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Alberta Securities Commission
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Department of Justice,
Government of the Northwest Territories
Nova Scotia Securities Commission
Registrar of Securities, Legal Registries Division,
Department of Justice, Government of Nunavut
Ontario Securities Commission
Prince Edward Island Securities Office
Autorité des marches financiers
Saskatchewan Financial Services Commission
Registrar of Securities, Government of Yukon

Dear Sirs:

Re: Request for Comments for Proposed National Instrument 45-106 and Consequential Amendments

Thank you for the opportunity to comment on the Proposed National Instrument 45-106: Prospectus and Registration Exemptions ("Proposed NI 45-106") and on the consequential amendments arising from the proposed instrument. The Canadian Securities Administrators are to be commended for their initiative to harmonize the prospectus and registration exemptions and to consolidate the various exemptions into one instrument.

The purpose of this letter is to comment on one specific provision of the proposed instrument which would have a prejudicial, and presumably inadvertent, consequence on capital markets participants particularly to registered dealers involved in a bona fide private placement of securities, whether on an underwritten or agency basis. The provision in question is Section 1.5 of Proposed NI 45-106 which provides as follows:

> Under this Instrument, the only exemption available for a trade in a security where the purchaser is acting as an underwriter is section 2.34.

Section 2.34 of Proposed NI 45-106 exempts from the prospectus and registration requirements the purchase by an underwriter or a trade by an underwriter to another underwriter. By virtue of Section 2.13 of Multilateral Instrument 45-102: Resale of Securities (and the proposed

amendment to Appendix F of that instrument) any subsequent trade by an underwriter of securities acquired pursuant to Section 2.34 of Proposed NI 45-106 is a distribution.

Related to the foregoing is Section 5.3 of the proposed amendment to Ontario Securities Commission Rule 45-501: Ontario Prospectus and Registration Exemptions ("Amended 45-501") which provides as follows:

> No exemption in this Rule is available for a trade in a security where the purchaser is acting as an underwriter.

The effect of the foregoing is accurately described in the Request for Comments as follows:

> *Section 1.5 Underwriter Exemption*
>
> Currently purchasers acting as underwriters can purchase securities under the accredited investor exemption available in section 2.3 of the Existing Rule 45-501 rather than under clause 72(1)(r) of the Act. This allows purchasers acting as underwriters to substitute the indefinite hold period that attaches to trades made in reliance on clause 72(1)(r) with the four month hold period that applies to trades made in reliance on the accredited investor exemption. The purpose of section 1.5 is to prevent purchasers acting as underwriters from selling securities to the public without a prospectus.

In considering the implications of these proposed changes, it is critical to keep in mind the definition of underwriter set out in Section 1(1) of the *Securities Act* (Ontario). That definition states, in part, that an "underwriter" is:

> a person or company who, as principal, agrees to purchase securities with a view to distribution or who, as agent, offers for sale or sells securities in connection with a distribution (emphasis added)

The stated purpose of Section 1.5 of Proposed NI 45-106 (and the related proposed Section 5.3 of Amended 45-501) (collectively, the "Proposed Amendments") is to prevent persons from purchasing securities as an "underwriter" (both in the commercial sense of the word and within the meaning of the extended definition of the *Securities Act*) and then reselling the securities after four months without the protections of a prospectus. It is not clear why, as a policy matter, this poses a concern in that a four month hold period has been accepted in the general private placement environment. If an "underwriter" is prepared to purchase securities and hold them for four months, it is submitted that an underwriter should not be prohibited from selling these securities. It is further submitted that an underwriter should be treated no differently than any other private placement purchaser who may purchase all or a significant portion of a private placement offering be able to sell the securities after the hold period expires or pursuant to another exemption (for instance, to an

accredited investor) where the purchaser must continue to hold the securities for the balance of the four month hold period.

Specific concerns which arise from the Proposed Amendments are described below.

CHILLING EFFECT ON UNDERWRITTEN PRIVATE PLACEMENTS

A registered dealer sometimes participates in an "underwritten private placement" whereby the dealer commits to purchase securities pursuant to a private placement with the intention of identifying substitute purchasers to actually purchase the offered securities at the closing. By virtue of the Proposed Amendments, if a substitute purchaser were not identified for a portion of the private placement offering, that portion which the dealer acquires on closing can only be sold by the underwriter by way of a prospectus. The effect of the Proposed Amendments is that dealers will be reluctant to commit to an underwritten private placement (for fear of not having an efficient or effective way to sell the securities which a substitute purchaser has not purchased at the closing), thereby depriving issuers of the certainty that a financing of this kind affords.

