* Financial Stability Board (FSB) is an international body that monitors and makes recommendations about the global financial system
  + Looking at Macroeconomic issues – 20,000 foot overview
    - They wouldn’t worry about crypto unless they believe it would impact the global financial system
* IOSCO: set standards for securities regulators across the world
  + CSA and BCSCn consider IOSCO
  + Seeks to build sound capital markets and fair and efficient markets, investor protection, promote confidence
  + Do lots of work with information sharing b/t countries

FSB Report on Crypto-assets

* <http://www.fsb.org/2018/10/crypto-asset-markets-potential-channels-for-future-financial-stability-implications/>
* In early 2018, roughly a third of FSB member jurisdictions indicated that some regulated financial institutions were investing, trading or dealing in crypto-assets or crypto-asset derivatives.
  + FSB not as interested in retail investors—they get worried about regulated FIs investing in cryptoassets b/c of the volatility of those assets affecting financially important companies
* \* Really interesting \*
  + Operational issues on trading platforms can also lead to fragmented market structure. While a strong network of regulated trading platforms, brokers, and dealers can increase market liquidity by connecting buyers and sellers, most crypto-asset trading platforms globally are not registered as regulated exchanges, and many have experienced service disruptions or hacking that have halted or limited the ability of buyers and sellers to transact, or resulted in the largescale theft of customers’ and/or the exchanges’ crypto-assets.
  + Often because crypto-asset trading platforms either are not registrable or fail to register, in most jurisdictions their activity is not supervised in any capacity, unlike traditional financial institutions or infrastructures.
  + Why interesting? Global body saying it is important and taking notice which could lead to fragmented market structure
    - FSB is likely going to have lots of conversations with IOSCO which will start taking to all securities regulators to get on this
    - Increases momentum for change in BC and Canada
* Confidence Effects:
  + If crypto-assets become significantly more actively traded by financial institutions or significantly more widely used by the general public, then materialisation of the primary risks described above could damage faith in those institutions and the financial system.
  + If the public were to judge the policy response to the emerging risks in crypto-asset markets to be inadequate, trust in the financial system and in financial regulators **could be further eroded**.
    - If this stuff starts to pick up momentum without regulation, it could affect global trust in the financial system
  + Confidence in crypto-asset markets themselves can be impaired by price manipulation, cyberincidents at crypto-asset trading platforms and questions over governance. Damage to the credibility of crypto-assets could hinder prospects for the future application of blockchain and DLT to financial services.
    - Not taking the view of just securities regulator, but that it could pollute people’s trust in blockchain generally
* Regulatory approaches and communications:
  + There have been moves towards self-regulation by some crypto-asset trade associations.
  + While a discussion of policy responses specific to financial stability may be considered premature, a number of options may be available to domestic authorities to regulate these platforms
  + A large number of authorities and some Standard Setting Bodies have issued statements or warnings about bitcoin and other crypto-assets, for example that assets offered in ICOs are highly speculative and that investors should exercise caution.
    - Ie. alerts, guidance, notices
* IOSCO response
  + International Organization of Securities Commissions (IOSCO) has established an ICO Consultation Network to discuss experiences and concerns regarding ICOs, and is developing a Support Framework to provide a resource for members in considering how to address domestic and cross-border issues stemming from ICOs that could impact investor protection. IOSCO is discussing other issues around crypto-assets, including, for example, regulatory issues around crypto-asset platforms.
* IOSCO always asks questions about the regulatory perimeter and whether there are activities outside of the perimeter that they need to bring within

Conclusion

* Could this be covered by a different regulatory scheme?
  + Perhaps commodities regulation – similar to buying gold
* Tension between innovation and managing risk
  + How do you strike the balance b/t allowing innovation and regulation standing in the way?
* Not unique to cryptoassets – there is always a regulatory race ex. London v NY trying to become the primary trading jurisdiction
  + If you don’t keep up with innovation, the results could be disastrous
  + Bit of a competition among regulators to see who can best serve new innovation
* NYAG document is interesting in its effort to empower investors
* We are starting to see crypto slow down a little bit and regulators catch up
  + Some regulators would like to just wait and see if crypto dies
  + Some regulators are more interested in keeping up and changing the regulatory scheme and support blockchain as a potentially useful innovation
* What would have to go wrong with crypto to trigger a financial crisis? From a high perspective, it seems like the value of crypto is relatively safe in that it is

# November 7, 2018

## Derivatives

**Exchange Contracts**

* **Definition:**
* **"exchange contract"** means a futures contract or an option that meets both of the following requirements:
  + (a)its performance is guaranteed by a clearing agency;
  + (b)it is traded on an exchange pursuant to standardized terms and conditions set out in that exchange's bylaws, rules or regulatory instruments, at a price agreed on when the futures contract or option is entered into on the exchange,
  + and includes another instrument or class of instruments that meets both of those requirements and is designated as an exchange contract in an order the commission may make for the purpose of this definition;
* Prospectus requirement does not apply to exchange contracts
  + Why? You know all the terms of the contract

**Two main kinds of derivatives that are securities**

* Options: contracts that entitle you, but do not oblige you, to buy a specific security on a specific date at a specific future price
  + The value of the option comes from the security which it is based on
  + Derivative = its value is derived from something else
* Swap: where parties agree to exchange obligations
  + Example: credit default swap – one party will agree to pay (stream of payments or one time payment) in exchange for another party assuming an obligation of theirs
    - Money that is owed, you can pay a third party money so that if you ever default to the first party, the 3rd party that you have entered the CDS with will pay the default 🡪 functions like insurance
    - Different than insurance: can only enter into insurance for something you own but you can get a CDS for anything
    - One party is agreeing to offload risk and one party is agreeing to take on risk
    - CDS’s are not standardized
    - The value of the CDS is going to rise or fall based on the default risk of the party entering into it
    - They are anonymous: you don’t know who the counterparty is generally. However, since there is a clearing agency \

Derivatives

* Initially were seen to be outside of the purview of securities regulation
* In BC, there was a blanket order (91-501) which granted a blanket exemption from prospectus and registration requirements for qualified parties (ex. satisfied parties or hedgers)
* Futures contracts that are not exchange contracts which require future physical delivery of commodities and cannot be settled by cash are not covered by the act
* Foreign exchange contracts: if making an agreement to buy FX within 3 days, they are not coverd by the BCSA

