CIRI Canadian Investor Relations Institute

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Re: Changes to Proposed NI 51-102 Continuous Disclosure Obligations including Forms 51-102F1 through 51-102F6

Canadian Investor Relations Institute

CIRI is a professional, non-profit organization of corporate executives and consultants responsible for communication between public companies and the investment community. With 760 members, CIRI is the world's second largest society of investor relations professionals. Approximately 89% of CIRI's public company members are listed on The Toronto Stock Exchange, 6% on the TSX Venture Exchange, and 34% are interlisted on a US exchange. CIRI is headquartered in Mississauga and has active chapters in Toronto, Montreal, Calgary and Vancouver.

CIRI's mission is to "advance the practice of investor relations, the professional competency of its members, and the stature of the profession". The prime focus of the organization is the education of its members about investor relations best practices through regular and ongoing professional development programs.

General comments

CIRI supports the objectives of NI 51-102 which are to:

- Harmonize continuous disclosure (CD) requirements among Canadian jurisdictions;
- Replace existing local CD requirements;
- Enhance the consistency of disclosure in the primary and secondary markets; and
- Facilitate capital-raising initiatives such as an integrated disclosure system.

Progress in changed NI 51-102

CIRI provided a submission on the first draft of NI 51-102. We are pleased to see some of our comments reflected in the second draft, including: clarification and streamlining of definitions for exempt issuers, with the new concept of 'venture issuer' that replaces a variety of categories of small issuers; streamlined requirements for business acquisition reporting though we believe that the CSA's fallback of aggregated material change reports could prove to be the most efficient; recognition of some of the recommendations of the CICA regarding the MD&A framework, though we believe changes to forms for the MD&A and AIF require further work to facilitate an integrated disclosure system that is efficient for issuers and effective for investors.

Emphasize importance of plain language

CIRI whole-heartedly endorses the CSA's initiative to instruct issuers to prepare the MD&A using plain language principles. We believe that for many investors, particularly retail investors, the primary need is not for more information about an issuer's circumstances, but an easier way to understand and interpret the information that is made available. There is a big difference between providing information and enabling understanding. The use of plain language is central to moving toward achieving this higher standard of disclosure.

If anything, we'd like to see a greater emphasis placed on the use of plain language in disclosure documents. Plain language helps to level the investment playing field – providing less sophisticated and time constrained retail investors with a more meaningful opportunity to better understand corporate performance and direction. In the end, it saves time and money for all investors and, in itself, would require a standard of discussion that for many issuers would be significantly higher.

Ultimately, we'd like to see the CSA emulate and expand on the plain language standards and requirements currently required by the Securities and Exchange Commission. We sense Canadian regulators are headed in that direction. We wish the issue of plain language would be given greater visibility and attention, sooner.

Support distribution of financial statements, MD&A on request

CIRI is pleased that the CSA has retained its position that financial statements and MD&A must be sent only to those who request them. We do not object to a requirement that issuers must annually inquire of their shareholders whether they would like to receive such documents, as long as this requirement, related to the provisions of NI 54-101, is not onerous. We are unsure of exactly what procedures this requirement would entail and feel it important that this be spelled out within NI 51-102.

CIRI believes in the principle that issuers must provide reasonable access to important disclosure documents. Increasingly, the Internet is the preferred vehicle for this distribution. Is it possible today to be a serious investor and not be connected to the Internet? We think not. The disadvantage is too great. Nonetheless, for the time being, it is reassuring that shareholders can gain access to important disclosure documents in print, by mail, if they so choose, although we would prefer that they be directed for these copies to company websites and SEDAR.

Support need for a fourth quarter MD&A

We continue to support the principle that companies provide a fourth quarter MD&A, though we recognize that this cannot be required when in fact detailed fourth quarter financial statements are not currently required.

Support provision for a safe harbour

We continue to believe that the CSA should provide for safe harbour, similar to the US Private Securities Litigation Reform Act of 1995, and are pleased to see that this is provided for in Ontario's Bill 198.

Below, we have provided comment on: (I) questions 1 through 4 posed by the CSA in its Request for Comments; (II) a request for clarification whether to file means to deliver under the proposed accelerated filing timetable; and (III) concerns about changes to the MD&A and AIF.

