

July 2003

NEW INSIDER REPORTING OBLIGATIONS FOR EQUITY MONETIZATIONS

The Canadian Securities Administrators (the “CSA”) have issued a Notice of Request for Comments¹ on a proposed new rule requiring the filing of insider reports for certain equity monetizations and other similar derivative transactions. Insiders of a reporting issuer who enter into transactions having the prescribed effect may have an obligation to file an insider report pursuant to Multilateral Instrument 55-103 (the “Proposed Rule”).

The Proposed Rule has been developed in response to concerns that current insider reporting requirements may not capture certain derivative transactions, including equity monetizations that satisfy one or more of the fundamental policy rationales for insider reporting. The CSA explains in Companion Policy 55-103CP (the “Companion Policy”) that insiders may profit from material undisclosed information by entering into derivative transactions that for technical reasons fall outside of insider reporting requirements. This creates inefficiencies because the market is unaware of the insider’s true holdings and, by inference, the insider’s views of the reporting issuer’s prospects. A further objective of the Proposed Rule is to achieve greater consistency between U.S. and Canadian insider reporting requirements.

THE ESSENCE OF THE PROPOSED RULE

Under the Proposed Rule, an insider must file an insider report in the prescribed form within 10 days of entering into an agreement, arrangement or other transaction that changes the insider’s “economic exposure” to the reporting issuer or changes the insider’s “economic interest in a security” of the reporting issuer unless the insider is required to file an insider report under any other provision of Canadian securities law.

“Economic exposure” in relation to a reporting issuer means the extent to which the economic, financial or pecuniary interests of a person or company are aligned with the trading price of securities of the reporting issuer or the economic, financial or pecuniary interests of the reporting issuer.

“Economic interest in a security” means the extent to which a person or company is entitled to receive, bears or is subject to

- (a) an economic, financial or pecuniary reward, benefit or return from a particular security, or
- (b) an economic, financial or pecuniary loss or risk of loss in respect of a particular security,

and includes, without limitation, the extent to which such person or company has or shares the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in such security or a transaction which directly or indirectly involves such security.

¹(2003) 26 OSCB 1805

EXEMPTIONS

Section 2.2 of the Proposed Rule contains a number of exemptions to the insider reporting requirement. Obviously, arrangements which do not involve a security of the reporting issuer or a derivative in respect of which the underlying interest is or includes as a material component a security of the reporting issuer need not be reported. Compensation arrangements between the issuer and the insider are exempt so long as (i) the compensation arrangement is disclosed in the financial statements or other public document of the reporting issuer; or (ii) the material terms of the compensation arrangement are set out in a written document and the alteration to economic exposure or economic interest occurs as a result of the satisfaction of a pre-established condition or criteria described in the document, and does not involve a discrete investment decision by the insider. An exemption is available for a pledge of securities as security for a debt, so long as recourse is not limited to the securities of the reporting issuer. In addition, there is relief from the insider reporting requirements of the Proposed Rule where an insider has obtained exemptive relief under NI 55-101, in another jurisdiction or under Part 4 of the Proposed Rule.

CONCLUSIONS

While the policy rationale behind the Proposed Rule is meritorious, it has some shortcomings that may be

addressed by the CSA upon receipt of comments from market participants in the coming months. The Proposed Rule requires disclosure of a debt transaction that is limited in recourse to securities of the reporting issuer in all cases notwithstanding that the Companion Policy specifically identifies the concern as transactions where an insider is entitled to settle its obligations by putting the securities of the reporting issuer to the lender in full satisfaction of the debt. In a normal lending transaction where securities are pledged as collateral, any lender would want clear and unequivocal protection from exposure to the pledged securities through margining requirements. Another problem with the Proposed Rule is that it appears to require the disclosure of exact terms of a subject transaction notwithstanding that structures and pricing are generally considered to be competitive information. It is probably enough for the market to know that an insider is laying off its exposure to price fluctuations in the securities of a reporting issuer without having to publicise the structure of the transaction or the spreads and fees charged by a particular investment bank.

Perhaps the most troublesome aspect of the Proposed Rule is that insiders are required to disclose the existence of pre-existing transactions which continue in force after the effective date of the rule and which have the prescribed effect. Understandably, if such transactions are not disclosed, the insider reporting regime will continue to convey materially misleading information about certain insiders' true economic position in the issuer

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

For further information, please contact your McMillan Binch lawyer or one of the lawyers listed below:

Tim Baron	416.865.7096	tim.baron@mcmillanbinch.com
Tania Fecko	416.865.7929	tania.fecko@mcmillanbinch.com
Nicole Frew	416.865.7904	nicole.frew@mcmillanbinch.com
Richard Higa	416.865.7864	richard.higa@mcmillanbinch.com
Mark Lobsinger	416.865.7107	mark.lobsinger@mcmillanbinch.com
Shahen Mirakian	416.865.7238	shahen.mirakian@mcmillanbinch.com
Gary Ostoich	416.865.7802	gary.ostoich@mcmillanbinch.com
Stephanie Robinson	416.865.7204	stephanie.robinson@mcmillanbinch.com
Robert Scavone	416.865.7901	rob.scavone@mcmillanbinch.com
David Wentzell	416.865.7036	david.wentzell@mcmillanbinch.com