Financial Crisis

* Buildup
  + Low interest rates
  + Granting mortgages to increasingly high risk borrowers
  + Mortgages were being taken off the books with Mortgage backed securities (CDOs)
    - Flatten out the risk of individual defaults if you put a bunch of mortgages together
* What happened:
  + Mortgages started to fail – banks with mortgages on their backs were having to write down all their mortgages
  + Value of the portfolios significantly decreased
  + Some of the banks had entered into CDSs with other parties regarding the MBSs assuming that the other party would not default
  + Banks from other countries entered into the US housing market to buy MBSs -- international engagement and movement of money
* Lehman brothers:
  + Significantly exposed to debt and mortgages and it was obvious they were not going to be able to meet their obligations
  + Decision was made that they should be permitted to fail b/c it was extremely risky behavior
  + By permitting lehman brothers to fail, it created a sense of panic – banks failing was not a part of the understanding of where the economy was
  + Fact that Lehman brothers failed was a huge shock and it turned out that AIG ahd entered into CDSs with Lehman brothers which caused AIG to be on the hook for billions of dollars
* Too big to fail: Government realized that if one big bank failed then it wouldcause a chain reaction
  + Bear Stearns was on the brink of failure as well—they ended up being acquired by JP Morgan for a discount (6% of value). JP morgan was pressured to prop the system up
  + Had international effects: bank runs in Scotland
  + Concern in global markets (beyond banking and finance industries)
  + This turned into a liquidity crisis b/c no banks wanted to enter into contracts with each other due to the inability to determine the risk of other parties
    - Overnight loans dried up which translated to customers not being able to take money out
    - If this starts to happen, where people cant take money out or use credit cards, it would cause significant panic among consumers and also businesses
* 2009: G20 leaders got together and they recognized that in the complexity of risk transfers, considerable risk was brought to the financial system itself and this needed to be addressed
  + They identified two key risks which were not addressed by existing securities regulation (mostly central bankers who came together and not securities regulators)
    - A lack of transparency in activity in the derivatives market
      * Neither regulators nor market participants had information about the derivaitves market or counterparties exposure 🡪 not enough info about growing risk in the system in order to be able to do anything about the risk
      * Bilateral collateral management (self regulation) was not sufficient to deal with the overall risk
        + The ability of individual parties to design their own risk models was becoming increasingly difficult b/c of interconnectedness of the financial system 🡪 not useful to have individual countries gather information
      * People were not able to value the derivatives which caused the financial crisis
    - Significant market participants were not subject to capital requirements, so they were at risk of defaults which led to a lack of collateral and capital
      * Too big to fail: idea that entities were so significant and integral to entire financial system that their failure would have a huge impact on the system at large 🡪 try to avoid this going forward
      * There were players who were significant to the entire capital market (dealers and participants in global securities market) participated with the G20 and contributed to the commitments that were made moving forward
  + They came to an agreement that they are going to require all of their members to adopt rules that are consistent with addressing these risks
    - 4 different commitments:
      * Improve transparency:
        + 1) requiring all derivatives be reported to trade repositories

Trade repositories would provide aggregated information about derivatives and provide regulators info about each derivative

* + - * + 2) certain standardized derivatives would have to be traded on exchanges

Platforms would publish info about all derivatives traded 🡪 high level commitment to push trading of derivatives onto exchanges and platforms in order to increase transparency of trade information and standardize contracts

* + - * Reducing risk of defaults by significant market participants
        + 3) Impose requirements for market participants to clear derivatives using central counterparties – central counterparties would guarantee the derivative

CCP’s obligations would essentially net out b/c the risks of default of the individual parties would cancel each other out

* + - * + 4) impose capital and collateral requirements on participants where deriviatives were not cleared through a central clearing party

If you were not trading one of the standardized derivatives which had to be cleared through CCPs, required to have a threshold level of capital

* Since these commitments were made, there have been various international bodies (ex. IOSCO, FSB) which have influenced these commitments to be adopted worldwide
  + Ex. Bank of Canada, Federal Department of Finance and all securities commissions became the “heads of agencies” who decided what to do to honor the commitments from the G20
    - They recognized that banks in Canada were significant players in the derivatives market and “systemically important” – size of market in Canada is not big enough to pose a risk to international finance community besides a few of the banks within Canada
    - Canadian firms form a small part of the global OTC market and were not engaged in the type of conduct which caused the financial crisis
    - Therefore, having entered the commitments, it would be harmful to the capital markets in Canada to impose the commitments on Canadian entities when they were not the cause of the crisis and were insulated to a certain extent
    - Why would Canada impose these requirements if they were not the cause?
      * Could be a problem for the future
      * Interconnectedness of global economy
      * Other jurisdictions imposed the requirements
  + Canadian securities committee was implemented in2010 to determine how to comply with international commitments

To illustrate Canada has implemented several national instruments in response to G20 participants

* NI 91-401 <https://www.bcsc.bc.ca/Securities_Law/Policies/Policy9/Group/?group=91%20401>
* It was determined that derivatives were essentially the cause of the problem – speculation derivaitves specifically
* Ni 91-406: Derivatives: OTC central counterparty clearing
* NI 91-407: Derivatives registration
  + - * NI 91-501: OTC derivatives
        + requires registration
      * MI 91-101: Product determination rule (Ontario and Alberta opted out b/c they amended their respective acts and took a different view about the intended action to be captured
        + Sets out as a threshold matter what woud be covered by other rules that come in with respect to derivatives
        + Defines derivative
        + Talks about excluded contracts and instruments

Fall within th definition of derivative but get carved out of the regime

Ex. Gaming contracts, insurance contract , FX currency, delivery of commodity other than currency where intended to settle by physical delivery

* + - * MI 96-101: trade repositories and data reporting
        + Sets up a requirement for trade repositories to be recognized – other recognized agencies are exchanges etc.