I. Responses to request for comments

Request 1: Filing documents

b) We do not think it necessary that all contracts that may materially affect the rights of securityholders should be published as an attachment to, or an integral part of, the AIF, as is proposed in Part 12. We believe such a provision could make the AIF too cumbersome for most investors to use, unnecessarily costly for issuers to produce, and could infringe on confidential information involving private parties.

Recommendation: We recommend providing in the AIF a summary statement of the effects or potential effects of any agreements that may impact the rights of securityholders. Any documents available to the public could be referenced in the AIF and accessible through the SEDAR and/or EDGAR websites.

Request 2: Business acquisition disclosure

In our 2002 comment on proposed NI 51-102, we agreed conceptually with the need for enhanced disclosure regarding significant acquisitions. We also acknowledged that the Business Acquisition Report (BAR) parallels an SEC requirement. We commented that despite our overall approval, we believe the proposed BAR significance test is flawed. We further expressed the view that the level of detail required by the BAR serves to compromise timeliness in favour of detail. We also noted a concern that the cost and additional time required for a compilation report outweighs the benefits.

Significance test

CIRI continues to believe that income is too cyclical to use as a standard significance measure. Income is subject to the vagaries of business cycles, discrepancies in business stages of maturity, and rates of profitability. As we wrote in 2002, "We believe that balance sheet measures, such as total assets or total capital, should be considered as qualifying measures... balance sheet amounts are more stable and provide more insight into overall financial position."

The CSA's Specific Question 2(b), regarding whether the test for significance could be a guideline rather than a prescription, seems to support our view that the original test for significance was too rigid and not indicative of a company's true financial situation. Casting significance tests as guidelines underscores the need for judgment in assessing an acquisition's impact on the acquirer's economic value.

Recommendation: Issuers should apply the Asset and Investment tests in determining whether an acquisition is significant. The third test, namely Part 8.2(2)(c) the Income Test, should not be used to determine significance in a business acquisition. Moreover, we would answer the CSA's question in the affirmative that, yes, the test for significance should be a guideline rather than a prescription.

BAR as a subset of Material Change Report

The tradeoff between detail and timeliness in reporting business acquisitions has not been addressed. As we wrote in 2002, "The Instrument allows filing 75 days after closing a transaction. Yet a transaction may not close for months after it is announced, by which time the Business Acquisition report may be stale. ... We believe a reduction of the level of detail in the report should be considered in conjunction with reduction in the time allotted to file the report."

The CSA's request implies that it is open to fundamentally changing or perhaps eliminating the BAR. The CSA's question about making the BAR a subset of material change reporting appears to address CIRI's original concern that detail was being favoured at the expense of timeliness. If the BAR was a subset of Material Change Report, less detail would be required and the report would be issued within 10 days, as opposed to the 75 days stipulated by the BAR.

Furthermore, CIRI suggested in 2002 that "...there should be some mechanism to encourage more timely disclosure of readily available information." Rather than producing one BAR, a series of Material Change Reports could be issued as new information about the acquisition becomes available, without having to aggregate detailed financial information prior to release. The detail required by the BAR also creates a concern over competitive intelligence, especially for those acquiring private businesses. Filing as a material change would allow for a "Confidential" Material Change Report. We feel the benefits of shorter reporting times and the ability to disseminate information as it comes to the fore or withhold competitively sensitive material outweigh the proposed system's deviation from a SEC-patterned BAR report.

Recommendation: CIRI supports the notion that the BAR should be recast as a subset of material change. Consequently, we suggest the CSA provide extensive guidelines on thresholds and financial statement disclosure, drawing on the BAR rules, but requiring less detailed disclosure, particularly where confidentiality and competitive intelligence issues arise.

Compilation report

Although not recognized by the most recent CSA draft, CIRI continues to view the requirement that a compilation report be included with pro forma financial statements as unnecessary.

Recommendation: If issuers are required to issue pro forma financial statements, they should also not be required to produce a compilation report as stated in Part 8.3(3)(a)(iv).