AGENT PURCHASING A PORTION OF THE OFFERING TO ENSURE THE SUCCESSFUL COMPLETION OF A PRIVATE PLACEMENT FINANCING

The extension of the Proposed Amendments to a conventional private placement financing pursuant to which a registered dealer acts as an agent also has implications which are prejudicial and presumably inadvertent. Two such implications are described below. In a typical agency private placement, a registered dealer is retained as an agent to facilitate a distribution of securities. As it is an agency offering, the registered dealer does not intend to purchase the securities as a principal. Occasionally there are circumstances (such as where a potential investor has not completed the necessary subscription form in time or where the agency offering has not been fully subscribed as at the closing date) where, to assist the issuer and facilitate a successful offering, the agent might subscribe for the remaining securities with a view to reselling them shortly after closing on a private placement basis. The agent generally does not intend to hold the securities for an extended period of time and certainly not through the entire four month hold period. Prior to the Proposed Amendments the agent would purchase these securities as an accredited investor and sell the securities to another accredited investor (a possibility being foreclosed by the Proposed Amendments). Currently, if the agent acquires the securities as an accredited investor and subsequently sells the securities within the four month hold period, the hold period will continue until the end of the four months commencing on the date the agent acquired the securities. [1]

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[1]Section 1.8 of Companion Policy 45-102 to Multilateral Instrument 45-102: Resale of Securities.

It should be noted that the exemptions available to a consultant in Division 4 of Article 2 of Proposed NI 45-106 are not available as the services provided by the agent are related to a distribution and as such an agent could not be a consultant as defined in Section 2.22 of proposed NI 45-106.

The effect of the Proposed Amendments is that an agent acting on a private placement would not be inclined to perform this "stand in" role to facilitate a successful offering because if it did, the agent would be able to sell the securities it so acquired only by requiring the issuer to file a prospectus to do so. Consequently, private placement transaction closings would be delayed (to ensure all required paperwork is in place and the offering is completely sold) or be required to be completed at a smaller offering size. The elimination of this facilitating role of an agent in a private placement financing would not be beneficial to issuers, private placement investors or the agents themselves.

UNDERWRITER RECEIVING COMPENSATION WARRANTS

It is entirely typical in a private placement (whether underwritten or on an agency basis) for the dealer to receive compensation warrants which are exercisable for a period following closing (often up to two years). The compensation warrants are intended to compensate the dealer for its efforts in connection with the financing and allow for a lower cash commission to be paid by the issuer to the dealer (allowing more of the cash proceeds of the offering to be received by the issuer). Traditionally, the compensation warrants have been issued to the agent pursuant to the accredited investor exemption and, upon exercise, the underlying shares could be sold following a four month hold period.

The Proposed Amendments would prohibit the dealer from effecting the trade in the underlying securities without a prospectus being filed.

It is not apparent that there is any prejudice in a dealer in a private placement being able to exercise compensation warrants received by it in connection with the offering and selling the underlying securities after four months. Typically, the compensation warrants do not represent more than 10% of the securities offered in the private placement and consequently the effect of the exercise of the compensation warrants and the sale of the underlying securities would not have a significant impact on the capital markets.

Requiring the securities underlying compensation warrants to be sold only pursuant to a prospectus would require dealers to either forego compensation warrants in return for a higher cash commission or require the issuer to file a prospectus (and incur the related expenses) for the sole purpose of qualifying a sale of securities underlying the compensation warrants. It is suggested that the benefit to the capital markets of the foregoing (if any) are far outweighed by the costs and other burdens of the Proposed Amendments.

SUGGESTED AMENDMENT

In light of the foregoing, it is respectfully suggested that the Proposed Amendments be eliminated. If, as a policy matter, it is determined that the Proposed Amendments should be maintained, it is alternatively suggested that Section 1.5 of Proposed NI 45-106 and Section 5.3 of Amended 45-501 specifically provide that these sections do not apply to an underwriter (including an agent) who acts in connection with a bona fide private placement distribution.

We thank you again for the opportunity to comment and would be pleased to answer any questions you may have.

Yours very truly,

David Matlow

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