They are going to be gatekeepers in the system and market intermediaries as b/t market participants, oversee market participants, role in system to gather data and disseminating data

Once they are recognized, they are subject to part 4 of the Act whereby the commission can regulate on them

They become an essential gatekeeper within the system

* + - * + Second part of the rule requires counterparties to report trading
        + Third part: where there is no dealer or CCP, there must be an agreement in writing between parties about who will report it
        + Rule requires that every participant have a legal entity identifier – that is the number you will enter in to the trade repository

Product identifier for each derivative type

Now suddenly going to have trade reporting and data about lots of different data

* + - * + Exclusions: Part 5

Commodity derivative

General exposure, which does not exceed $250 million, do not have to report

Derivative b/t gov’t and consolidated entity

* + - * + There are 3 recognized repositories in BC

Central Counterparties

* CCP becomes middleman to insure defaulting + insure efficiency
* By having CCP, addressing the risk of other counterparties, but must come up with appropriate balance for CCP itself – mitigated default
* CCPs will therefore have requirements about who can deal with CCP
  + Capital capability and obligation management – do you have the ability to manage your own risk?
  + CCP will require that parties post initial margin

94-101

* If you are trading in a mandatory clearing derivative (Interest rate swaps, Forward rate agreements), these must be cleared through a CCP

95-401: Consultation paper about marginal collateral requirements for non-contreally cleared derivatives

* If they are cleared through CCP, do not need to post collateral
* A covered entity would be defined as a financial entity with an aggregate month-end average notional amount under all outstanding non-centrally cleared derivatives above $12 000 000 000 excluding derivatives with affiliated entities benefitting from the intragroup exemption.
  + These entities need to pose collateral
  + Entities which post less than 12 billion per month, no need to post collateral 🡪 not good for economy
* Tension: derivative transactions which we don’t want to interfere with b/c imposing regulations on them would be burdensome
  + Balance b/t protecting real economy and inhibiting productive activity
* Type of eligible collateral: rules establish what is eligible as collateral and how to value it

Why did the financial crisis happen?

* Started with AIG and CDS’s—AIG was exposed to something like 1 trillion dollars worth of credit default swaps and many of the other parties defaulted so they were exposed to 1 trillion of debt
* Mortgage backed securities: banks were lending without checking the credit of the people applying for mortgages (no income no asset loans). Lots of people began to default on their mortgages all at the same time so the banks had to begin seizing houses to satisfy their debt. However, due to the number of people who were defaulting, the real estate market tanked because there were fewer buyers and therefore the underlying asset prices for the mortgage backed securities (houses) declined significantly. Therefore, the mortgage backed securities essentially became worthless
* CDO’s
* Rating agencies were rating mortgage backed securities too high
* Regulation gap

# November 14, 2018

**Baseline Requirement for insider trading**

* **87**   (1)In this section, **"reporting issuer"** does not include a mutual fund.
  + (2)An insider of a reporting issuer must, in accordance with the regulations,
    - (a)file reports disclosing the insider's
      * (i)beneficial ownership of, or control or direction over, directly or indirectly, securities of the issuer, and
      * (ii)interest in, or right or obligation associated with, a related financial instrument of a security of the issuer, and
    - (b)make other prescribed disclosure.
* Notes:
  + Only applies to reporting issuers.
  + Broadly worded: Beneficial ownership, directly or indirectly, “related financial insruments”.
    - Tries to catch all transactions that an insider is entering into
      * **"related financial instrument"** means
        + (a)an instrument, agreement, security or exchange contract the value, market price or payment obligations of which are **derived from**, referenced to or based on the value, market price or payment obligations of a security, or
        + (b)any other instrument, agreement or understanding that affects, directly or indirectly, a person's economic interest in respect of a security or an exchange contract;
      * Anything that is linked to the value of the security of the issuer – this is to avoid insiders avoiding the obligation to report their information
* This gives access to anyone who wants to know information about what insiders are trading
  + Discourages insiders from trading on non-disclosed information b/c it creates a record of insider trading which could be used for future liability

Two rules flow from this section

* 55-102
* 55-104: Insider reporting requirements
  + 3.1—Reporting requirement – An insider must file insider reports under this Part and Part 4 in respect of a reporting issuer if the insider is a reporting insider of the reporting issuer.
  + “reporting insider” means an insider of a reporting issuer if the insider is
    - (a) the CEO, CFO or COO of the reporting issuer, of a significant shareholder of the reporting issuer or of a major subsidiary of the reporting issuer;
    - (c) a person or company responsible for a principal business unit, division or function of the reporting issuer;
    - (f) a management company that provides significant management or administrative services to the reporting issuer or a major subsidiary of the reporting issuer, every director of the management company, every CEO, CFO and COO of the management company, and every significant shareholder of the management company;
    - (h) the reporting issuer itself, if it has purchased, redeemed or otherwise acquired a security of its own issue, for so long as it continues to hold that security; or
      * (i) any other insider that (i) in the ordinary course receives or has access to information as to material facts or material changes concerning the reporting issuer before the material facts or material changes are generally disclosed; and
      * (ii) directly or indirectly exercises, or has the ability to exercise, significant power or influence over the business, operations, capital or development of the reporting issuer;
  + “significant shareholder” means someone who has access to more than 10% of the voting rights attached to the issuer’s outstanding voting securties
* NI 55-102: system for electronic disclosure by insiders – the place where insiders file reports
  + s.2.1: File “insider profile”
  + SEDI is the database where insider information is published for the public
    - Gives info about insider, where they are insider, why they are an insider, date became an insider and date that ceased being insider,
    - Issuer information: type of company, whether they are a reporting issuer or not, etc.
    - Summary Reports: reports about the actual trading—insider transaction detail, issuer report history, insider information by issuer, weekly summary
      * Allows you to follow companies and insiders
      * The trading that is reported on SEDI is trading that is supposed to be on information that everyone has access to

Special Relationships

**Definition of special relationships**

* **3**  For the purposes of sections 57.2 and 136, a person is in a special relationship with an issuer if the person
  + (a)is an insider, affiliate or associate of
    - (i)the issuer,
    - (ii)a person that is proposing to make a take over bid, as defined in section 92, for the securities of the issuer, or
    - (iii)a person that is proposing
      * (A)to become a party to a reorganization, amalgamation, merger, arrangement or similar business combination with the issuer, or
      * (B)to acquire a substantial portion of the property of the issuer,
  + (b)is engaging in or is proposing to engage in any business or professional activity with or on behalf of the issuer or with or on behalf of a person described in paragraph (a) (ii) or (iii),
  + (c)is a director, officer or employee of the issuer or of a person described in paragraph (a) (ii) or (iii) or (b),
  + (d)knows of a material fact or of a material change with respect to the issuer, having acquired the knowledge while in a relationship described in paragraph (a), (b) or (c) with the issuer, or
  + (e)knows of a material fact or of a material change with respect to the issuer, having acquired the knowledge from another person at a time when
    - (i)that other person was in a special relationship with the issuer, whether under this paragraph or any of paragraphs (a) to (d), and
    - (ii)the person that acquired knowledge of the material fact or material change from that other person knew or reasonably ought to have known of the special relationship referred to in subparagraph (i).