Request 3: Disclosure of auditor review of interim financial statements

Subsection 4.3(3) regarding interim financial statements requires disclosure if an auditor has not performed a review, or if the auditor expressed a qualified opinion, denied assurance or expressed some adverse communication. 4.3(3) requires no disclosure if an unqualified report was given. 6.5 provides an option to make these disclosures in the MD&A rather than the interim statements.

As the subsection stands, report readers would have to become familiar with the regulation to decipher what circumstances require disclosure and where such disclosures are required. We cannot identify the rationale for this complexity. CIRI proposes that the rule be amended to require disclosure for all of the aforementioned circumstances including the instance of an unqualified report. In the interest of simplicity, the auditor review disclosure should be required in the interim financial statements only, with no option to disclose elsewhere.

Finally, we believe that what is meant by a ‘review’ should be clarified so that investors know what comfort they should take from the review, and what degree of accountability applies to the auditors. We are concerned that retail investors may rely on reviews but not know what they are or mean.

Recommendation: Issuers should be required to disclose if an auditor has or has not reviewed interim financial statements. If the auditor has expressed a qualified or adverse opinion or denied any assurance, then this would be considered material information, and the issuer must include a written review report from the auditor accompanying the interim statements.

Request 4: Two-tier MD&A disclosure

b) There is a fundamental question of whether venture issuers should be generally subject to less stringent disclosure requirements than are more senior issuers. In general, CIRI believes this violates the critical principle that all investors are entitled to expect that all issuers must provide appropriate disclosure of material information that may affect the trading and price of their securities, regardless of the issuers’ size or the exchange on which they may be listed. It should not be sufficient that that those considering investments in venture issuers must accept a de facto warning that these companies are permitted to meet lower standards of disclosure.

Nevertheless, we recognize that the CSA has determined that a two-tier disclosure policy is required and acceptable in order to minimize the cost and management burden for venture issuers. However, specifically regarding whether venture issuers should be exempted from having to discuss and analyze changes or additions to accounting policies that have taken place or that are planned, we frankly believe the answer is clear.

Past or planned changes to accounting policies may materially affect an issuer’s financial statements and investors’ understanding of the condition of the company. The costs of disclosing, discussing, and analyzing such changes should be minimal. Further, it may be argued that any such costs would be offset by the benefits of increasing investors’ confidence in the issuer’s disclosure standards, and that ought to have a positive impact on the valuation of the securities and the company’s ability to raise additional capital.

Recommendation: While two-tier disclosure requirements seem destined to become part of the Canadian regulatory landscape, full MD&A disclosure should be not be selectively applied. All issuers, including venture issuers, should be required, without exemption, to disclose, discuss and analyze changes, deletions or additions to accounting policies that have taken place or that are planned.

II. Request for clarification of ‘filing’ under accelerated timetable

Further clarification on subsection *4.2 Filing Deadline for Annual Financial Statements* would be very helpful in managing the timelines and expectations of the executive and Boards of Directors of issuers. Subsection 4.2 is clear about the change to a 90-day deadline from the current 140-day deadline as specified in Ontario Securities Act (OSA) 78(1). However, what is not clear is whether or not there is any consideration of the impact of OSA 79, which requires every financial statement filed pursuant to OSA 78 to be concurrently sent by reporting issuers to each holder of its securities.

The two concerns on this item relate to the added time require to print, bind and distribute the annual reports.

The first concern is for issuers' ability to balance timeliness and the quality of disclosure. Most issuers should be able to successfully adjust the schedules of their management and Boards of Directors to meet the new deadlines for filing the statements and related materials on SEDAR within the 90-day limit. However, it usually takes a few weeks after final auditor and Board approval of these materials to deliver them to security holders. If that delivery must also fall within the 90-day timeframe, it will significantly raise the risk of sacrificing the quality, accuracy and thoroughness for the sake of speed. We recognize that the document most at risk under subsection 4.2 is the annual report and those less at risk are those documents which have been traditionally simpler in their presentation, such as the management information circular and the annual information form.

The second concern relates to the ambiguity of whether or not OSA 79 is impacted by the change in subsection 4.2. CIRI assumes that since no mention of any change to OSA 79 is outlined in national instrument 51-102 then we should assume that delivery would continue to be concurrent with filing. We would prefer that national instrument 51-102 be clear on this issue.

