Notice of Proposed Instrument and Companion Policy

Proposed Amendment to and Restatement of
National Instrument 55-101
Exemption from Certain Insider Reporting Requirements
and
Companion Policy 55-101CP
Exemption from Certain Insider Reporting Requirements

May 14, 2004

Request for Public Comment

The Canadian Securities Administrators (the CSA) are publishing for a 90-day comment period the following documents:

- National Instrument 55-101 *Exemption from Certain Insider Reporting Requirements* (the Proposed Instrument), and

- Companion Policy 55-101CP *Exemption from Certain Insider Reporting Requirements* (the Proposed Policy).

The Proposed Instrument and the Proposed Policy are collectively referred to as the Proposed Materials.

The Proposed Materials are being published concurrently with this Notice and can be obtained on websites of CSA members, including the following:

- www.bcsc.bc.ca
- www.albertasecurities.com
- www.sfsc.gov.sk.ca
- www.msc.gov.mb.ca
- www.osc.gov.on.ca
- www.lautorite.qc.ca

The Proposed Materials are intended to replace the current version of National Instrument 55-101 *Exemption from Certain Insider Reporting Requirements* (the Current Instrument) and Companion Policy 55-101CP *Exemption from Certain Insider Reporting Requirements* (the Current Policy) that came into effect in all CSA jurisdictions on May 15, 2001. The Current Instrument and the Current Policy will continue to be in force in all jurisdictions until such time as they are replaced by the Proposed Materials or otherwise amended or repealed.

We request comments on the Proposed Materials by August 13, 2004.

Substance and Purpose of the Current Instrument and the Current Policy

Canadian securities legislation requires insiders of a reporting issuer to disclose ownership of and trading in securities of that reporting issuer. The insider reporting requirements serve a number of functions, including deterring illegal insider trading and increasing market efficiency by providing investors with information concerning the trading activities of insiders of the issuer, and, by inference, the insiders' views of their issuers' prospects.

The purpose of the Current Instrument and the Current Policy is to provide certain exemptions from the obligation to file insider reports under Canadian securities legislation where the policy rationale underlying the obligation do not apply. For more information about the Current Instrument and the Current Policy, please refer to the Notice and related materials which were published in May 2001 at the time the Current Instrument and Current Policy came into force. Copies of this Notice, the Current Instrument and the Current Policy can be obtained on the websites of the CSA members noted above.

Substance and Purpose of the Proposed Instrument and the Proposed Policy

1. Summary of Changes to the Current Instrument and the Current Policy

The most significant changes to the Current Instrument are as follows:

(a) The Proposed Instrument contains an exemption from the insider reporting requirements for senior officers of a reporting issuer or a subsidiary of a reporting issuer who meet the following criteria (the *non-executive officer exemption*):

- the individual is not in charge of a principal business unit, division or function of the reporting issuer or a major subsidiary of the reporting issuer;
- the individual does not in the ordinary course receive or have 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
- the individual is not an insider of the reporting issuer in any other capacity.

(b) The requirement in the Current Instrument to prepare and maintain a list of insiders exempted from the insider reporting requirement by virtue of certain provisions of the Current Instrument has been supplemented by a requirement to maintain a list of insiders who are not so exempted. As an alternative to complying with the requirement to prepare and maintain a list of exempt insiders and a list of non-exempt insiders, a reporting issuer may instead file an undertaking with the regulator or securities regulatory authority that it will make available to the regulator or securities regulatory authority, promptly upon request, a list containing the information described in such lists as at the time of the

request.

(c) The Proposed Instrument also contains a new requirement requiring reporting issuers to prepare and maintain reasonable policies and procedures relating to monitoring and restricting the trading activities of its insiders and other persons with access to material undisclosed information relating to the reporting issuer or to an investment issuer of the reporting issuer.