Donnini

* Facts:Discussed possible financing for a company with his boss. Discusion was around the fact that the financing would be done at $6.75 for share. The next day, he traded an unusually high number of shares of that issuer. He did it through an intermediary. He was short selling the security of the issuer and sells them for $7. He would make 25 cents per share.
* Allegation: made those trades based on the undisclosed material fact that there was a possible financing that was going to take place. He argued that it wasn’t material, that it wasn’t a fact, and therefore, he did not have knowledge of material fact. So the element of insider trading had not been made out
* Issue: can a contingent event be a fact? YES
* Decision: guilty
* Ratio: even if something hasn’t matured into a material change, it can be a material fact
  + Material fact includes situations that have not materialized yet and contingent events
* Reasons: There was a material fact of financing, material fact of negotiations of financing, and the porposed price and size of the transaction was a material fact
  + He argued he was not elevated enough in the organization to be an insider but he was found to be more than a common employee – he had access to the information
  + He would not have engaged in the unusual trading if he did not know that the price would change – it was deliberate and intentional to use the effort to his benefit
* Notes: what if contingent event does not materialize?
  + Should still prosecute. Penalizing the intention to make money off of insider information – ex. still would prosecute a robbery even if there was nothing valuable to steal

***Lewis v Fingold***

* Unexpectedly disappointing results for Cineplex. He sold the shares knowing this.
  + He argued that he did not think they were disappointing on a grand scale and he believed in the head of the company and the company’s ongoing projects. He did not think it was materal
* Issue: on a BOP, can someone establish a genuine and reasonable belief that they did not think non-public information is not material?
* Decision: commission accepted argument
  + Very fact specific. One has to place a lot of credibility on this individual
* Notes: example of cases of arguing actual elements of the offence

Tipping

* Giving information to analysts or institutional investors – not permitted

Seto

* Company who trades securities to a director based on undisclosed info (ie. issue shares for $7/share). They trade to the director for 6.50/share before it has been disclosed. The defence was that this director knew of the information so theres no problem.
* Is there an issue here?
* The OSC cited, with approval, *Re Seto*,14 where the Alberta Securities Commission (the "**ASC**") held that conduct contrary to the public interest could be established even though the accused was not liable under insider trading provisions. In that case, the issuance of options to insiders of an issuer at a time when the issuer had been notified that it would be subject to a take-over bid was not technically in breach of the legislation.15 Nonetheless, the ASC exercised its public interest jurisdiction to find the respondent CEO liable for profiting from material information that was not generally disclosed. The OSC adopted the ASC's holding that not addressing trades based on undisclosed material information obtained through an officer's position would undermine the integrity of the capital markets.

Circumstancial evidence: Re Suman case 2012 OSC

* Suman was an employee of a subsidiary of a company. Allegation was that he knew of a proposal to acquire another company and that he had told his wife about it. He dnied knowing about it. Commission looked at a variety of factors and made inferences based on these.
* Ratoio: They said it was appropriate to draw inferences from circumstantial evidence where the inferences are reasonably and logically drawn from the facts established by the evidence and the evidence is clear, convincing and cogent
  + Did not have evidence that he knew
* Evidence that he had:
  + Evidence of trading – in 3 hours, spent $285,000 on shares
  + 3 days—Purchased options which entitled him to another 90,000 shares for $100,000
  + Starts selling, and sold most of his holdings making a profit of $954,000
  + He had done various internet searches that suggested he was trying to get a handle on the situation
  + They did not have facts to prove that he knew that his employer was going to buy another company
* Conclusion: guilty of illegal insider trading

Criminal Code insider trading prohibitions

* Standard for criminal code is BRD whereas same prohibition under BCSA is BOP
* Not a focus

# November 21, 2018

**Administrative Tribunals**

**Overview on what to talk about**

* Takeover bids
  + General concepts
  + Discussion about public interest, wrt takeover bids
  + Defensive tactics: NP 62-202
  + Poison Pills and Private Placements
    - Red Eagle case/Hecla mining case

**Fact Pattern—illustrates real world complications of take over bids and issues regulator run into**

* Canadian Publicly Listed engineering company: Aecom
* Aecom, a year ago, received a take over bid proposal from a state owned chinese engineering firm
  + It was a friendly deal—board was receptive to the offer, not a hostile take over
  + Offer price was agreed to be $20.37/share
* On the morning of the announcement, the stock traded $19.80/share
  + Why was this lower than the take over bid? Closing risk: there was a risk that one of the necessary regulatory approvals for the transaction might not be given
* Within 48 hours of the announcement of the bid, 25 million shares had traded on the TSX.
  + Aecom had 60 million shares outstanding—almost half of the total number of shares traded
    - This is not uncommon – when deals are announced, huge volumes of trading often happens
    - Reason: class of institutional investors called arbitrage firms who only invest in situations like Aecom, and they swoop in and buy a huge number of shares in the aftermath of the transaction
* Result: the market was right. One of the things that Aecom did, was that it had a contract with Ontario Hydro, to service its nuclear reactors. For reasons of national interest, the fed. gov’t decided that it was not prepared to have a state owned Chinese firm to service those contracts, the IP that goes along with it and safety issues, so it did not approve the transaction
* Regulator thoughts:
  + Ensure shareholders of target company are treated fairly. Which shareholders are the ones we should be interested in?
    - There are a set of shareholders who existed prior to the deal
    - Significant chunk of a different set of shareholders post announcement of the deal, who live for this exact set of circumstances ie. risk assessing a whole host of outcomes. They have a different perspective on this. They are interested b/c there were a set of circumstances that they sought to invest in, not b/c they believed in the company. They have different interests than the people who were there before the deal was announced
  + Regulations should stay out of take over bids b/c there is a highly liquid market. Shareholders can vote about their feelings of the deal on the market ie. sell shares if they don’t like, buy shares if they do like
    - Massive financial disconnect b/t price of the bid and what the market is doing. Not so simple to say that we don’t need to worry about shareholders and their reactions. There is a big difference b/t holding onto your shares and buying/selling on the market
    - Various factors in a deal suggest that consumer protection legislation should kick in