As most issuers have simpler production and distribution requirements for their interim reports than their annual reports, the interim reporting timelines are not as much of a concern. Nonetheless, adjustments will have to be made by issuers to their interim reporting schedules to accommodate auditor and Board approval within the new 45-day timelines. Any clarification of the continued requirement for convergence of filing and distribution would also be appreciated for the interim reports.

III. Changes to the MD&A and AIF

(i) MD&A – Changes largely overlook CICA guidelines

The MD&A is well defined in Form 51-102F2, but differs in some significant ways from the CICA's guidance on preparation and disclosure for the MD&A as published in 2002.

The CICA guidance and the CSA both state that the MD&A should be written primarily for current and prospective investors. Both authorities also agree that the MD&A should give investors the ability to look at the issuer through the eyes of management.

However, in 51-102 there is no mention of including the issuers' business strategies, key performance drivers and core capabilities, all of which form most of the CICA's recommended MD&A disclosure framework. Issuers that have implemented appropriate disclosure practices and sincerely try to help investors make informed investment decisions, typically disclose all of these items. The best issuers go a step further by disclosing how they did against stated operational and financial objectives. While not all of these issuers place the material within their MD&A, the CICA formalizes investor demand for this kind of disclosure through their MD&A guidance.

CIRI is disappointed that 51-102 doesn't acknowledge the need for this disclosure, nor the thoughtful approach on this issue put forward by the CICA. In a Canadian market that lacks regulatory harmonization both domestically and internationally, it is troubling that a more complementary approach could not have been taken by the CSA and CICA to adopt a common disclosure framework for the MD&A.

(ii) AIF – Concerns about new requirement to disclose 'promoters'

We support a number of additions in the changed AIF – including ratings from any rating organizations and interest of management and others in material transactions.

However, we have serious concerns about Item 11 of proposed form 51-102F1, Annual Information Form. The form requires TSX-listed companies to disclose if they have made use of what is referred to as "promoters", whether a person or a company, for the TSX-listed company or a subsidiary of the company, within the past two years. The AIF is to reveal the nature and amount of value the promoter receives from the issuer.

CIRI has serious concerns that: (1) the term promoter is not defined in CSA NI 51-102 and, in past securities regulation references, this term has applied to legitimate investor relations consultants as well as to promoters who practice "inappropriate touting of securities" [reference: OSC Five-Year Review committee Draft Report]; and (2) this is a new requirement for TSX-listed companies, which are less likely to engage promoters that tout stock than are smaller, less established public issuers, and (3) no rationale is provided for this proposed new requirement in the AIF.

Provide definition of a promoter

The Ontario Securities Act [Subsection 1(1)] defines a promoter [as referenced in the Five-Year Review Committee draft report, page 133] as "a party involved mainly in the acts of founding, organizing or substantially reorganizing the business of an issuer. This definition focuses on the promoter's involvement in the formative stage of an issuer's development." The BC Securities Act includes the concept of promotional activities in connection with the purchase or sale of an issuer's securities under the definition of investor relations activities. We understand this broader definition is to prevent officers or directors that are banned from their positions in public companies because of touting their shares from reappearing with the same companies in an investor relations position, which was not covered by the ban.

While recognizing that "investor relations activities can be an integral part of the corporate communications strategy," the Five-Year Review Committee draft states: "We are suggesting that the Commission ought to have the power to deal with inappropriate 'touting' of securities and promotional activities relating to the purchase and sale of an issuer's securities, where conduct contrary to the public interest can be demonstrated."

In its submission to the Five-Year Review Committee, CIRI recommended that there be: "a definition of promoters adopted by the CSA, leading to a change in the BC Securities Act. If investor relations is to be referenced by the CSA, we recommend a separate and proper definition, to clearly distinguish it from promotion or touting." CIRI maintains that it is important that all regulators understand the distinction so that they do not undermine the practice of investor relations, an important function that contributes to the credibility and efficiency of capital markets.

CIRI defines investor relations as "the strategic management responsibility that integrates the disciplines of finance, communications and marketing to achieve an effective two-way flow of information between a public company and the investment community, in order to enable fair and efficient capital markets."