(d) The existing exemption in the Current Instrument relating to *acquisitions* of securities pursuant to an "automatic securities purchase plan" has been amended to include an exemption for certain *dispositions* of securities that commonly occur in connection with a plan, and that we believe may be reported on an annual basis (the *specified disposition amendment*). These dispositions include:

- a disposition which is incidental to the operation of an automatic securities purchase plan and which does not involve a "discrete investment decision" by the director or senior officer; and

- a disposition which is made to satisfy a tax withholding obligation arising from the distribution of securities under an automatic securities purchase plan and which results from an irrevocable election by the senior officer or director to fund the tax withholding obligation through a disposition of securities not less than 30 days prior to the date of the disposition.

(e) The existing exemption in the Current Instrument relating to acquisitions of securities pursuant to an "automatic securities purchase plan" has also been amended to provide that the alternative reporting requirement that allows for a consolidated report to be filed within 90 days of the end of the calendar year does not apply if, at the time the alternative report becomes due, the individual has ceased to be subject to an insider reporting requirement (the *alternative report amendment*). This situation may arise, for example, in the following circumstances:

- the individual may have ceased to be an insider at the time the alternative filing requirement becomes due; or

- the individual may have subsequently become entitled to rely on an exemption contained in an exemptive relief decision or Canadian securities legislation (such as, for example, an exemption contained in NI 55-101).

We have attached to this Notice as Appendix "A" a blackline showing the changes that we propose to make to the Current Instrument and the Current Policy.

2. Reasons for proposing these changes

We have proposed the changes contained in the Proposed Materials as we believe that these changes will improve the effectiveness of the insider reporting system by better focusing the insider reporting requirement on meaningful information that is important to the market.

Accordingly, we believe that the principal benefits associated with these changes are as follows:

- enhanced deterrence against unlawful insider trading, since the insider reporting obligation will now focus more closely on insiders who routinely have access to material undisclosed information;

- increased market efficiency, since the trading activities of "true" insiders may be obscured under the current system by the large volume of insider reports filed by persons who are statutory insiders but who do not routinely have access to material undisclosed information; and

- a significant reduction in the regulatory burden associated with insider reporting on insiders, issuers and the securities regulatory authorities.

We have briefly summarized the rationale underlying the non-executive officer exemption, the specified disposition amendment and the alternative report amendment below.

3. Background to the non-executive officer exemption

The definition of "insider" in Canadian securities legislation includes individuals who hold the title of "vice-president". When the insider reporting requirements were developed in the 1960s, persons who held such a title generally were considered to exercise a senior officer function and were therefore required to file insider reports.

Since that time, we recognize that it has become widespread industry practice, particularly in the financial services sector, for issuers to grant the title of "vice-president" to certain employees primarily for marketing purposes. This phenomenon is sometimes referred to as "title inflation" or "title creep". In many cases, these individuals do not ordinarily have access to material undisclosed information prior to general disclosure and would not reasonably be considered to be senior officers from a functional point of view. (In this notice, such vice-presidents are referred to as "non-executive vice-presidents".) For many larger issuers, the ratio of non-executive vice-presidents to vice-presidents who exercise a senior officer function may be very high.

We recognize that requiring *all* vice-presidents to file insider reports may impose significant regulatory costs on these individuals and their issuers for little or no corresponding benefit. It has been suggested that the current requirements may actually serve to undermine the policy objectives underlying the insider reporting requirements, since the trading activities of "true" insiders may be hidden by the large volume of insider reports filed by non-executive vice-presidents. Consequently, as a result of changes in industry practice, we believe that it is no longer appropriate to require all persons who are "vice-presidents" to file insider reports.

In March 2002, CSA staff published a staff notice entitled CSA Staff Notice 55-306 *Applications for Relief from the Insider Reporting Requirements by certain Vice-Presidents.* This notice outlined the circumstances in which staff would support applications for relief from the requirements under Canadian securities legislation to file insider reports by persons who are technically insiders by virtue of holding the title of "vice-president" but who do not have access to confidential inside information.

Subsequent to the publication of this notice, the CSA have had the opportunity to consider a number of applications for insider reporting relief by non-executive vice-presidents. The amendments contained in the Proposed Materials are generally consistent with the recommendations contained in the staff notice and with recent exemptive relief orders.