Take over bid concepts

* Why do we regulate the way in which someone can buy the shares of a company? Two fundamental reasons:
  + Protect interest of the shareholders:
    - the reality of public companies: 25-30% of shareholders show up to vote at annual general meetings
      * Practical consequence: you can control what a public company does in Canada by owning way less than 50% of the shares in a company. Most companies in Canada can be controlled by 15-20% of outstanding shares
    - worried about control premium: people are willing to pay for the control of a company.
      * If people can control public companies by owning a small number of shares, they may pay more for those shares than they would otherwise pay.
    - Therefore, entire take over bid regime is another example of consumer protection provisions—trying to ensure equal treatment that deals with reality of the above two issues

**NI 62-104**

* Governs take over bids and issuers bids
* Important concepts:
  + Provides definition of take over bid: when you make an offer to purchase any number of shares, and when you combine it with the shares you already own, take you over 20% of the outstanding shares, you are making a take over bid
    - Can’t evade rules by parceling ownership: when you are acting jointly and in concert with someone, NI 62-104 will aggregate shares
  + Offer to all security holders: if making a take over bid, you must make a bid to all security holders. Can’t do it to a subset of security holders
  + When you come to make a bid, the highest price you can pay within the previous 90 days, has to be the price you make in the offer
  + Can be commenced by sending a circular or having a press release
    - Bidder has to send a take over bid circular: can be a short document or a massive document.
      * If all cash bid with few provisions = short
  + Target company’s board has to prepare a director’s circular in response – they have to respond
    - Board has to do one of three things in this: recommend 1) accept; 2) reject; 3) no recommendation and explanation for that
  + Bid does not have to be for all the shares—have to make the offer to everyone, but you don’t have to buy all the shares
    - If buying less than 100%, when they come to acquire the shares, the most take a proportionate amount of the sahres ie. to everyone who offers shares. May result in buying “half shares”
  + S.2.29: adds requirements in terms of what the form of the offer must be.
    - 1) bid must be open for 105 days (previously, 35 days)
      * In friendly deal, can shorten it
      * If no agreement, 105 days
    - 2) At least 50.1% of the shares of the target must be tendered in support of the bid
      * A majority of the target shareholders have to have agreed to take the bid, in order for the bidder to take up any shares
    - 3) if bidder takes up any shares, bidder must provide a 10 day tail – people who did not tender their shares have 10 days to take up the offer
      * 10 day period after acquisition where people can tenders their shares after seeing the result of the intial tender
  + Two exceptions to entire regime:
    - 1) s.4.1, 62-104: normal course purchase exemption—buy not more than 5% of the shares in any 12 month period over an exchange
    - 2) s.4.2: private agreement exemption—buy any number of shares from not more than 5 vendors of shares where the purchase price is not more than 115% of the market price for the shares
    - Exemptions: don’t make sense relative to s.2.29:
      * Lengthened bid outstanding from 35-105 days in response to a belief that target boards did not have time to find an alternative transaction
      * Implemented a majority rule concept in take over bid – can’t take over a company unless more than 50.1% of shareholders agree
      * Exemptions do not contain this requirement

**Regime makes no sense**

* 50.1% rule is not founded upon a securities regulation rule in the first place
* Founded upon a worry that corporate Canada will get taken over by larger Canadian corporations or non-resident corporations
* Gov’ts have used securities leg. to accomplish policy goal (which may or may not be appropriate)
* As a consequence: when regulators adopt a rule for a reason that is not intrinsic to their regime, their regimes never make sense – always end up with a bust
  + Can take over Canadian companies through exemption but if you do it the normal way, you have to follow all the requirements

**Public interest:**

* What does this mean wrt securities law?
  + BCSA does not have any purposes to it which makes it different than OSA
  + OSA has two express purposes: 1) investor protection; 2) fostering fair and efficient capital markets
    - Consumer protection legislation and a market legislation
* This is the listed mandate for the BCSCn
* Rare and happy day when these two are in alignment—they usually are in conflict
* Ontario: their case law says that there is a ranking of those two purposes
  + Consumer protection is the primary obligation
  + This gives them very clear guidance as to what to do when they are in conflict
* BC does not have the same case law or view.
  + No rank order which says that in all circumstances consumer protection is first. A given issue may prioritize the two.
* These are in play in the take over bid area

Take over bid and Public Interest

* Best interest of shareholders of target
* Fair and efficient capital markets: other considerations need to be taken into account
* When we think about take over bids: brings securities law and corporate legislation into conflict.
  + Analyzes what Corporate legislation requirements are placed on directors during a take over bid
  + US Law: case law that has developed with what to do when the two types of legislation conflict
    - Canada does not have this
  + Recognition that this was a place for securities law to take a role b/c they did not have the same jurisprudence to guide how directors should and shouldn’t behave
  + Where is line b/t securities law and corporate law?

**NP 62-202**

* This NI speaks to securities regulators views about what are appropriate steps (which could be viewed as defensive tactics) in response to a take over bid
* Defensive tactics:
  + Typical response when this occurred before securities legislation: issue more shares under private placement. Acquiring control of the company was that much harder
  + Outstanding debt: amend debt so that when we get taken over, all of the debt comes due with penalty clauses
* Key Issues in 62-202
  + S.3: primary objective of the take-over bid provisions of Canadian securities legislation is the protection of the bona fide interests of the shareholders of the target company.
    - Seems easy but isn’t – not all sahreholders are the same and not all bought for the same reason
  + S.3: A secondary objective is to provide a regulatory framework within which take-over bids may proceed in an open and even-handed environment.
  + S.3(5): unrestricted auctions produce the most desirable results in take-over bids and they are reluctant to intervene in contested bids.
  + S.3(5)However, they will take appropriate action if they become aware of defensive tactics that will likely result in shareholders being deprived of the ability to respond to a take-over bid or to a competing bid.