In its standards of practice for the IR profession, CIRI clearly differentiates promoters from investor relations practitioners as follows: "Stock promoters are individuals or firms that seek the highest attainable share price for their clients as quickly as possible without regard to fundamental value. Unlike stock promoters, investor relations practitioners do not attempt to directly influence trading volume, liquidity or stock price. Moreover, they do not recommend stocks or trading strategies, provide investment advice or forecast share price performance. Some promoters attempt to confuse investors by calling themselves IR consultants."

Why the new requirement?

TSX-listed companies would appear to be less vulnerable to touting than TSX Venture companies, but these companies are not required to file an AIF. As touters typically have a vested interest in the shares' performance because of existing share positions and remuneration in shares or options, then perhaps any third parties remunerated in shares or options should be disclosed, together with the basis of their remuneration, all in the spirit of transparency. Most IR consultants are not paid in shares, except at times when a client does not have sufficient cash flow to pay in cash as was the case with many high tech companies in the late 1990s.

We are not opposed to public companies disclosing investor relations consultancy relationships, as long as they are disclosed in a positive way, as are legal and auditing relationships, and clearly separate from promoters. Neither are we opposed to transparency about the basis on which IR consultants are remunerated.

Recommendations

- The term 'promoters' should be defined for purposes of the CSA's NI 51-102 and it should not refer to investor relations. Issuers should be required to disclose the basis on which the promoter is remunerated, as required in Item 11.
- The CSA should explain why it has added the new requirement to disclose use of promoters to form 51-102F1 Annual Information Form.
- The term investor relations should be clearly defined, distinct from promoters. We offer CIRI's definition of investor relations [see above].

(iii) AIF and MD&A – Need to co-ordinate content for integrated disclosure system

The Notice and Request for Comment identifies additions to the AIF, which "are important disclosure that should be available to investors on a regular annual basis, not just to new investors when an issuer is doing a public offering. This change also reflects the possibility that a future integrated disclosure system may require the AIF to be a comprehensive disclosure document." It would appear that the AIF is intended to become the core disclosure document.

However, the CICA has proposed that the MD&A, in its annual and interim forms, become the core disclosure document where "all significant information is disclosed and updated, as necessary." [page 15, Guidance on Preparation and Disclosure.]

CIRI believes that the two documents should be co-ordinated to form the core integrated disclosure document, with the AIF providing basic disclosure at a point in time [the CSA's definition of the AIF is: "a disclosure document intended to provide material information up to a point in time."] and the MD&A a living document of quantitative and qualitative information updated quarterly and referenced into the AIF.

Additionally, we note that the AIF is accessible to shareholders only on request or by accessing SEDAR and that TSX Venture Exchange and other junior issuers will not be required to produce an AIF per se. Is this appropriate for the core disclosure document? While many issuers also make the AIF available on their websites, we recommend that all issuers be required to post on their websites the AIF, or the filings that comprise an AIF in the case of venture issuers.

In reviewing the forms for the AIF and MD&A we note a lack of co-ordination of content and direction for issuers which we believe together would result in varying standards of disclosure, inefficiencies and added costs for issuers preparing the documents, and lack of reporting consistency to the detriment of investors. The following are some of our observations:

- While the AIF is to reflect the company's position at a point in time, the new AIF apparently is to provide prospective information. Section 4.1 states: "Discuss changes in your company's business that you expect will occur during the current financial year."
- The financial discussion prescribed by the AIF form continues to differ from MD&A requirements – the categories to be discussed in the AIF are fewer, and the time period is three fiscal years versus two for the MD&A. What is the reason for this discrepancy? Why not simply reference the latest annual MD&A, or the latest two MD&As, which is what many issuers do in any case?
- Overall, there is overlap between the information that the changed AIF form requires, the MD&A form requires and the CICA has recommended, and we believe this overlap needs to be addressed so that issuers can report more efficiently, and investors know which document to access for the specific information they require.
- The annual MD&A form calls for issuers to provide certain financial information for each of the eight most recently completed quarters. We agree that there should be discussion of causes for variations for the fourth quarter, since a fourth quarter interim MD&A is not otherwise required. However, we recommend referencing first through third quarter interim MD&As into the annual MD&A rather than repeating information that already has been reported.

CIRI appreciates the opportunity to make this submission and we would be pleased to answer any questions you may have.

Yours truly,

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