4. Background to the specified disposition amendments

Part 5 of the Current Instrument provides a limited exemption from the insider reporting requirement for an insider who participates in an automatic securities purchase plan. As is made clear by section 4.2 of the Current Policy, the exemption is available only in circumstances in which the insider, by virtue of participation in the plan, is not making discrete investment decisions for acquisitions under such plan. Accordingly, under the Current Instrument, the exemption is not available for

- acquisitions that do involve a discrete investment decision (such as an acquisition of securities pursuant to a "cash-payment option" under a plan), or

- dispositions (regardless of whether the disposition in question involves a discrete investment decision).

We recognize that, under some types of automatic securities purchase plans, certain dispositions of securities may occur in the course of the ordinary operation of the plan, which dispositions may not reflect a discrete investment decision on the part of the participant. For example, an automatic securities purchase plan may involve a convertible or exchangeable security, such as in the following example:

- Step 1 – Grant of a restricted share unit or award (each unit or award representing the right to receive one common share once the unit or award has vested) under an automatic securities purchase plan.

- Step 2 – The restricted share unit or award vests.

- Step 3 – In accordance with the terms of the automatic securities purchase plan, the restricted share units or awards are exchanged for common shares.

Under the above example (and assuming the restricted share unit or award constitutes a security), the use of an exchangeable security may negate the benefit of the insider reporting exemption for acquisitions under an automatic securities purchase plan. This is because, although the

acquisition of common shares at step 3 is exempt, the disposition of the restricted share unit or award is not.

Accordingly, we have proposed a change to the exemption in Part 5 of the Current Instrument to allow for certain types of dispositions specified in section 5.4 of the Rule (a specified disposition). A specified disposition includes a disposition that is incidental to the operation of the automatic securities purchase plan and that does not involve a discrete investment decision by the director or senior officer.

A specified disposition will also include a disposition made to satisfy a tax withholding obligation arising from the distribution of securities under an automatic securities purchase plan in certain circumstances. We recognize that, under some types of automatic securities purchase plans, it is not uncommon for an issuer or plan administrator to sell, on behalf of a plan participant, a portion of the securities that would otherwise be distributed to the plan participant in order to satisfy a tax withholding obligation. Generally, the plan participant is required to elect either to provide the issuer or the plan administrator with a cheque to cover this liability, or to direct the issuer or plan administrator to sell a sufficient number of the securities that would otherwise be distributed to cover this liability. In many cases, for reasons of convenience, a plan participant will simply direct the issuer or the plan administrator to sell a portion of the securities.

However, where a plan participant elects to dispose of a portion of the securities to be acquired under an automatic securities purchase plan to fund a tax withholding obligation, the plan participant will lose the benefit of the automatic securities purchase plan exemption, since the participant will be required to file a report in respect of the disposition at the time of the acquisition. Although we are of the view that the election as to how a tax withholding obligation will be funded does contain an element of a discrete investment decision, we are satisfied that, where the election occurs sufficiently in advance of the actual distribution of securities, it is acceptable for a report of a disposition made to satisfy a tax withholding obligation to be made on an annual basis.

Accordingly, a disposition made to satisfy a tax withholding obligation will be a "specified disposition" if

- the participant has elected that the tax withholding obligation will be satisfied through a disposition of securities, has communicated this election to the reporting issuer or the automatic securities purchase plan administrator not less than 30 days prior to the disposition and this election is irrevocable as of the 30th day before the disposition; or

- the participant has not communicated an election to the reporting issuer or the automatic securities purchase plan administrator and, in accordance with the terms of the automatic securities purchase plan, the reporting issuer or the automatic securities purchase plan administrator is required to sell securities automatically to satisfy the tax withholding obligation.

5. Background to the alternative report amendment

Under the Current Instrument, if a director or senior officer relies on the exemption contained in section 5.1 of the Current Instrument (the automatic securities purchase plan exemption), the director or senior officer becomes subject, as a consequence of such reliance, to the alternate reporting requirement under section 5.3 to file one or more reports within 90 days of the end of the calendar year (the alternative reporting requirement).