**SH rights plans**

* Shortly after NP 62-202 came into effect, they developed
* Conceptual definition:
  + SH rights plan is a document which hsays that every SH of a company that has an SH rights plan in place, owns not only the share, but a right. Rights trade with shares
    - Right: triggered when somebody attempts to acquire more than 20% of the target company’s shares, w/o doing it in a permitted way.
      * Each SH rights plan has “permitted bid”
      * Right resulted in a massive dilution of the target company’s shares for every holder of the right except for person making the bid. Remaining shares of people who were not the take over bidder become diluted, which made it much more complicated to take over
* SH rights plan used b/c companies wanted protection from TO bids. Most large Canadian Public companies had rights plans at a particular time
  + Cases all dealt with situations where take over bidder complained of SH rights plan and tried to prevent it being triggered
* Case law:
  + Nothing inherently wrong with SH rights plan *Canadian Jorex*
  + However, can’t use SH rights plan to just say no forever. Target board was not allowed to have an SH rights plan open forever to block a hostile bid from ever going to SHs *Canadian Jorex*
  + ***Royal Host***Factors about when it was time for SH rights plan to go.
    - Generally: had target SHs approved of SH rights plan, how much time had the board had in order to look for alternative proposals. Was there a reasonable opportunity that another bidder may come along,

**Red Eagle Mining Corp. 2015 BCSCn**

**Facts:** Target was CB gold. Hostile bidder is Red Eagle. Competing friendly bid is from Batero. CB gold was a smell venture listed company on TSX-V—principal assets were mining properties in Columbia. They were in a difficult financial situation. Red Eagle also had properties in Columbia. Red Eagle and CB started to have friendly discussions but can’t reach a deal. Board of CB immediately following discussion puts a SH rights plan in place. Its obvious that they were concerned Red Eagle was going to go hostile. CB took the plan to the shareholders 5 months later who overwhelmingly approved the plan. Batero was 10% holder of CB, and had some of the same directors. After Sh meeting, CB gold entered into a transaction to sell substantially all of its assets to Batero. This triggers corporate law and securities law—needs shareholder approval. Some of SHs shareholders approach Red Eagle and say they don’t want the deal. They wanted Red Eagle to do a hostile takeover and offered their shares. CB gold gets ready for shareholder vote, but they knew that the SHs were going to turn them down. Upon learning that they were going to lose the vote, they announced a private placement with Batero as the main buyer acquiring shares under the private placement. Red Eagle complains immediately to exchange. CB needed stock exchange approval to make the placement. Upon Red Eagle complaining, CB gold said they were not going to proceed with private placement. Red Eagle and CB then try to go back to doing a friendly deal. RE and CB allegedly discussed a payment of $600,000 so it could continue running its business (they were on last legs). Deal falls apart. RE, the day after the deal falls apart, they publicly announce a hostile takeover of CB. CB has SH Rights plan. RE ultimately makes a permitted bid under the SH rights plan. Almost immediately after hostil bid announcement, CB gold and Batero enter into friendly deal at same price and they enter into a private placement as well, so that Batero will acquire about $600,000 worth of shares.

When it came to the hearing, almost at the expiration of the hostile take over bid, the private placement shares made the difference b/t whether or not Red Eagle would have had 50.1% of the shares or not.

RE approaches BCSCn: 1) cease trades of shares in private placement; 2) remove rights plan—emove 50.1% condition from the takeover bid, so it is no longer a permitted bid

Arguments:

* Red Eagle
  + Private placement should be cease traded b/c it was an inappropriate defensive tactic
    - If you look at 62-202—best outcome is for full and fair auction, and private placement is screwing up the auction b/c it is preventing the bid from being successful
  + Royal host Factors and 62-202—encouraging fair and efficient auctions
    - Rights plan achieved its purpose, there were dualing offers
    - Rights plan was doing nothing to encourage an auction so it should go
* CB Gold/Batero:
  + Red Eagle’s bid hasn’t been outstanding for 105 days, seeking to waive with 50.1% -- not in compliance with 62-104
  + Rights plan is serving a purpose b/c friendly bid from Batero hadn’t reached its tender date, so should let SHs who tendered to Red Eagle bid to move shares across to Batero bid. Rights plan served purpose to allows SHs to tender their shares to the right bid
  + Rights plan is still in place and is freezing everything and may allow for increasing prices of the ultimate sale
  + Overwhelming approval for Rights plan
  + CB gold offered the same private placement to Red Eagle as it did to Batero under the basis that they needed money to continue operations

Analysis of arguments

* First thing that is troubling about Red Eagle case is that CB Gold’s SHs were in favour of the rights plan and it should be left up to the will of the SHs
  + Aecom:
    - Shareholders that voted on SH rights plan are not the same shareholders that are going to be shareholders for CB gold when the takeover bid occurs
* Rights plan was serving a purpose b/c it was allowing SHs to get into the right bid
  + Contested and competed take over bids are all about strategy
  + Batero waited some time after Red Eagle bid was announced to launch its bid
  + Not the job of the BCSCn to decide when to make a bid
* Hard argument: BCSCn was part of the group that published new rules and need to make sure that Red Eagle has a 50.1% tender condition
  + Coercive b/c without 50.1% condition, the SHs of CB gold don’t get to decide, and Red Eagle may only take up 40% of the shares, so the remaining SHs would have a huge controlling Sh to deal with

Held:

* Refused to cease trade for private placement
* Applied to cease trade on SH rights plan

Reasons

* There is an auction going on right now
  + Batero, which was previously 10% and had acquired more shares in Private placement, and was in control of CB board of directors, anyone who wanted to take over CB gold was in an almost impossible position b/c of huge block of shares owned by Batero. The only party who was likely to take over CB was Batero.
  + The only way to allow the CB gold SHs to consider the Red Eagle bid was to waive the 50.1% condition— the 50.1% condition was functioning to end the auction
  + The number of shares of the company not owned by Batero in order to get the 50.1% condition was 75-80% of the outstanding shares.
  + Only way to encourage auction was to prevent 50.1% condition
* Private placement
  + Enough evidence to show that CB gold had not entered into Private placement to thwart Red Eagle’s bid 🡪 not a defensive tactic
  + Concerned that if you blocked the private placement, CB gold would have gone bankrupt before takeover bid finished

Conclusion

* Lifted rights plan
* Two bids stayed open—neither side raised their offer price. They both left it open for months. Slowly but surely, Red Eagle reported acquiring more and more shares of CB gold, until it got 50.1% of the shares and ended up taking over the company
* Fact that Red Eagle still wanted to do the 10 day tail showed that it was not a coercive bid
  + SHs had 10 days to decide whether they wanted to remain in the company or sell their shares.
  + This ensured that no one was going to get stuck in CB gold who didn’t want to be
  + This made it fair, despite not having 50.1% tender condition
* Ultimately, enough people decided that relationship b/t Batero and CB gold was not in their interest, and they wanted Red Eagle to control their company
  + At the end of the day, the shareholders and the market decided the outcome of the case