For example, a director may periodically acquire securities under an automatic securities purchase plan throughout a year and rely on the automatic securities purchase plan exemption from the insider reporting requirement for such acquisitions. As a consequence of such reliance, however, the director becomes subject to an alternative reporting requirement which is due within 90 days of the end of that year.

Under the Current Instrument, the director is required to file the alternative report even if, at the time the alternate report becomes due, the individual has ceased to be an insider or is otherwise exempt from the insider reporting requirement generally.

We are of the view that the principal rationale underlying the alternative reporting requirement is to ensure that insiders periodically update their publicly disclosed holdings to ensure that their publicly disclosed holdings convey an accurate picture of their holdings. If an individual has ceased to be subject to the insider reporting requirements at the time the alternative reporting requirement becomes due, we are of the view that it is not necessary to ensure that the alternative report is filed. Accordingly, we have added an exemption in this regard.

Authority for the Proposed National Instrument

In those jurisdictions in which the Proposed Instrument is to be adopted as a rule or regulation, the securities legislation in each of those jurisdictions provides the securities regulatory authority with rule-making or regulation-making authority in respect of the subject matter of the Proposed Instrument.

The Proposed Instrument is being proposed for implementation in Saskatchewan as a Commission regulation. In Saskatchewan, the following provisions of *The Securities Act, 1988* (Saskatchewan) (the Saskatchewan Act) provide the Saskatchewan Financial Services Commission (the Saskatchewan Commission) with authority to adopt the Proposed Instrument as a rule.

Clause 154(1)(h) of the Saskatchewan Act authorizes the Saskatchewan Commission to prescribe requirements in respect of the books, records and other documents that market participants shall keep, including the form in which and the period for which the books, records and other documents shall be kept.

Clause 154(1)(i) of the Saskatchewan Act authorizes the Saskatchewan Commission to make regulations regulating the listing or trading of publicly traded securities or exchange contracts including requiring reporting of trades and quotations.

Clause 154(1)(ii) of the Saskatchewan Act authorizes the Saskatchewan Commission to make regulations, among other things, respecting the media, format, preparation, form, content, execution and certification of documents required under the Saskatchewan Act.

Clause 154(1)(oo) of the Saskatchewan Act authorizes the Saskatchewan Commission to make regulations exempting any person, company trade or security from all or any provision of the Saskatchewan Act.

Unpublished Materials

In proposing the Proposed Instrument and the Proposed Policy, the CSA have not relied on any significant unpublished study, report, decision or other written materials.

Anticipated Costs and Benefits

The Proposed Instrument will be beneficial to certain market participants who fall within the scope of the insider reporting requirement of Canadian securities legislation as they will in some cases be relieved from reporting and in other cases will have to report less frequently. In addition, those persons or the reporting issuer of which they are an insider will no longer have to incur the expense of applying for relief.

The Canadian securities regulatory authorities are of the view that the benefits of the Proposed Instrument outweigh the costs.

Comments

Interested parties are invited to make written submissions with respect to the Proposed Instrument and the Proposed Policy. Submissions received by August 13, 2004 will be considered. Submissions received after that date may or may not be considered, depending upon the status of the initiative at that time.

Submissions should be sent to all of the Canadian securities regulatory authorities listed below in care of the Ontario Commission, in duplicate, as indicated below:

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
The Manitoba Securities Commission
Ontario Securities Commission
L'autorité des marchés financiers
Office of the Administrator, New Brunswick
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Department of Government Services and Lands, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon
Registrar of Securities, Nunavut

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 800, Box 55
Toronto, Ontario M5H 3S8

A diskette containing the submissions (in DOS or Windows format, preferably Word) should also be submitted. As securities legislation in certain provinces requires that a summary of the written comments received during the comment period be published, confidentiality of submissions received cannot be maintained.

Questions may be referred to any of:

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Text of Proposed Instrument and Proposed Policy

The text of the Proposed Instrument and the Proposed Policy follows.

DATED: May 14, 2004