Note:

* Entirely decided on public interest, there were no provisions which said that what Batero and CB did was wrong
  + Unique in this way—nothing hardwired in the rules which said that something governs or does not govern

**After Red Eagle, implemented changes to 62-104**

* Two things happened immediately in take over bid landscape:
  + 1) wiped out Securities exchange take over bids – when you make an offer to buy someone’s shares with your own shares
    - When a bid only had to be open for 35 days, there wasn’t a long enough time for the valuation of the companies to change. The exchange ratio after 105 days usually significantly changes
  + 2) Rights plan issues that were faced went away, b/c the rules that were introduced mirrored many of the rights plan provisions
    - Boards then looked at alternative ways of defending against hostile bids
    - This led to the next case – people responding to hostile bids with private placements

Hecla Mining – joint hearing between OSC and BCSCn

Facts:

* Hecla mining company is al arge public exchange mining company—bidder. Dolly Bardon is a small exploration stage company desperate for money. After commodities market crash in 2008-2011, companies entered into loan-to-own or rent-to-loan: expiration stage companies would enter into agreements with other companies where they secured all of the smaller companies assets. When the loan came due, very high likelihood that the lender would take all the assets. Small company was hoping to come up with financing in the interim period. When Dolly Bardon entered loan-to-own deal with Hecla, they agreed to Hecla having a right of first refusal on future finances—Hecla could disapprove Dolly Bardon future financing. Hecla was a 10% SH in DB. Loan is coming due as story begins. DB goes to Hecla and asks to extend loan. Hecla agrees but proposed onerous financial terms. Board of DB started negotiating a loan exchange arrangement along these terms.
* On the verge of expiry of the loan, a financing window opens up for silver companies on Venture exchange. Price of silver has a large rise—DB can suddenly raise enough money to pay out the loan from Hecla.
* DB was being approached to do private placements with companies. DB goes to Hecla and says we can pay off the loan but also wanted to do private placement. Hecla says no, and says they can’t do any equity financing. Someone in DB devises a plan to get rid of Hecla loan – enter into loan with another party to pay off Hecla, and immediately do a private placement to repay the new loan. Had to provide notice to pay out the loan to Hecla.
* Hecla immediately launches a hostile take over bid. 10 days later, DB announces loan to pay back Hecla, announces that they are going to pay back Hecla and announces the private placement.
* Hecla approaches BCSCn and OSC to stop private placement because it is an inappropriate defensive tactic under 62-202. Undertaking from DB to not close private placement until outcome of the hearing.
* DB says that it was not a defensive tactic, it was preservation to pay off the loan to Hecla. Shouldn’t cease trading for PP b/c it is not a defensive tactic

Held:

* Do not have to cease private placement – not a defensive tactic
* Enough evidence to determine, from board minutes and loan being due, and risk of assets being seized, that they were able to determine it was not a defensive tactic

Conclusion

* Worked out friendly deal with Hecla who took down 10-12% of financing for DB

Ratio:

* two stage test
  + 1) Can you prove that the corporate action used was not a defensive tactic—onus on target board
    - If this is satisfied, then the test ends and it is a matter of corporate law
      * Problem is that there are any number of reasons that the board may have engaged in this behavior – most cases will not be decided on this part of the test
      * Why? Not right to interfere unless you can say that 62-202 is engaged
  + 2) If not proven, look to factors which may indicate whether it is in the public interest to halt the transaction
    - Key factors:
      * Whether or not there was evidence that the SHs were supportive of the transaction
      * Whether or not the transaction might allow for an auction or a bid to carry on
      * Was there evidence of pre-existing discussion of a financing
      * Did the size of the financing generally line up from a size and business purposes perspective with the needs of the company ie. is there a connection b/t size of financing and business needs and purposes of the company

Notes:

* Only thing that rights plan does is interfere in dynamics in which a takeover bid can occur – easy to judge
  + Primarily under securities law
* Unlike rights plan, private placements serve other functions and engage corporate law
  + Particular transaction that DB engaged in had other potential legitimate business purposes
* Commission is seriously interfering in the business decisions of company on second prong of test
  + Commission is however, handcuffed in this situation

## Exam:

* **Public interest: investor protection and fair and efficient capital markets** 
  + **Always in play. Have it in your minds**
* To the extent that the text is more detailed than what we have talked about in class, its less likely that this is going to appear on the exam
* What is a security – cases and rules: probably going to come up
  + Is there a question of whether something is a security?
    - What indicates it is, what indicates otherwise?
* Definition of trade and distributions:
  + On those occurring, what does that mean
  + People who are distributing have to file a prospectus
  + People who trade have to be registered
* Know NIs that set out the general requirements
  + Don’t need to know great detail
  + Know the types of things to find in prospectus
  + Types of disclosure—full plain and true disclosure of material facts
* Materiality
  + Identify and discuss what suggests materiality
* Prospectus requirement
  + Req. to file prospectus. What can someone do before they file a prospectus
    - Can’t trade or distribute or do an act in furtherance of a trade
    - What can you say and do from a marketing standpoint before they have a preliminary prospectus – ie. bought deal
    - Who can be speaking and hwo can’t before preliminary prospectus
  + What can people say in waiting period b/t preliminary and final prospectus
    - Why do we have these rules for before, between and after?
    - All about disclosure
* Continuous disclosure – s.85: once a reporting issuer, provide continuous disclosure and know which NI requires disclosure
  + Two kinds of continuous disclosure obligations
    - Periodic disclosure: quarterly reporting and management
      * Audited or not; what is in it interim financial reporting; what is management discussion and analysis ie. intended to provide a narrative
      * Annual reporting
  + Types of statements being made—full true and plain. If making forward looking statements—*Kerr*: making statement about material facts about now and making assumption about future. Need reasonable basis. Should be explaining that it is forward looking, the basis upon which the forward looking statements are based upon, and why this makes it reasonable
    - True and reasonable at time making it, but be clear that it is true and reasonable AT THE TIME
  + Point of disclosure is to make informed decisions
  + **Timely continuous disclosure**: find basis in act, then go to 51-102.
    - What is a material change
    - Obligation to disclose any material change
    - Don’t have to definitively decide it is a material change, but raise issues as to why it might be a material change
      * News release? File on sedar (11-201)
* Why do these rules exist?
  + Understand what the rules are meant to accomplish
  + Doesn’t matter if you know all of the technicalities.
  + Want to understand how they fit together and what they are doing
    - This allows you to understand technical requirements and the spirit of the requirements
    - Better able to advise clients and better able to understand if you should be exempt from requriements
* Fact pattern – base requirements in act, this is the rule that governs, and the requirements that stem from that rule
* Registration:
  + 31-103
  + Registrants have a duty of to act fairly, honestly and in good faith
  + On fact pattern: did person need to be registerd, was there an exemption that they could have availed themselves, and what is registration achieving
  + Suitability: know your client
  + Capital requirements, solvency
* Derivatives:
  + Only what we talked about in class. Most of ruels in place are proposed or very technical, probably won’t get asked about inner workings of derivatives
  + What are concerns that arose around derivatives that led to development of derivative regime
  + Concerns from crisis
    - Concern about CCPs, margins, transparency around reporting of derivatives markets
  + Regulatory responses from crisis and what they may result in
* Market intermediary class
  + Exchanges, SROs, CCPs
  + Understanding where commission sits
  + Commission oversees various market intermediaries and how they sit relative to other commissions
  + S.24 of act.
* Machinery
  + SL is provincial – how is that they cooperate
  + One of the reasons that most of the requirements are in the rules is so we can achieve harmonization across provinces
  + Understand passport system—11-102
    - Permits registration or prospectus in one jurisdiction, you will be registered or receipted in other jurisdiction
    - Still have to pay money to each of the regulators
* Insider trading
  + Triggers for insider trading
  + Understand defences: other person knows disclosed information
    - Not making out all elements of the offence
  + Tipping: another offence
    - How tipping can go on
    - How tipping can be severed if the tippee does not know if you are in a special relationship
    - Can tip when its necessary in the course of business
  + Whats the problem with insider trading and tipping? Why is it okay in the necessary course of business? Don’t want people to be trading on undisclosed financial info, but if in the regular course of business it may make it more difficult o do business
* Exempt Market
  + Main exemption to understand – not in the business of trading exemption
    - CP 31-103—discussion about business trigger. In the business of trading (some jurisdictions) vs. if you trade
    - Exemption in BC that if you are not “in the business of trading” you are exempt from registration
    - What does it mean to be in the business of trading?
      * Trading for business purpose: are you doing thing that registrant does? Are you intermediating? Are you doing the type of thing we want to regulate?
    - Be able to determine on a fact pattern if someone is in the business of trading – probably not a right answer but identify issue
* Take over bids:
  + Probably nothing will come up on take over bids
  + But know where they are and what is the reason for a securities regime at all? Potential unfairness to investors
  + Discussion about public interest
  + Understanding that there is a tension with corp. law

# November 28, 2018—Enforcement

* Only the Crown can prosecute Securities cases

Speech from Justice McLachlin

* Tribunals provide specialized and technical resolutions in different situations, ensure greater innovation, flexibility and efficiency in the delivery of governmental programs and strategies, and provide an informal and rapid forum for public hearings, thereby minimizing time and costs related to litigation before ordinary courts. As Justice Abella stated while she was sitting on the Ontario Court of Appeal:
* *Designed to be less cumbersome, less expensive, less formal and less delayed, these impartial decision-making bodies were to resolve disputes in their area of specialization more expeditiously and more accessibly, but no less effectively or credibly.*
* In sum, without administrative tribunals, the rule of law in the modern regulatory state would falter and fail.  Tribunals offer flexible, swift and relevant justice.  In an age when access to justice is increasingly lacking, they help to fill the gap.  And there is no going back.

BCSCn Tribunals

* Reluctance of courts to recognize admin law in the way that McLachlin says
  + Greater access to justice—courts may not be that efficient
  + Robust source of law
* Hearing fairness is paramount
  + Try to ensure everything is fair to respondents
* Everything is run just like a trial in a court
* Differences:
  + No rules of evidence.
  + All electronic exhibits
  + Flexible but still formal
  + Three member panels
  + Not bound by precedent – tribunals tend to follow precedent for the most part
* Disclosure obligations
  + Disclose relevant evidence electronically

**Enforcement Outcomes**

* Send a letter
* Settle with parties
  + Can settle at any stage during investigation
  + Settlements are public
  + Overseen by Executive Director
  + Registrants probably more likely to settle b/c don’t want a big hearing
* Reciprocal Order
  + Can issue an order based on another Commission’s order reciprocal order
  + Ex. If OSC orders John doe to be prohibited for 5 years—under our act, BCSCn could use their information and seek to order a ban for 5 years
  + Criminal proceedings in the US: can bring an order, give notice and institute proceedings
* Primary—s.161
  + Almost always asking for orders under s.161

What is a security:

* Must be a security to be within BCSCn jurisdiction
* “Investment contract”: Very broad term
  + Favours regulators b/c it allows them to regulate instruments which may not be captured under other subsections
* Pacific Coin: Investment of money, in a common enterprise, with an expectation of profits to be derived from a third party
  + If I invest, and I get a return, likely could be an investment contract

SBC Financial 2018

* Alleged a case involving property which is an investment contract
* Panel said no:
  + The efforts of the third party were not met—do not think the condition of closing in a real estate transaction that is to be completed by a third party prior to investment is effort by a third aprty
  + Only way they differed from normal real estate transactions was that they arose through investment company

Braun (re)

* Pastor in church who defrauded churchgoers. Fraud is about trust
* It was determined to be a security:
  + Not purchasing beneficial interest in property.
  + They purported to have flipping scheme where you would invest money and you would get a profit by the increase in value in the property.
  + Paragraph 83: economic returns to be provided do not suggest that they were acquiring a beneficial interest, they were guaranteed a return so it was no way it could be related to a property.

CBM Canada’s Best Mortgage

* Related to promissory notes
* When looking at definition of security
  + Doesn’t matter what its called—substance over form. Economic reality of the situation
* Promissory notes were securities:
  + Para 122: plain reading of def. led to conclusion that promissory notes
  + Rebuttable presumption that promissory notes are securities
    - Strong presumption that unsecured, high interest bearing promissory notes are securities
* Jurisdiction: is there a state of facts demonstrating circumstances in which it would be appropriate for a tribunal to take jurisdiction over legal issue
  + Perpetrator or victim in jurisdiction—no problem
  + Alberta and BC have jurisdiction over TSX-V: