Chapter 6

Request for Comments

6.1.1 Proposed OSC Rule 45-501 Exempt Distributions

NOTICE OF PROPOSED RULE, POLICY AND FORMS UNDER THE SECURITIES ACTRULE 45-501 EXEMPT DISTRIBUTIONS COMPANION POLICY 45-501CP FORM 45-501F1, FORM 45-501F2, FORM 45-501F3 AND RESCISSION OF EXISTING RULE 45-501 AND COMPANION POLICY 45-501CP AND RULE 45-504 PROSPECTUS EXEMPTION FOR DISTRIBUTIONS OF SECURITIES TO PORTFOLIO ADVISERS ON BEHALF OF FULLY MANAGED ACCOUNTS

Introduction

On September 8, 2000, the Commission published for comment proposed Rule 45-501 Exempt Distributions (the "Proposed Rule"), Form 45-501F1, Form 45-501F2, Form 45-501F3 (the "Proposed Forms") and Companion Policy 45-501CP Exempt Distributions (the "Proposed Policy" and, together with the Proposed Rule and Proposed Forms, the "September Materials"). The Proposed Rule incorporates certain of the recommendations of the Task Force on Small Business Financing (the "Task Force") as set out in the October 1996 Report of the Task Force as it was presented to the Commission (the "Task Force Report") and will replace existing Rule 45-501 Exempt Distributions (the "Current Rule").

The Commission received submissions on the September Materials from 26 commentators. As a result of the comments received and the further consideration of the Commission, the Commission has made certain revisions to the Proposed Rule, Proposed Forms and Proposed Policy and is republishing the materials for comment (the "April Materials") with this Notice. A summary of the comments received on the September Materials and the Commission's responses are included in Appendix A.

For a discussion of the Commission's consideration of comments concerning the impact of the Proposed Rule on the distribution of pooled fund securities, see "Impact of Proposed Rule on the Distribution of Pooled Funds" in this Notice.

The Proposed Rule will also replaced Rule 45-504 Prospectus Exemption for Distributions of Securities to Portfolio Advisers on Behalf of Fully Managed Accounts ("Rule 45-504") which will be rescinded upon the coming into force of the Proposed Rule. The provisions of Rule 45-504 have been incorporated in the Proposed Rule.

Substance and Purpose of the Proposed Rule

In June 1994, the Commission established the Task Force with a mandate to make recommendations about the Ontario legislative and regulatory framework governing the raising of capital by small and medium-sized enterprises. In October 1996, the Task Force Report was published. The Commission established a staff committee to consider the Task Force Report and make recommendations for implementation. On May 7, 1999, the Commission published a concept paper entitled Revamping the Regulation of the Exempt Market ((1999) 22 OSCB 2835)(the "Concept Paper') which was based on the recommendations contained in the Task Force Report and outlined the Commission's proposals for revamping the regulation of the exempt market.

The Proposed Rule introduces two new exemptions reflecting the recommendation set out in the Task Force Report and the Concept Paper. The purpose of the new exemptions is to create an approach to exempt market regulation that is more consistent with the needs of that market and its investors. The new regime will provide a more rational basis for exempt financings than provided by the current exemptions. The Commission believes that the Proposed Rule represents a significant improvement over existing exempt market regulation.

The new exemptions are:

The Closely-Held Issuer Exemption - This exemption will permit issuers to raise a total of $3 million, through any number of financings, from up to 35 investors (excluding employees) without concern for the "qualifications" of the investors; and

The Accredited Investor Exemption – This exemption will permit issuers to raise any amount at any time from any person or company that meets specified qualification criteria.

The new exemptions will replace, among others, the private company exemption (paragraph 35(2)10 and subsection 73(1) of the Act), the private issuer exemption (section 2.17 of the Current Rule), the $150,000 exemption (paragraph 35(1)5 and clause 72(1)(d) of the Act), the seed capital exemption (paragraph 35(1)21 and clause 72(1)(p) of the Act) and the government incentive security exemption (section 2.4 of the Current Rule).

A detailed summary of the Proposed Rule may be found in the Notice published with the September Materials ((2000) 23 O.S.C.B. 6205).

Substance and Purpose of Proposed Policy

The purpose of the Proposed Policy is to set forth the views of the Commission as to the manner in which the Proposed Rule and the provisions of the Act relating to exempt distributions are to be interpreted and applied.

Summary of Changes to the Proposed Rule

The following is a summary of the substantive changes made to the September version of Proposed Rule and reflected in the April Materials.

Part 1 - Definitions

Accredited Investor

The family member exemption found in section 2.4 of the Proposed Rule in the September Materials has been removed as family members have been included in paragraph (q) of the definition of "accredited investor". The Commission determined that the benefits of creating a simple exempt market regime outweighed any investor protection concerns addressed by effectively prohibiting the participation of dealers in sales to family members. Including family members in the definition of accredited investor is consistent with the recommendations of the Task Force.

Paragraph (d) has been extended, based on a comment received, to include all federal and provincial co-operative financial institutions.

Paragraph (r) (formerly (q)) has been extended to include as accredited investors affiliated entities of the issuer. This change was made to address comments expressing concern that exemptions might not be available for certain transactions between members of a corporate group and for which the private company exemption would now be available.

In response to comments, the mutual fund prospectus disclosure requirements that were contained in paragraph (w) (formerly (v)) of the Proposed Rule have been removed. The Commission determined that mutual fund disclosure requirements are more appropriately dealt with in rules governing mutual fund disclosure.

Closely-held Issuer

The no advertising condition has been removed from the definition. In making the revision, the Commission recognized the potential difficulties surrounding determination of what constitutes advertising and the potential resulting uncertainty in the use of the exemption. The new exemption is intended to be a simpler, more straightforward exemption which obviates the need to engage legal counsel to ensure compliance with the exemption. The prohibition on an issuer incurring selling and promotional expenses in connection with trades made in reliance on the closely-held issuer exemption should effectively prohibit advertising without the associated uncertainty.

Part 2 - Exemptions from the Registration and Prospectus Requirements of the Act

The information statement delivery requirement has been removed as a condition of the exemption and included as a concurrent requirement. The revision was made to avoid uncertainty concerning the validity of trades where an information statement is not delivered as required.

The family member exemption in section 2.4 of the Proposed Rule in the September Materials has been removed and family members have been included in the definition of accredited investor.

The exemptions in this Part have been re-ordered to conform with the section numbers in Multilateral Instrument 45-102 Resale of Securities ("MI 45-102").

Section 2.13 of the Proposed Rule included in the September Materials which provided for the exemption for a trade in an underlying security where the right to purchase, convert or exchange is qualified by prospectus has been removed. The exemption will no longer be required once MI 45-102 is in force.

Part 3 - Removal of Certain Exemptions from the Registration and Prospectus Requirements

Subsection 3.4(2) has been added in order to allow a limited market dealer to act as a market intermediary in respect of trades made in reliance on the accredited investor exemption in section 2.3.

Part 4 - Offering Memorandum

Section 4.2 has been revised to remove the requirement to describe the statutory right of action in an offering memorandum as a condition to the availability of the exemption.

Part 7 - Filing Requirements and Fees

New subsection 7.5(7) provides an exemption from the reporting requirement for trades in securities of mutual funds or non-redeemable investment funds if the seller of the securities reports the trades annually. The exemption codifies *ad hoc* relief the Commission has granted on a regular basis.

Summary of Changes to the Proposed Policy

The Proposed Policy sets forth the views of the Commission as to the manner in which certain provisions of the Act and the rules relating to exempt distributions are to be interpreted and applied.

Part 2 - Exemptions from the Registration and Prospectus Requirements of the Act

Section 2.1 has been revised to clarify the interaction of the private placement exemptions, specifically relating to the use the exemption in section 2.1 of the Proposed Rule and the use of the services of an underwriter or sales agent in connection with the distribution. Sellers concurrently relying on the exemptions in sections 2.1 and 2.3 must ensure that

underwriters or sales agents are not involved in or compensated, directly or indirectly, for any trades made in reliance on section 2.1.

Subsection 2.2(1) has been added to provide guidance on the determination of accredited investor status for individuals. The subsection clarifies how to determine which financial assets should be included by providing the Commission's view on what factors are indicative of beneficial ownership of financial assets. Subsection 2.2(2) was added to clarify that spouses are to be treated as an "investing unit" and that either spouse may qualify as an accredited investor if both spouses taken together meet the financial asset or net income tests. This subsection further clarifies that the financial asset and net income tests are to be satisfied only at the time of the trade. The seller has no continuing obligation to monitor the purchaser's accredited investor status after the completion of the trade.

Subsection 2.3(1) has been added in order to provide guidance on the "common enterprise" concept. In particular, it clarifies that the concept is intended to operate as an anti-avoidance mechanism where multiple business entities are organized to finance a what is in essence a single business enterprise.

Section 2.7 has been added to alert market participants to the new resale instrument, MI 45-102 and to indicate that many of the exemptions contained in the current Rule will be contained in the resale instrument.

Part 3 - Certification of Factual Matters

This section has been revised to clarify that it is the seller's responsibility to ensure that trades in securities are made in compliance with applicable securities laws.

Impact of Proposed Rule on the Distribution of Pooled Funds

The Commission received considerable comment concerning the impact of the Proposed Rule on the distribution of securities of mutual funds and non-redeemable investment funds on a private placement basis, including those investment funds commonly referred to as "pooled funds". Commentators were particularly concerned that the proposed accredited investor exemption would adversely impact the distribution of pooled fund securities to non-accredited investors to the extent such distributions are currently being made using the $150,000 exemption. There was also concern about the expiry of Commission rulings exempting additional investments by such investors in amounts less than $150,000.

The Commission recognizes that many portfolio advisors are of the view that they should be permitted to use in-house pooled funds without the current restriction requiring a managed to acquire minimum of $150,000 worth of a fund or the proposed restriction which will require the principal of the managed account to be an accredited investor. This issue was also raised in connection with the introduction of Rule 45-504 and the Commission responded to this issue in the Notices of proposed Rule 45-504 [1].

The Commission has decided not to make material changes to the Proposed Rule at this time to address the concerns raised by commentators. It is the Commission's view that a review of the appropriate regulatory response regarding the exempt distribution of pooled funds taking into account, among other things, the extent to which the changes under the Proposed Rule serve the needs of pooled fund investors is required. Accordingly, the Commission has now mandated Commission staff to review the issues raised by pooled funds with a view to returning to the Commission with a proposed scheme.

The Commission expects that the implementation of the Proposed Rule will change the regulatory framework used by market participants to distribute pooled funds in the following ways:

- Market participants may sell securities of pooled funds to managed accounts provided the principal of the account is an accredited investor.

- Market participants will not be able to sell securities of pooled funds to clients who are not accredited investors, even where those clients already hold securities of those pooled funds. Persons or companies that are not accredited investors will be able to continue to hold securities of pooled funds which they acquired under exemptions from prospectus and registration requirements available prior to the coming into force of the Proposed Rule, but will not be eligible for exempt purchases of any additional securities.

Authority for the Proposed Rule and Forms

The following sections of the Act provide the Commission with authority to adopt the Proposed Rule and Proposed Forms. Paragraphs 143(1)8 and 20 authorize the Commission to make rules which provide for exemptions from the registration and prospectus requirements under the Act and for the removal of exemptions from those requirements. Paragraph 143(1)11 authorizes the Commission to make rules regulating the listing or trading of publicly traded securities and paragraph 143(1)13 authorizes the Commission to make rules regulating trading or advising in securities to prevent trading or advising that is fraudulent, manipulative, deceptive or unfairly detrimental to investors. Paragraph 143(1)39 authorizes the Commission to make rules requiring or respecting the media, format, preparation, form, content, execution, certification, dissemination and other use, filing and review of all documents required under or governed by this Act, the regulations or the rules and all documents determined by the regulations or the rules to be ancillary to the documents and paragraph 143(1)43 authorizes the Commission to make rules prescribing fees.

[1] See Notice of Proposed Rule 45-504 Prospectus Exemption for Distributions of Securities to Portfolio Advisers on Behalf of Fully Managed Accounts (1997) 20 OSCB 3367 and Notice of Final Rule 45-504 (1997) 21OSCB 959.

Related Instruments

The Proposed Rule and Proposed Policy are related in that they deal with the same subject matter. The Proposed Policy is related to Parts XII and XVII of the Act and Parts III and V of the Regulation.

Conflicting Regulations

In connection with the implementation of the Proposed Rule, it is the intention of the Commission to amend the Regulation under the Act to the extent that certain provisions of the Regulation require consequential amendment. The implementation of the Proposed Rule requires that the following amendments to the Regulation be made:

1. Subsections 149(1), (2) and (3), which deal with applications for exempt purchaser recognition, will be revoked since the exemptions for persons or companies that are exempt purchasers will no longer be available.

2. Clause 154(1)(c) refers to the exemptions from the prospectus requirement under clauses 72(1)(a), (c) and (d) of the Act, all of which will no longer be available. Clause 154(1)(c) will be amended to delete the references to these exemptions and to refer to the exemption for accredited investors set out in the Proposed Rule.

3. The definition of "designated institution" in subsection 204(1) of the Regulation will be amended to delete clause (i), which refers to an exempt purchaser, and to add a new clause (i) as follows:

   (i) a company or a person, other than an individual, that is an accredited investor as defined in section 1.1 of Ontario Securities Commission Rule 45-501 *Exempt Distributions.*

4. Subsection 45(1) of Schedule 1 - Fees will be revoked since applications for exempt purchaser recognition will no longer be accepted. Section 7.6 of the Proposed Rule prescribes the amount of fees payable in respect an application for accredited investor recognition.

5. Form 11, Application For Recognition As An Exempt Purchaser will be revoked since the related exemptions from the registration and prospectus requirements will no longer be available.

Comments

Interested parties are invited to make written submissions with respect to the Proposed Rule. Submissions received by May 7, 2001 will be considered. Please note that comments received after the deadline will not be considered.

Submissions should be made to:

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, Ontario M5H 3S8
email: **jstevenson@osc.gov.on.ca**

A diskette containing an electronic copy of the submissions (in DOS or Windows format, preferably WordPerfect) should also be submitted. As the Act requires that a summary of written comments received during the comment period be published, confidentiality of submissions received cannot be maintained.

Questions on the April Materials may be referred to:

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Questions on pooled funds should be referred to:

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Text of Proposed Rule

The text of the Proposed Rule, the Proposed Policy and the Proposed Forms follows, together with footnotes that are not part of the Proposed Rule, Companion Policy or Proposed Forms but have been included to provide both background and explanation.

Rescission of Existing Rule

The Proposed Rule will result in the rescission of Current Rule 45-501 and Rule 45-504. The text of the proposed rescissions will be as follows:

> "Rule 45-501 Exempt Distributions is hereby rescinded."
>
> "Rule 45-504 Prospectus Exemption for Distribution of Securities to Portfolio Advisers on Behalf of Fully Managed Accounts is hereby rescinded."

April 7, 2001.

APPENDIX A

SUMMARY OF COMMENTS RECEIVED BY THE COMMISSION ON PROPOSED RULE 45-501 *EXEMPT DISTRIBUTIONS*

Section references in this Appendix denote sections of the Proposed Rule or Companion Policy contained in the September Materials. Where a section number has changed as a result of changes to the September Materials, the corresponding section in the April Materials is included in square brackets.

A list of commentators is included in Schedule A.

GENERAL COMMENTS

Several commentators expressed the view that the proposed regime will not adequately address the capital raising needs of issuers throughout the various stages of their development. One commentator suggested including additional exemptions which occupy the middle ground between exemptions with very limited investor involvement on the one hand and very restrictive investor qualification standards on the other hand and should be designed using the full range and combination of investor safeguards, including stock exchange listings and broker involvement, as well as differing minimum purchase amounts, investor sophistication tests and disclosure requirements. Another commentator suggested that developing an exempt market regime similar to that in Alberta and British Columbia would address these concerns. third commentator suggested including a new exemption based on the percentage of an investor's aggregate small and medium business enterprise investments to his or her total equity. While some commentators suggested abandoning the proposals in favour of a regime identical to, or more similar to, that in the United States, other commentators disagreed.

The Commission recognizes that there are many potential types and combinations of exemptions that could be used to produce an exempt market regulatory regime. The Task Force canvassed the various possibilities including the regimes in British Columbia and the United States and determined that the proposed regime is most appropriate for the Ontario capital markets. The Commission agrees with the Task Force's recommendations and is of the view that the proposed regime will better facilitate capital formation in Ontario and ensure adequate investor protection.

Several commentators expressed the view that the initiative should have been national in scope to harmonize exempt market regulation across all Canadian jurisdictions for compliance purposes and to facilitate ease of doing business in Canada. Commentators indicated, however, that they support the Commission's decision to revise the Ontario regime at this time rather than postponing such revision in order to pursue harmonization with the exempt distribution regimes of the other jurisdictions.

The Commission recognizes the benefits that could be derived from a nationally harmonized exempt market regime and the Commission will continue to pursue the possibility of developing such a regime. However, the Commission is of the view that the goal of harmonization should not be permitted to

adversely affect the timely implementation of improvements to the Ontario capital markets.

One commentator was of the view that the proposals are inconsistent in some respects with the approach in the U.S. where the activities of private companies appear to be unrestricted. In particular, section 4 of the Securities Act of 1933 provides that the registration statement requirements of section 5 of the 1933 Act do not apply to "transaction by an issuer not involving any public offering".

The Commission recognizes that similar to the private companies in Ontario relying on the private company exemption, private companies in the United States could theoretically raise an unlimited amount of money on reliance in the exemption in subsection 4(b) provided the sales do not constitute a public offering. The Commission understands however that due to judicial gloss on what constitutes a public offering, the exemption is not necessarily as expansive as it appears and there is uncertainty as to its availability. The Commission further understands that as a result of the uncertainty, Rule 506 of Regulation D was introduced as a safe harbour. Rule 506 deems trades made in accordance with certain conditions not to be "transactions involving any public offering". The conditions require purchasers to be accredited investors or otherwise sophisticated.

In the closely-held issuer exemption, the Commission has formulated an exemption which will not create the uncertainty currently created by the private company exemption and the similar uncertainty created by subsection 4(b) of the 1933 Act in the United States.

SPECIFIC COMMENTS - THE RULE

Section 1.1 - Definitions

"Accredited Investor"

Paragraph (d)

One commentator was concerned that paragraph (d) does not include federally-incorporated cooperative credit unions and other associations incorporated under the *Cooperative Credit Associations Act* (Canada). The commentator submitted a revised definition of paragraph (d) that, in the commentator's view, would include all federal and provincial cooperative financial institutions.

The paragraph has been amended to ensure inclusion of include federally-incorporated cooperative credit unions and other associations incorporated under the Cooperative Credit Associations Act (Canada).

Paragraphs (m) and (n)

Several commentators were concerned about the monetary thresholds for determining accredited investor status. In general, these commentators expressed the view that the net worth and net income thresholds were too high for individuals, thereby limiting the pool of investment capital for small businesses. Commentators made a number of recommendations, including: (i) reducing the financial asset threshold from $1.0 million to $750,000; (ii) having a net worth threshold of $200,000 and limiting an individual's investment in a private placement to a maximum of 20% of his or her financial assets; and (iii) reducing the individual net income threshold to $150,000, or a joint net income threshold of $250,000.

Both the Task Force and the Commission dismissed the idea of exemptions which permit investors to invest a percentage of net worth or income as being too cumbersome. It is the Commission's view that determining whether an investor exceeds an asset threshold is much simpler than determining an exact level assets for the purposes of a percentage investment scheme.

The income thresholds are considered to be appropriate and are comparable with the thresholds for recognition as an accredited investor in the United States.

One commentator recommended inserting the words "or an RRSP or RRIF established by or for an individual" after the word "individual" in paragraph (m) and (n)

Paragraph (aa) of the definition of accredited investor provides that persons or companies all of whose legal and beneficial interests are held by accredited investors are also accredited investors. Therefore, where an individual is an accredited investor, a trust governed by a RRSP or RRIF under which the individual is the beneficiary and for which a trust company is the trustee will also be an accredited investor.

Another commentator stated that it was not clear how to determine net realizable value. The commentator made the assumption that net value means net of expenses of disposition but not of taxes. The commentator posed several questions such as whether appraisals would be required, how currencies should be treated as exchange rates change over time and whether RRSPs are included and, if so, whether pre or post-tax.

One of the reasons for moving from the net asset test in the Concept Paper to a financial asset test was to simplify the determination of eligibility. It was expected that valuations would generally not be required due to the nature of the assets included in the definition of financial assets. However, if there is difficultly in determining the value of an asset with reasonable certainty, a valuation may be appropriate.

Assets denominated in foreign currencies should be valued using the prevailing exchange rates at the time of the valuation. Personal RRSPs would generally fall within the definition of financial assets but entitlements under group RRSPs or pension plans typically would not be considered beneficially owned assets. The paragraph has been amended to clarify that the value attributed to financial assets should be determine before applicable taxes.

The Proposed Rule has also been revised to clarify that financial assets should be net of related liabilities. A new definition of related liabilities has been included in the Proposed Rule.

The Proposed Policy has been amended to include a discussion of the calculation of net assets for the purpose of determining eligibility.

One commentator recommended amending paragraph (n) to include individuals whose average net income over a period has exceeded $200,000 or whose average joint net income has exceeded $300,000, even if those levels have not been reached in each year.

The purpose of requiring earnings to exceed a certain level in each period is to ensure that the investor has consistent earning ability and is therefore in a position to withstand losses going forward.

Several commentators raised comments concerning the term "net income". One commentator recommended clarifying paragraph (n) by including a definition of "net income". Another commentator suggested that the definition of "net income" mean net income before income taxes. Another commentator asked what should be netted out of income and, in particular, whether the figure to use is net of living expenses and taxes. The commentator also asked whether capital gains would be included and, if so, pre or post-tax.

In response to comments, the Proposed Rule has been revised to qualify the term net income by clarifying that it is net income before taxes. The Commission is of the view that an appropriate net income figure to use for the purposes of determining eligibility is net income as calculated for federal income tax purposes prior to the deduction of income tax credits. That portion of an investor's capital gains added to income for tax purposes would be included in the net income figure on a pre-tax basis.

One commentator asked who would determine whether an investor's expectation of achieving the required income threshold in the coming year is reasonable.

The Commission is of the view that the seller of securities may rely on the investor's express expectation of income level for the coming year unless the issuer has reason to believe that the expectation is unreasonable.

One commentator suggested that the Rule should be available if the purchaser represents that it meets the asset or income thresholds, provided the issuer has no reason to believe that the representation is not correct.

The Commission is of the view that a seller and their legal counsel should determine the appropriate steps to ensure compliance with the exemption. Section 3.1 of the Proposed Policy provides a discussion of practical ways a seller could confirm accredited investor status. It should be noted however that section 3.1 of the Proposed Policy is only for informational purposes and a seller is ultimately responsible for taking the appropriate steps to ensure compliance with the exemption.

Paragraph (o)

A commentator recommended that paragraph (o) be expanded to include non-trading officers and directors of a member of the Investment Dealers Association.

The Commission is of the view that non-trading officers and directors of investment dealers should not be included in the accredited investor definition. Such officers and directors have generally not completed the proficiency requirements required to become a registrant which is the basis for the existence of this category of accredited investor. The Commission does not consider that registrants necessarily have the ability to assess all possible investments. Registrants are included as accredited investors because they are participants in the industry and should have the ability to determine when to seek advice concerning a particular potential investment.

Paragraph (p)

One commentator questioned whether family trusts established by or for an officer, director or promoter of the issuer should be included along with RRSP's in paragraph (p). The commentator noted that exemption orders issued by the Commission in the past have provided parallel treatment for trusts and RRSPs.

The Commission has determined that it is appropriate to incorporate the family member exemption into the accredited investor exemption rather than maintaining a separate the family member exemption. As such, the family members listed in the family member exemption in the Proposed Rule will be included in the definition of accredited investor. As a result of making family members accredited investors and the effect of paragraph (y)[aa] of the definition of accredited investor, family trusts will generally fall within the definition of accredited investor.

Also, a family trust with net assets of at least $5 million would otherwise qualify as accredited investor by virtue of paragraph (s)[t].

Paragraph (s)[t]

One commentator was concerned that the list of entities in paragraph (s)[t] would not include all potential types of investment vehicles in the venture capital market. The commentator suggested adding the words "or other similar investment vehicles" after the words "or estate". Alternatively, the commentator suggested amending paragraph (x)[z] to refer to paragraph (s)[t], although the commentator expressed that the latter option would be less preferable.

The category of accredited investor defined in paragraph (s)[t] is not restricted to entities that are carried on as investment vehicles. The commentator did not provide examples of any of the vehicles that would fall outside of the definition and which should be included. The Commission is not prepared to include a catch-all category. Ad hoc recognition as an accredited investor will be available in appropriate circumstances.

One commentator indicated that the "net asset" test would not work for investment vehicles that have the right to call on investors' funds for investment. These vehicles may not have the requisite level of net assets but may have the ability to call on substantial financing at any time.

The Commission is of the view that any reasonably sized vehicle would have an initial asset base of at least $5 million although they maintain the right to call upon a significant amount of the other funds. If the vehicle did not meet the asset threshold, ad hoc recognition as an accredited investor or exemption from the registration and/or prospectus requirements is available in appropriate circumstances.

One commentator was concerned the many substantial entities that are capitalized for various reasons principally with debt will not met the net assets threshold. The commentator recommended a gross assets or revenues test as well as a right to call on funds test of $5 million instead of the net assets test.

In many circumstances where an issuer would meet the asset threshold if financing was done in the form of equity instead of debt, the issuer will otherwise qualify as an accredited investor by virtue of paragraph (y)[aa].

Paragraph (t)[u]

One commentator was of the view that guidance should be given on the circumstances in which the Commission will recognize a person to be an accredited investor and suggested the circumstances should be broad enough to facilitate access by the less than wealthy who nevertheless are informed and wish to participate. The commentator indicated that broader access could be justified in the case were an offering memorandum is provided given the new statutory right of action.

The provision is intended to give the Commission flexibility to grant accredited investor status for particular circumstances not already considered and listed in the definition of accredited investor. All general circumstances which would give rise to accredited investor status are currently included. The Commission will consider applications for recognition on a case by case basis.

Paragraph (v)[w]

Three commentators suggested that disclosure of the type that would be required in the context of prospectus qualified mutual funds under paragraph (v)[w] is unnecessary and too detailed to be of use to the readers of mutual fund prospectuses. One of the commentators recommended that such disclosure be eliminated entirely or, alternatively, accompanied by an amendment to Form 81-101F2 which would only require such disclosure to be included in a fund's AIF and only if the fund's investments under this exemption were to exceed a prescribed percentage of the fund's net assets. Another commentator suggested that the disclosure requirements for prospectus qualified mutual funds would be more appropriately set out in a rule relating to mutual funds.

In response to comments and further consideration of the paragraph, the Commission has amended the Proposed Rule to remove the disclosure requirements of paragraph (v)[w]. The Commission has determined that disclosure requirements are more appropriately dealt with in the legislation and rules governing mutual fund prospectus disclosure.

Paragraph (w)[x]

Several commentators were concerned about the exclusion of securities of mutual funds and non-redeemable investment funds as permitted investments for the purpose of the definition of managed accounts in paragraph (w)[x]. One commentator was concerned that under the proposed regime discretionary investment managers currently using pooled funds to manage client accounts will be forced to either prospectus qualify existing pooled funds or liquidate units of pooled funds held in client accounts. Several commentators recommended that the definition of managed account be amended to permit purchases of in-house managed mutual funds or pooled funds where the portfolio advisor has discretionary authority to make investment decisions on behalf of the managed account.

The Commission will be considering under a separate initiative whether it is appropriate for managed accounts of persons and entities that are not accredited investors to be permitted to purchase units of mutual funds or non-redeemable investment funds on an exempt basis. The Notice indicates that a project has be commenced to examine in-house pooled funds and their use to determine whether or not they present any unique regulatory concerns. The Commission recognizes the valuable input that it has received to date on pooled funds and encourages stakeholders to continue to participate in the development of an appropriate regulatory framework.

The accredited investor exemption will provide greater flexibility for many managed accounts. Under the new exemption, managed accounts of persons or entities that are accredited investors will no longer be required to purchase pooled fund securities in $150,000 increments or seek ad hoc relief for the purchase of additional securities. Such managed accounts will be able to purchase any amount of pooled fund securities at any time.

Commentators indicated that one effect of the removal of the exempt purchaser exemptions was to remove the ability of accounts that are fully managed by trust companies to purchase any amount of units of pooled funds.

The Proposed Rule has been amended to permit accounts that are fully managed by trust companies to continue the activities they are currently permitted to conduct. In particular, a new paragraph (y) has been included in the definition of accredited investor which makes trust managed managed accounts accredited investors irrespective of the type of securities to be acquired.

Paragraph (y)[aa]

One commentator stated that subsidiaries and affiliates of other accredited investors should be expressly included.

Paragraph (y)[aa] provides that persons or companies wholly owned by persons or companies that are accredited investors are also accredited investors. Also, paragraph (q)[r] has been amended to provide that persons or companies that are affiliated with the issuer are also accredited investors.

Other

One commentator recommended that the definition of accredited investor include minor children, minor grandchildren and dependants of persons mentioned in subsections 1.1(m) and (n).

Children and other family members of accredited investors can be given the benefit of acquisitions of securities in reliance and the exemption through the use of trusts or other structures which would fall within paragraph (y)[aa] of the definition.

Two commentators suggested that the definition include endowments, foundations and group RRSPs.

Certain of the noted entities may fall within the definition of accredited investor if they take the form of a person or entity referred to in paragraph (s)[l] and have the requisite asset level or if they are registered charities.

"Closely-held Issuer"

Several commentators questioned why the pool of investors was limited to 35 persons or companies, given that the existing "private issuer" exemption permits 50 prospective purchasers.

The "35 unaccredited investor" limit provided for in the proposed closely-held issuer exemption represents a balance between: (a) facilitating small companies' access to capital; and (b) limiting the potential risk assumed by unsophisticated investors. The closely-held issuer exemption is designed to be used by companies to raise investment capital from people and entities known by the issuer's principals and not through broad solicitations of potential investors. The private issuer exemption achieved a similar objective by prohibiting offers to the public. The closely-held issuer exemption is intended to remove the uncertainty surrounding this concept but still limit general solicitations through the prohibition on an issuer which incurred promotional or selling expenses.

Furthermore, the closely-held issuer exemption may prove less numerically restrictive than the private issuer exemption because accredited investors would count toward the 50 investor limit for purposes of the private issuer exemption whereas they would not count toward the 35 investor limit under the closely-held issuer exemption.

One commentator was of the view that the investor limit should be 35 shareholders and not 35 security holders so as to avoid the otherwise required analysis of what is a security. The commentator also suggested that the limit should be calculated on the basis of legal ownership as the determination of beneficial ownership is often very difficult if not impossible and also potentially invasive.

The Commission is of the view that the definition in the Act of the term "security" provides adequate guidance on what constitutes a security. A threshold based on shareholders as opposed to security holders would permit issuers to undertake significant financing through the issuance of debt or other "non-share" securities. Also, the term "share" is not defined in Ontario securities law and therefore it would be possible to avoid inclusion of certain securities through arbitrary labelling.

The Commission considers it appropriate to base the threshold on beneficial ownership. Closely-held issuers will generally be smaller issuers where determining beneficial ownership should be straightforward. Depositories and intermediaries would generally not be involved with the securities of closely-held issuers.

One commentator suggested that the definition of "closely held issuer" appears to exclude a "private mutual fund". The commentator, therefore, requested that the Commission clarify whether the prospectus exemption in subsection 73(1)(a) of the Act for securities of a private mutual fund will continue to be available after implementation of the Proposed Rule.

The Commission is not proposing to remove the exemption for trades in securities of private mutual funds contained in clause 73(1)(a) of the Act.

One commentator, in support of their view that the closely held issuer exemption is not simple, highlighted that an issuer proposing to rely on the exemption would be required to determine whether there had ever been advertising in connection with the sale of its securities.

The Proposed Rule has been revised to remove the no advertising condition in the definition of closely-held issuer and the prohibition on advertising in the closely-held issuer exemption. In making the revisions, the Commission recognized the potential difficulties surrounding determination of what constitutes advertising. It should be noted however that the Proposed Rule still provides that selling or promotional expenses may not be incurred in connection with a trade made in reliance on the closely-held issuer exemption.

One commentator indicated that the exemption suggests that if an issuer has advertised at any time in the past then they are prohibited from using the exemption. The commentator suggested that the restriction should only pertain to advertising undertaken after the implementation of the exemption and should preferably only apply to advertising in connection with the trade in question.

As noted above, the restriction on advertising in connection with the closely-held issuer exemption has been removed from the Proposed Rule.

"Financial Assets"

Several commentators recommended adopting a broader definition of the term "financial assets". For example, commentators suggested that "financial assets" should include real estate held for investment purposes, alternative investments such as futures contracts, insurance contracts, RRSPs, group RRSPs and pension plans. With regard to real estate, one commentator suggested including the net equity or unencumbered value of such assets.

The definition is intended to generally include liquid assets that an investor can afford to lose and the value of which is relatively easy to determine. Insurance contracts, group RRSPs and pension plan entitlements are illiquid assets and therefore not appropriate to include in the definition. Real estate holdings are generally relatively illiquid and difficult to value.

The Companion Policy provides guidance in how to determine what assets constitute financial assets.

"Exchangeable Security" and "Exchange Issuer"

One commentator suggested that the definitions should not require a reporting issuer.

Reporting issuer status is required to ensure that investors do not receive securities of a non-reporting issuer on exchange. This requirement ensures that there is disclosure in the

marketplace concerning the issuer of the securities to be received on exchange and that the security holder does not receive securities subject to resale restrictions.

Section 2.1 - Exemption for a Trade in a Security of a Closely-Held Issuer

General

One commentator was of the view that the new exemption was not simple and would require a review of all past financing to determine compliance with the $3 million cap.

The $3 million cap only applies to trades made pursuant to the exemption. Proceeds from trades made prior to the coming into force of the Proposed Rule would not count towards the threshold. The Commission is of the view that a closely-held issuer should be able to determine fairly readily from its corporate records the total amount of all proceeds received from distributions made in reliance on the exemption.

One commentator was concerned that the exemption would not adequately protect investors as promoters could literally go "door to door" or use telemarketing to lawfully sell securities while only having to provide the information statement. The commentator was of the view that investors should be provided with a prescribed form of offering memorandum.

The closely-held issuer exemption is intended to be a simple exemption which can be used by new and small issuers to raise funds without the need to involve professional advisors. The exemption represents a balance between the risks assumed by investors investing pursuant to the exemption and the creation of a simple exemption which will facilitate capital formation in Ontario.

A commentator expressed concern over the proposed removal of the private company exemption. The commentator was concerned that transactions which are effectively private transactions but which involve funds over $3 million and where all the investors are not accredited investors would now be excluded from the exempt market regime.

In recognition of the comment, paragraph (q)[r] of the definition of accredited investor has been amended to provide that affiliates of issuers are accredited investors. The amendment should alleviate the concerns expressed by the commentator.

Investor and Investment Limits

One commentator expressed the view that the investor and investment limits under the closely-held issuer exemption failed to adequately account for the multiple stages in which emerging companies are typically financed. The commentator, therefore, suggested that the restrictions in the exemption should be redesigned or a separate distribution exemption should be introduced incorporating annual rolling investor and investment limits.

In the view of the Commission, the proposed revisions provide a simple and flexible regulatory scheme which will facilitate the raising of capital throughout the various stages of business development while providing appropriate investor protection. In particular, the closely-held issuer exemption will allow issuers to raise a significant amount of capital from 35 investors irrespective of the relationship of the investors to the issuer. The 35 investors exclude certain employees and accredited investors including family members. The flexibility of the accredited investor exemption will allow issuers increased access to the angel and venture capital markets.

The Commission is not prepared to amend the exemption to provide for such things as annual "refreshments" of the exemption as the current thresholds provide an appropriate overall level of acceptable risk having regard for the characteristics of the capital markets in Ontario.

The Commission will monitor the efficacy of the proposed regime following implementation and address any issues that arise concerning the exemptions and access to capital accordingly.

Another commentator viewed the $3 million proceeds cap as too restrictive. The commentator recommended increasing the proceeds cap to $5 million.

The Commission has determined that the $3 million dollar cap represents an appropriate balance between facilitation of capital formation and investor protection. Under the proposed cap, 35 investors could each invest approximately $85,000 which represents a significant individual investment level.

One commentator inquired whether the $3 million threshold was net or gross of expenses and commission.

The $3 million threshold represents the gross proceeds received from distributions made in reliance on the exemption.

Information Statement

One commentator expressed the view that the proposed information statement would neither adequately inform nor protect purchasers. The commentator was concerned that the lack of meaningful information for purchasers could result in funds being raised by unscrupulous persons for very weak projects, and that this may have a negative effect on the reputation and integrity of the junior capital markets across all Canadian jurisdictions. The commentator, therefore, recommended extending the provision to require that purchasers be provided with an offering memorandum.

The information statement is not intended to inform investors about the issuer or investing generally. The information statement is intended to provide prospective purchasers with some guidance as to the information concerning the issuer they may want to review prior to making an investment and to also remind investors of the risks associated with investing, particularly in smaller issuers.

The Commission did not mandate an offering memorandum requirement for use of the closely-held issuer exemption as the utilization of the exemption is intended to be straightforward and inexpensive. The time and cost associated with preparing such documentation would outweigh the benefits derived from such a requirement. Issuers are free to provide offering memorandum to purchasers purchasing under the exemption.

Another commentator was concerned that the validity of securities issued in reliance on the closely-held issuer exemption may be subsequently called into question in the

event that the information statement is not provided to the purchaser at least four days prior to the trade. The commentator also expressed the view that there may be ambiguity about whether the information statement was "provided" to the purchaser. The commentator suggested that the provision be amended to provide that the purchaser may rescind the trade at any time up until the fourth day following the date upon which he or she is provided with the information statement.

The requirement to provide an information statement has been removed as a condition of the exemption and included as a concurrent requirement. As a result, the failure to deliver the information statement should not bring the validity of a trade made in reliance on the exemption into question. However, failure to deliver an information statement would constitute a contravention of Ontario securities law and trigger the enforcement powers of the Commission.

One commentator suggested that the proposal be modified to clarify that the information statement must be provided at least 4 days before the commitment date given the "in furtherance of" aspect of the definition of "trade".

In the view of the Commission, the date of a firm commitment is the date of the trade for the purposes of the information statement delivery requirement. Therefore, the information statement is required to be provided at least four days prior to the commitment date.

Promoters

One commentator was of the view that the promoter condition should be based on the knowledge of the issuer given the vagueness of the definition of promoter.

It is expected that the promoter of a closely-held issuer would generally be a principal of the issuer and therefore the issuer should be in a position to satisfy itself that the condition has or has not been met.

Advertising and Selling Expenses

One commentator recommended clarifying what would constitute "selling" expenses by inserting the words "except for expenses relating to administrative or professional services".

It is the Commission's view that this provision does not require qualification. Some clarification has been provided in section 2.1 of the Proposed Policy.

Certain commentators recommended that the advertising and selling expenses prohibition be eliminated. Two commentators expressed the view that a company that offers or sells its securities by advertising should not be disqualified from relying on the closely-held issuer exemption.

The Proposed Rule has been amended to remove the prohibition on advertising in the definition of closely-held issuer and in the closely-held issuer exemption.

A commentator suggested that a closely-held issuer should be able to use a brokerage firm to raise capital in a private placement. The commentator also suggested that a brokerage firm should be allowed to raise capital for a closely-held issuer through a password protected web-site on the internet where investors are pre-qualified as qualified investors.

The exemption does not expressly prohibit participation by market intermediaries. However, an important investor protection aspect of the exemption is the effective exclusion of market intermediaries. The exemption is intended to encourage capital raising from investors with some relation to the issuer. The exemption is not intended to facilitate general solicitations to unsophisticated investors through networks of market intermediaries. The Commission is of the view that permitting such general solicitations would be contrary to its investor protection mandate under the Act.

Anti-Avoidance

One commentator recommended including a definition of "common enterprise" in the Proposed Rule. The commentator was concerned that use of the exemption would require a complex analysis of the "common enterprise" concept.

The Companion Policy has been revised to provide clarification concerning the "common enterprise" concept. Common ownership interests or substantially similar business undertakings are the principal considerations in applying the "common enterprise" concept.

Section 2.3 - Exemption for a Trade to an Accredited Investor

Several commentators were concerned about the compliance obligations that would be imposed on the issuer under the net worth and net income provisions. Two commentators recommended that an issuer be able to rely on a representation from an investor that they have accredited investor status. Another commentator suggested that if, upon becoming a client, an investor satisfies the accredited investor requirements, the exemption should continue to apply until such time as the investor notifies the investment manager otherwise. In the alternative, the commentator recommended that the accredited investor exemption should apply during any one calendar year, provided that the investor has certified his or her continuing accredited investor status to the investment manager.

The Commission is of the view that it is the issuer's responsibility for taking appropriate actions to ensure compliance with the exemption. The Commission does not consider it appropriate to mandate the methods by which an issuer can satisfy its responsibility. Issuers are under similar obligations with certain current exemptions such as the seed capital exemption.

Purchasing As Principal

One commentator requested confirmation that the purchase by a manager on behalf of a managed account under subsection 1.1(w)[x] would be considered to be a purchase by the account "as principal" under section 2.3.

It is the view of the Commission that in circumstances described, the portfolio manager is acting in the capacity of agent for the managed account purchasing as principal.

Family Law Principles

Two commentators were concerned about the interaction of the accredited investor exemption with family law principles. One commentator suggested that paragraph (n) of the definition of "accredited investor" should include a requirement that a spouse consent to, or otherwise signal awareness of, the use of his or her assets to qualify his or her spouse as an accredited investor. The same commentator suggested that this requirement could be satisfied by having the spouse provide a declaration of consent.

The asset and income thresholds are solely measures of sophistication. They do not obviate the need to comply with other applicable requirements, restrictions or prohibitions that arise from securities regulation or elsewhere.

Section 2.4 - Exemption for a Trade to a Family Member of an Officer, Director or Promoter of the Issuer

The Members

Some commentators were concerned about the limited scope of the family member exemption. Two commentators recommended that the exemption should be extended to include siblings and one commentator recommended that it should be expanded to include close friends and business associates of the senior officers and directors of an issuer.

The Commission has determined that it is appropriate to incorporate the family member exemption into the accredited investor exemption rather than maintaining a separate the family member exemption. As such, the family members listed in the family member exemption in the Proposed Rule will be included in the definition of accredited investor. The Commission does not consider it appropriate expand the definition of accredited investor to permit trades to siblings or close friends and business associates. The closely-held issuer exemption is intended to facilitate trades to such individuals.

Advertising and Selling Expenses

One commentator recommended clarifying what would constitute "selling" expenses in subsection 2.4(c) by inserting the words "except for expenses relating to administrative or professional services".

The family member exemption has been removed and the noted condition is no longer applicable to sales to family members made under the accredited investor exemption.

Information Statement

One commentator questioned whether the regulatory protections under the family member exemption would adequately protect purchasers. The commentator recommended that the family member exemption be amended to include a requirement that purchasers be provided with an information statement substantially similar to Form 45-501F3.

The Task Force recommended the inclusion of family members in the definition of accredited investor on the basis that their close relationship with principals of the issuer alleviated investor protection concerns. The Commission is of the view that provision of the information statement to family members is not necessary and that they should be treated in a manner consistent with the treatment of other accredited investors.

Section 2.6 - Exemption for a Trade in Connection with a Securities Exchange issuer Bid

One commentator recommended that the condition in the section which provides that the issuer not be in default should be based on a knowledge standard since one may not be aware of defaults.

The Act provides for the provision of certificates indicating that an issuer is not in default of the requirements of the Act or regulations and therefore compliance with the requirement is not unduly onerous.

Section 2.8 - Exemption for a Trade upon Exercise of Conversion Rights in a Convertible Security

One commentator recommended that both substantive and drafting amendments be made to subsection 2.8. The commentator suggested that the subsection be amended to include language that would result in the complete exemption being found in one place.

The approach taken in the Proposed Rule is consistent with the general approach to rule drafting taken by the Commission.

Section 2.12 - Exemption for a trade in a Security Acquired in Connection with a Take-over Bid

One Commentator was of the view that issuers with actual or *pro forma* assets should be exempt from subsection (d) since it is an RTO-related anti-avoidance provision which has only served to create the need for additional exemptive relief in Ontario that does not apply in other provinces.

This section has been removed from the Proposed Rule. First trades in securities acquired pursuant to subsection 72(1)(j) are dealt with in MI 45-102.

Section 3.1 - Removal of Certain Exemptions Generally

Three commentators were concerned about the proposed replacement of the $150,000 exemption with the net assets and net income tests. Two of the commentators expressed the view that the $150,000 exemption is a useful financing option that should be maintained for use in Ontario alongside the proposed exemptions. One commentator suggested that the minimum investment amount should be reduced to $97,000. Another commentator, however, suggested that the $150,000 exemption provides investors with greater protection and regulators with a more effective means of monitoring compliance than either the net assets or net income tests.

The asset and net worth tests are based on the Task Force's conclusion that an investor's sophistication should be measured primarily by the ability to withstand the loss of the investment. While using either a "net worth" test or an income test to determine whether a potential investor can afford to lose an investment cannot fully assess sophistication, such

tests do provide a strong proxy for sophistication. The Commission agrees with the Task Force's conclusion that the $150,000 it not an appropriate proxy for sophistication and therefore maintaining the $150,000 dollar exemption is not supportable.

Certain commentators were concerned that the removal of the "seed capital" and "government incentive securities" exemptions would impede capital-raising activities. In particular, one commentator noted that some small issuers that have relied upon the seed capital and government incentive securities exemptions to market flow-through share offerings in the past, would not be able to rely on the closely-held issuer exemption.

The accredited investor exemption is intended to replace the noted exemptions. The seed capital and government incentive securities exemptions both require purchasers to be sophisticated. The Commission has, through the definition of accredited investor, set out what entities and persons it considers to be sophisticated. The accredited investor exemption will be available for many if not all of the financings now completed in reliance on the seed capital and government incentive securities exemptions.

Several commentators were concerned that the proposed exemptions and the manner in which they are being implemented will not provide an exempt distribution regime which is expansive enough to best serve Ontario's capital markets. According to one commentator, any revisions to the exempt distribution regime should supplement, rather than substitute, the current exemptions. In particular, the commentator suggested that exemptions should be introduced in Ontario modelled on British Columbia's $25,000 exemption and the short form document exemption.

As noted previously, the proposed revisions provide a simple and flexible regulatory scheme which will facilitate the raising of capital throughout the various stages of business development while providing appropriate investor protection. The Commission will monitor the efficacy of the new regime to ensure it is meeting the needs of the marketplace and its investors.

Section 3.3 - Removal of Exemptions for Securities of a Private Mutual Fund with a Promoter or Manager

The Proposed Rule removes the exemptions from the registration and prospectus requirements for trades in a security of a private mutual fund if it is administered by a trust company and there is a promoter or manager of the mutual fund other than the trust company. One commentator recommended that the term "manager" be defined and suggested that the definition should not inhibit a trust company from exercising its fiduciary responsibilities and appointing a portfolio adviser other than itself if it considers that to do so would be in the best interest of security holders of the common trust fund.

The prohibitions would not ordinarily prevent a trust company from contracting for advisory services so long as the trust company remains the manager of the fund. Management of a fund would include responsibility for the investment decisions of the fund.

Section 3.4 - Removal of Registration Exemptions for Market Intermediaries

One commentator was of the view that the closely-held issuer exemption, like the private company exemption, should be available to market intermediaries.

The Commission is of the view that making the exemption available to market intermediaries is inconsistent with the restriction on selling and promotional expenses.

Part 4 - Offering Memorandum

Two commentators recommended deleting the provision providing for the removal of the closely-held issuer exemption, the accredited investor exemption and the family member exemption if the statutory right of action is not described in the offering memorandum. The commentators suggested that while it made sense to require such disclosure under the previous regime where there was a contractual right of action, such disclosure is no longer necessary where there is a statutory right of action.

The Commission is of the view that it is appropriate for investors to be made aware of their rights under the Act. The requirement to disclose the statutory right of action is consistent with the similar disclosure requirement in the prospectus context.

Section 6.5 - The Resale Of An Underlying Security of a Multiple Convertible Security or an Exchangeable Security Acquired under Certain Exemptions

One commentator expressed the view that section 6.5 should apply only to the resale of underlying securities acquired pursuant to an exemption from the prospectus requirement. The commentator was concerned that, as drafted, section 6.5 would apply to securities acquired in a trade which does not itself constitute a distribution. The commentator, therefore, recommended inserting the words "under an exemption from the prospectus requirement" after "[a] trade in an underlying security acquired".

The proposed addition to the section is not required due to the definition of "type 1 trade" in the Proposed Rule which only includes trades made under an exemption from the prospectus requirement.

Part 7 - Filing Requirements and Fees

Another commentator suggested that the proposed Form 45-501F3 should be redrafted in a way more appropriate to the variety of potential recipients. The commentator was concerned that sophisticated non-accredited investors may find the tone of the form to be somewhat condescending.

The Form has been prepared having regard for divergent characteristics of potential recipients. The Commission would only be concerned with the alleged condescending tone if the tone alone would prevent what the commentator refers to as "sophisticated non-accredited investors" from making an investment.

Several commentators expressed the view that the filing and fee requirements are too onerous for professional investment counsellors who rely upon exempt distributions when offering units of pooled funds to investors. Two commentators recommended that the filing and fee requirements be amended to provide an exemption for continuously offered pooled funds to fully managed accounts. In the alternative, the commentators recommended amending the filing and fee requirements to permit filings to be completed on an annual basis and to provide for a reduced flat fee. Two commentators recommended that an annual fee based on assets under administration be adopted. In the further alternative, one commentator suggested harmonizing the filing and fee requirements across all Canadian jurisdictions.

The Proposed Rule has been amended to include a new provision which provides an exemption from the filing requirement in connection with distributions of units of pooled funds to managed accounts provided a fund report all trades in a financial year within 30 days of the end of the year and pays the requisite fee at that time. The relief is contained in subsection 7.5(7) of the Proposed Rule.

The fees payable in connection with exempt trades are being examined as part of a project which is looking at the entire fee structure of the Commission. It would therefore be premature to provide any type of fee relief in the Proposed Rule.

One commentator noted that the Commission has granted orders to a number of investment managers permitting them to file the required form and pay the fee annually for all units of a pooled fund issued in the relevant year. The commentator noted that most of these orders specifically applied to "a trade in units of a fund made pursuant to clause 72(1)(a), 72(1)(c) or 72(1)(d) of the Act...". The commentator requested confirmation that, notwithstanding these statutory references, investment managers would be able to continue to rely on these orders and file the required form for pooled funds on an annual basis.

The rulings granted prior to the coming into force of the rule generally would not be effective for trades made in reliance on the accredited investor exemption. However, as noted above, similar relief has been included in the Proposed Rule.

Another commentator suggested that portfolio managers should be permitted to put the name of the portfolio manager in item 5, as deemed principle, when investing managed accounts through in-house managed pooled funds. According to the commentator, the identity of the managed accounts should remain confidential given the private nature of the discretionary contractual relationship between a portfolio manager and a client.

The Commission does not believe there is reason to treat those investors that utilize advisory services in a different manner than other investors.

Form 45-501F2

The form requires a certification that the trade is an arm's length transaction made in good faith which certification is not required be subsection 2.5(2) or (3) of National Instrument 45-102.(SR)

The form has been amended to remove the requirement for certification of the arm' length nature of the transaction.

SPECIFIC COMMENTS - THE COMPANION POLICY

Section 2.3 - Sunset of Pooled Fund Rulings

One commentator was concerned about the Commission's intention to dispense with "sprinkling orders" granted under subsection 74(1) of the Act. The commentator noted that as a consequence of the restrictive definition of "financial assets", some pooled fund investors would not be able to rely on any exemptions.

To the extent that a investor invested in pooled funds in reliance on the $150,000 exemptions and the investor does not fall within the definition of accredited investor, that investor would generally be restricted from acquiring further units of the fund on an exempt basis.

The same commentator questioned whether the reference in section 2.3 of the Proposed Policy to section 2.1 of the Proposed Rule was a typographical error. The commentator suggested that the correct reference is section 2.3 of the Proposed Rule.

The reference in section 2.3 has been changed accordingly.

Section 3.1 - Seller's Certificate

One commentator recommended that the requirement for a "statutory declaration" under section 3.1 of the Proposed Policy be eliminated. The commentator suggested that a representation from the investor would be sufficient for the purposes of the Policy and the Proposed Rule and that such a representation should be permitted to be given electronically (i.e., by clicking a spot on a website).

The Proposed Policy provides suggestions of possible alternative ways in which sellers can ensure they are able to rely on a particular exemption. It does not mandate the provision of statutory declarations. Also, the Commission has determined that it is neither necessary nor appropriate to specify acceptable media.

Part 4 - Offering Memorandum

One commentator suggested that in order to ensure purchasers in Ontario and the United States are provided with the same level of information, and in order to promote consistency between existing and proposed exemptions, the provision excluding future oriented financial information in offering memoranda should be removed.

The regulation of future oriented financial information is being examined in connection with the development of proposed National Instrument 52-101Future Oriented Financial Information.

Other Comments

One commentator recommended that the Proposed Policy clarify the point in time at which any test set forth in the Proposed Rule would be satisfied. The commentator suggested that the appropriate point in time is at the time of the investment, and is not a continuing test during the life of the investment.

The Proposed Policy has been revised to clarify that the tests are point in time tests and are not required to be satisfied on an ongoing basis.

SCHEDULE A - LIST OF COMMENTATORS

1. Allen & Allen
2. Armstrong Perkins Hudson LLP
3. Barclays Global Investors
4. BayStreetDirect Inc.
5. BCE Inc.
6. Business Law Section, Canadian Bar Association (Ontario)
7. Canadian Bankers Association
8. Canadian Venture Capital Association
9. Canadian Venture Exchange
10. Connor, Clark & Lunn Investment Management Ltd.
11. Credit Union Central of Canada
12. Information Technology Association of Canada
13. Investment Counsel Association of Canada
14. Investment Funds Institute of Canada
15. Mary Condon, Associate Professor, Osgoode Hall Law School
16. McCarthy Tetrault
17. Meighen Demers
18. Nexus Investment Management Inc.
19. Northern Securities Inc.
20. Osler, Hoskin & Harcourt LLP
21. Sharwood Inc.
22. Simon Romano
23. Steven J. Trumper
24. TD Asset Management Inc.
25. RT Investment Management Holdings Inc.
26. Royal Bank of Canada

ONTARIO SECURITIES COMMISSION RULE 45-501

EXEMPT DISTRIBUTIONS

PART 1 DEFINITIONS

1.1 Definitions - In this Rule

"accredited investor" means

(a) a bank listed in Schedule I or II, or an authorized foreign bank branch listed in Schedule III, of the *Bank Act* (Canada);

(b) the Business Development Bank incorporated under the *Business Development Bank Act* (Canada);

(c) a loan corporation or trust corporation registered under the *Loan and Trust Corporations Act* or under the *Trust and Loan Companies Act (Canada)*, or under comparable legislation in any other jurisdiction;

(d) a co-operative credit society, credit union central, federation of caisses populaires, credit union or league, or regional caisse populaire, or an association under the *Cooperative Credit Associations Act* (Canada), in each case, located in Canada;[2]

(e) a company licensed to do business as an insurance company in any jurisdiction;

(f) a subsidiary of any company referred to in paragraph (a), (b), (c), (d) or (e), where the company owns all of the voting shares of the subsidiary;

(g) a person or company registered under the Act or securities legislation in another jurisdiction as an adviser or dealer, other than a limited market dealer;

(h) the government of Canada or of any jurisdiction, or any crown corporation, instrumentality or agency of a Canadian federal, provincial or territorial government;

(i) any Canadian municipality or any Canadian provincial or territorial capital city;

(j) any national, federal, state, provincial, territorial or municipal government of or in any foreign jurisdiction, or any instrumentality or agency thereof;

(k) a pension fund that is regulated by either the Office of the Superintendent of Financial Institutions (Canada) or a provincial pension commission or similar regulatory authority;

(l) a registered charity under the *Income Tax Act* (Canada);

(m) an individual who, either alone or jointly with a spouse, beneficially owns financial assets having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds $1,000,000;[3]

(n) an individual whose net income before taxes exceeded $200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded $300,000 in each of those years and who, in either case, has a reasonable expectation of exceeding the same net income level in the current year;[4]

(o) an individual who has been granted registration under the Act or securities legislation in another jurisdiction as a representative of a person or company referred to in paragraph (g), whether or not the individual's registration is still in effect;

(p) an officer, director or promoter of the issuer or an affiliated entity of a promoter of the issuer;

(q) a spouse, parent, grandparent or child of an individual referred to in paragraph (p);

(r) a person or company that, in relation to the issuer, is an affiliated entity or a person or company referred to in clause (c) of the definition of distribution in subsection 1(1) of the Act;[5]

(s) an issuer that is acquiring securities of its own issue;

(t) a company, limited partnership, limited liability partnership, trust or estate, other than a mutual fund or non-redeemable investment fund, that had net assets of at least $5,000,000 as shown on its most recently prepared financial statements;

(u) a person or company that is recognized by the Commission as an accredited investor;

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2 This category has been revised to include federal and provincial cooperative financial institutions.

3 This category has been amended to clarify that financial assets are to be valued on a pre-tax basis but net of related liabilities. A definition of "related liabilities" has been added to the revised Rule.

4 This category has been amended to clarify that accreditation is based on net income before taxes.

5 This category has been expanded to include affiliated entities, as defined in subsection 1.2(1).

(v) a mutual fund or non-redeemable investment fund that, in Ontario, distributes its securities only to persons or companies that are accredited investors;

(w) a mutual fund or non-redeemable investment fund that, in Ontario, distributes its securities under a prospectus for which a receipt has been granted by the Director;[6]

(x) a managed account if it is acquiring a security that is not a security of a mutual fund or non-redeemable investment fund;

(y) an account that is fully managed by a trust corporation registered under the *Loan and Trust Corporations Act*;

(z) an entity organized outside of Canada that is analogous to any of the entities referred to in paragraphs (a) through (g) in form and function; and

(aa) a person or company in respect of which all of the owners of interests, direct or indirect, legal or beneficial, are persons or companies that are accredited investors;

"closely-held issuer"[7] means an issuer, other than a mutual fund or non-redeemable investment fund, whose outstanding securities

(a) are subject to restrictions on transfer contained in the constating documents of the issuer or one or more agreements among the issuer and the holders of its securities; and

(b) are beneficially owned, directly or indirectly, by not more than 35 persons or companies, exclusive of

(i) persons or companies that are, or at the time they last acquired securities of the issuer were, accredited investors; and

(ii) current or former employees of the issuer or an affiliated entity of the issuer, or current or former consultants as defined in Rule 45-503 Trades to Employees, Executives and Consultants, who in either case beneficially own only securities of the issuer that were issued as compensation by, or under an incentive plan or arrangement of, the issuer or an affiliated entity of the issuer;

provided that:

(A) two or more persons who are the joint registered holders of one or more securities of the issuer shall be counted as one beneficial owner of those securities; and

(B) a corporation, partnership, trust or other entity shall be counted as one beneficial owner of securities of the issuer unless the entity has been created or is being used primarily for the purpose of acquiring or holding securities of the issuer, in which event each beneficial owner of an equity interest in the entity or beneficiary of the entity, as the case may be, shall be counted as a separate beneficial owner of those securities of the issuer;

"convertible security" means a security of an issuer that is convertible into, or carries the right of the holder to purchase, or of the issuer to cause the purchase of, a security of the same issuer;

"entity" means a company, syndicate, partnership, trust or unincorporated organization;

"exchangeable security" means a security of an issuer that is exchangeable for, or carries the right of the holder to purchase, or of the exchange issuer to cause the purchase of, a security of another issuer;

"exchange issuer" means an issuer that distributes securities of a reporting issuer held by it in accordance with the terms of an exchangeable security of its own issue;

"financial assets" means cash, securities, or any deposit or evidence thereof that is not a security for the purposes of the Act;

"managed account" means an investment portfolio account of a client established in writing with a portfolio adviser who makes investment decisions for the account and has full discretion to trade in securities of the account without requiring the client's express consent to a transaction;

"multiple convertible security" means a security of an issuer that is convertible into or exchangeable for, or carries the right of the holder to purchase, or of the issuer or exchange issuer to cause the purchase of, a convertible security, an exchangeable security or another multiple convertible security;

"MI 45-102" means Multilateral Instrument 45-102 Resale of Securities;

"portfolio adviser" means

(a) a portfolio manager; or

(b) a broker or investment dealer exempted from registration as an adviser under subsection 148(1) of the Regulation if that broker or investment dealer is not exempt from the by-

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6 The requirement proposed in the previous version of the revised Rule that the prospectus contain certain disclosure provisions has now been removed.

7 The restrictions on advertising included in the definition of "closely-held issuer" and in the exemption, as proposed previously, have now been removed.

laws or regulations of The Toronto Stock Exchange or the Investment Dealers' Association of Canada referred to in that subsection;

"Previous Rule" means Rule 45-501 Exempt Distributions as it read when it was published on January 8, 1999 at (1999) 22 OSCB 56;

"related liabilities" means liabilities incurred or assumed for the purpose of financing the acquisition or ownership of financial assets and liabilities that are secured by financial assets;[8]

"spouse", in relation to an individual, means another individual to whom that individual is married, or another individual of the opposite sex or the same sex with whom that individual is living in a conjugal relationship outside marriage;

"Type 1 trade" means a trade in a security under an exemption from the prospectus requirement in clause 72(1)(a), (b), (c), (d), (l), (m), (p) or (q) of the Act, or section 2.3 of this Rule, or section 2.4, 2.5 or 2.11 of the Previous Rule;

"Type 2 trade" means a trade in a security under an exemption from the prospectus requirement in clause 72(1)(f) (other than a trade to an associated consultant or investor consultant as defined in Rule 45-503 Trades to Employees, Executives and Consultants), (h),(i),(j),(k) or (n) of the Act, or section 2.5 or 2.8 of this Rule; and

"underlying security" means a security issued or transferred, or to be issued or transferred, in accordance with the terms of a convertible security, an exchangeable security or a multiple convertible security.

1.2 Interpretation

(1) In this Rule a person or company is considered to be an affiliated entity of another person or company if one is a subsidiary entity of the other, or if both are subsidiary entities of the same person or company, or if each of them is controlled by the same person or company.

(2) In this Rule a person or company is considered to be controlled by a person or company if

(a) in the case of a person or company,

(i) voting securities of the first-mentioned person or company carrying more than 50 percent of the votes for the election of directors are held, otherwise than by way of security only, by or for the benefit of the other person or company, and

(ii) the votes carried by the securities are entitled, if exercised, to elect a majority of the directors of the first-mentioned person or company;

(b) in the case of a partnership that does not have directors, other than a limited partnership, the second-mentioned person or company holds more than 50 percent of the interests in the partnership; or

(c) in the case of a limited partnership, the general partner is the second-mentioned person or company.

(3) In this Rule a person or company is considered to be a subsidiary entity of another person or company if

(a) it is controlled by,

(i) that other, or

(ii) that other and one or more persons or companies each of which is controlled by that other, or

(iii) two or more persons or companies, each of which is controlled by that other; or

(b) it is a subsidiary entity of a person or company that is the other's subsidiary entity.

[8] This is a new definition added as a result of a change to paragraph (m) of the definition of "accredited investor", which clarifies the manner in which financial assets are to be valued for accreditation purposes.

PART 2 EXEMPTIONS FROM THE REGISTRATION AND PROSPECTUS REQUIREMENTS OF THE ACT[9]

2.1 Exemption for a Trade in a Security of a Closely-held Issuer

(1) Sections 25 and 53 of the Act do not apply to a trade in a security of a closely-held issuer if

(a) following the trade, the issuer will be a closely-held issuer and the aggregate proceeds received by the issuer, and any other issuer engaged in common enterprise with the issuer, in connection with trades made in reliance upon the exemption in this section will not exceed $3,000,000;

(b) no promoter of the issuer has acted as a promoter of any other issuer that has issued a security in reliance upon this exemption within the twelve months preceding the trade; and

(c) no selling or promotional expenses are paid or incurred in connection with the trade.

(2) If a trade is made under subsection 2.1(1), the seller shall provide an information statement substantially similar to Form 45-501F3 to the purchaser of the security at least four days prior to the date of the trade unless, following the trade, the issuer will have not more than five beneficial holders of its securities.[10]

2.2 Exemption for a Trade in a Variable Insurance Contract

(1) Sections 25 and 53 of the Act do not apply to a trade by a company licensed under the *Insurance Act* in a variable insurance contract that is

(a) a contract of group insurance;

(b) a whole life insurance contract providing for the payment at maturity of an amount not less than three quarters of the premiums paid up to age 75 for a benefit payable at maturity;

(c) an arrangement for the investment of policy dividends and policy proceeds in a separate and distinct fund to which contributions are made only from policy dividends and policy proceeds; or

(d) a variable life annuity.

(2) For the purposes of subsection (1), "contract", "group insurance", "life insurance" and "policy" have the respective meanings ascribed to them by sections 1 and 171 of the *Insurance Act*.

2.3 Exemption for a Trade to an Accredited Investor - Sections 25 and 53 of the Act do not apply to a trade in a security if the purchaser is an accredited investor and purchases as principal.

2.4 Exemption for a Trade by a Control Person in a Security Acquired under a Formal Take-Over Bid

(1) Section 53 of the Act does not apply to a trade that is a control person distribution in a security that was acquired under a formal bid as defined in Part XX of the Act, if

(a) the offeree issuer had been a reporting issuer for at least 12 months at the date of the bid;

(b) subject to subsection (2), the intention to make the trade was disclosed in the take-over bid circular for the take-over bid;

(c) the trade is made within the period commencing on the date of the expiry of the bid and ending 20 days after that date;

(d) a notice of intention and a declaration prepared in accordance with Form 23 to the Regulation are filed by the seller before the trade;

(e) an insider report under Form 55-101F1 is filed by the seller within three days after the completion of the trade; and

(f) no unusual effort is made to prepare the market or to create a demand for the securities and no extraordinary commission is paid for the trade.

(2) Paragraph (1)(b) does not apply to a trade to another person or company that made a competing formal bid for securities of the same issuer for a per security price not greater than the per security consideration offered by that other person or company in its take-over bid.[11]

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[9] Certain exemptions contained in this Part in the version of the revised Rule published previously have now been moved to Multilateral Instrument 45-102 Resale of Securities ("MI 45-102") and several of the remaining exemptions have been renumbered and/or reordered.

[10] The requirement to provide an information statement has been moved from the closely-held issuer exemption into a new subsection (2), such that this requirement is no longer a condition to the availability of the exemption.

[11] The family member exemption in section 2.4 of the version of the revised Rule published on September 8, 2000 has been removed as family members have now been included in the definition of "accredited investor".

2.5 Exemption for a Trade in Connection with a Securities Exchange Issuer Bid - Sections 25 and 53 of the Act do not apply to a trade in a security that is exchanged by or for the account of the offeror with a securityholder of the offeror in connection with an issuer bid as defined in Part XX of the Act if, at the time of the trade, the issuer whose securities are being issued or transferred is a reporting issuer not in default under the Act or the regulations.

2.6 Exemption for a Trade upon Exercise of Conversion Rights in a Convertible Security - Sections 25 and 53 of the Act do not apply to a trade by an issuer in an underlying security of its own issue to a holder of a convertible security or multiple convertible security of the issuer on the exercise by the issuer of its right under the convertible security or multiple convertible security to cause the holder to convert into or purchase the underlying security or on the automatic conversion of the convertible security or multiple convertible security, if no commission or other remuneration is paid or given to others for the trade except for administrative or professional services or for services performed by a registered dealer.

2.7 Exemption for a Trade upon Exercise of Exchange Rights in an Exchangeable Security - Sections 25 and 53 of the Act do not apply to a trade by an exchange issuer in an underlying security to a holder of an exchangeable security or multiple convertible security of the exchange issuer on the exercise by the exchange issuer of its right under the exchangeable security or multiple convertible security to cause the holder to exchange for or purchase the underlying security or on the automatic exchange of the exchangeable security or multiple convertible security, if the exchange issuer delivers to the Commission a written notice stating the date, amount, nature and conditions of the proposed trade, including the net proceeds to be derived by the exchange issuer if the underlying securities are fully taken up and either

(a) the Commission has not informed the exchange issuer in writing within 10 days after the delivery of the notice that it objects to the proposed trade, or

(b) the exchange issuer has delivered to the Commission information relating to the underlying security that is satisfactory to and accepted by the Commission.

2.8 Exemption for a Trade on an Amalgamation, Arrangement or Specified Statutory Procedure - Sections 25 and 53 of the Act do not apply to a trade in a security of an issuer in connection with

(a) a statutory amalgamation or statutory arrangement; or

(b) a statutory procedure under which one issuer takes title to the assets of another issuer that in turn loses its existence by operation of law or under which one issuer merges with one or more issuers, whether or not the securities are issued by the merged issuer.

2.9 Exemption for a Trade in a Security under the Execution Act - Sections 25 and 53 of the Act do not apply to a trade in a security by a sheriff under the *Execution Act*, if

(a) there is no published market as defined in Part XX of the Act in respect of the security;

(b) the aggregate acquisition cost to the purchaser is not more than $25,000; and

(c) each written notice to the public soliciting offers for the security or giving notice of the intended auction of the security is accompanied by a statement substantially as follows:

These securities are speculative. No representations are made concerning the securities, or the issuer of the securities. No prospectus is available and the protections, rights and remedies arising out of the prospectus provisions of the *Securities Act*, including statutory rights of rescission and damages, will not be available to the purchaser of these securities.

2.10 Exemption for a Trade in Debt of Conseil Scolaire de L'île de Montréal - Sections 25 and 53 of the Act do not apply to a trade if the security being traded is a bond, debenture or other evidence of indebtedness of the Conseil Scolaire de L'île de Montréal.

2.11 Exemption for a Trade to a Registered Retirement Savings Plan or a Registered Retirement Income Fund - Sections 25 and 53 of the Act do not apply to a trade in a security by an individual or an associate of an individual to a RRSP or a RRIF established by or for that individual or under which that individual is a beneficiary.

[12]

PART 3 REMOVAL OF CERTAIN EXEMPTIONS FROM THE REGISTRATION AND PROSPECTUS REQUIREMENTS

3.1 Removal of Certain Exemptions Generally - The exemptions from the registration requirement in paragraphs 3, 4, 5, 18 and 21 of subsection 35(1) and paragraph 10 of subsection 35(2) of the Act and the exemptions from the prospectus requirement in clauses (a), (c), (d), (l) and (p) of subsection 72(1) and clause (a) of subsection 73(1) as it relates to paragraph 10 of subsection 35(2) of the Act are not available for a trade in a security.

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[12] Section 2.13 of the revision of the revised Rule published on September 8, 2000 has been deleted as this exemption will be included in MI 45-102.

3.2 Removal of Exemptions for Bonds, Debentures and Other Evidences of Indebtedness - The exemption from the registration requirement in subparagraph 1(c) of subsection 35(2) and the corresponding exemption from the prospectus requirement referred to in clause 73(1)(a) of the Act are not available for a trade in a bond, debenture or other evidence of indebtedness that is subordinate in right of payment to deposits held by the issuer or guarantor of the bond, debenture or other evidence of indebtedness.

3.3 Removal of Exemptions for Securities of a Private Mutual Fund with a Promoter or Manager - The exemption from the registration requirement in paragraph 3 of subsection 35(2) and the corresponding exemption from the prospectus requirement referred to in clause 73(1)(a) of the Act are not available for trades in a security of a private mutual fund if it is administered by a trust company and there is a promoter or manager of the mutual fund other than the trust company.

3.4 Removal of Registration Exemptions for Market Intermediaries

(1) The exemptions from the registration requirement in subsection 2.2(1) and sections 2.1, 2.3, 2.5, 2.6, 2.7, 2.8, 2.9 and 2.11 are not available to a market intermediary.

(2) Despite subsection (1), a limited market dealer may act as a market intermediary in respect of a trade referred to in section 2.3.

PART 4 OFFERING MEMORANDUM

4.1 Application of Statutory Right of Action - The right of action referred to in section 130.1 of the Act shall apply in respect of an offering memorandum delivered to a prospective purchaser in connection with a trade made in reliance upon an exemption from the prospectus requirement in section 2.1 or 2.3.

4.2 Description of Statutory Right of Action in Offering Memorandum – If the seller delivers an offering memorandum to a prospective purchaser in connection with a trade made in reliance upon an exemption from the prospectus requirement in section 2.1 or 2.3, the right of action referred to in section 130.1 of the Act shall be described in the offering memorandum.[13]

4.3 Delivery of Offering Memorandum to Commission - If an offering memorandum is provided to a purchaser of securities in respect of a trade made in reliance upon an exemption from the prospectus requirement in section 2.1 or 2.3, the seller shall deliver to the Commission a copy of the offering memorandum within 10 days of the date of the trade.

PART 5 DEALER REGISTRATION

5.1 Removal of Exemption unless Dealer Registered for Trade Described in the Exemption - An exemption from the registration requirement or from the prospectus requirement in the Act or the regulations that refers to a registered dealer is not available for a trade in a security unless the dealer is registered in a category that permits it to act as a dealer for the trade described in the exempting provision.

PART 6 RESTRICTIONS ON RESALE OF SECURITIES ACQUIRED UNDER CERTAIN EXEMPTIONS

6.1 Resale of a Security Acquired by a Promoter - A trade by a promoter of an issuer in a security of the issuer acquired under an exemption from the prospectus requirement in section 2.1 or 2.3 is a distribution unless the conditions in subsection (2) or (3) of section 2.9 of MI 45-102 are satisfied.

6.2 Resale of a Security Acquired under Section 2.1 - A trade in a security acquired under the exemption from the prospectus requirement in section 2.1, other than a trade referred to in section 6.1, is subject to section 2.6 of MI 45-102.

6.3 Resale of a Security Acquired under Section 2.3 - A trade in a security acquired under an exemption from the prospectus requirement in section 2.3, other than a trade referred to in section 6.1, is subject to section 2.5 of MI 45-102.

6.4 Resale of a Security Acquired under Clause 72(1)(h) of the Act - A trade in a security acquired under the exemption from the prospectus requirement in clause 72(1)(h) of the Act, other than a trade to which section 6.5 applies, is subject to section 2.6 of MI 45-102.

6.5 Resale of an Underlying Security of a Multiple Convertible Security, Convertible Security or an Exchangeable Security Acquired under Certain Exemptions - A trade in an underlying security acquired on conversion or exchange of a multiple convertible security, convertible security or exchangeable security, if the multiple convertible security, convertible security or exchangeable security was acquired in a Type 1 trade, is subject to section 2.5 of MI 45-102.

6.6 Resale of a Security Acquired under Section 2.6 or 2.7 - A trade in an underlying security acquired under an exemption from the prospectus requirement in section 2.6 or 2.7 on a forced conversion or exchange of a multiple convertible security, convertible security or exchangeable security acquired by the holder in a Type 2 trade, is subject to section 2.6 of MI 45-102.

[13] Subsection 4.2 has been revised to provide that it is a requirement resulting from reliance upon the exemption in section 2.1 or 2.3 and not a condition to the availability of either exemption.

6.7 Resale of a Security Acquired under Section 2.5 or 2.8 - A trade in a security acquired under an exemption from the prospectus requirement in section 2.5 or 2.8 is subject to section 2.6 of MI 45-102, unless, in the case of a security acquired under section 2.5, the trade is exempt under section 2.9 of MI 45-102.

6.8 Resale of Security Acquired under Certain Exemptions in Rule 45-503 – A trade under an underlying security acquired under exemption from the prospectus requirement in section 2.2, 3.1, 3.2, 3.3, 5.1 or 8.1 of Rule 45-503 Trades to Employees, Executives and Consultants, other than a trade by an associated consultant or investor consultant as defined in Rule 45-503 Trades to Employees, Executives and Consultants, is subject to section 2.6 of MI 45-102.

6.9 Resale of a Security Acquired under Section 2.11 – A trade in a security acquired under the exemption from the prospectus requirement in section 2.11 is subject to section 2.5 or 2.6 of MI 45-102, whichever section was applicable to the person or company making the initial trade.

PART 7 FILING REQUIREMENTS AND FEES

7.1 Form 45-501F1 - Every report that is required to be filed under subsection 72(3) of the Act or subsection 7.5(1) shall be filed in duplicate and prepared in accordance with Form 45-501F1.

7.2 Form 45-501F2 - Every report that is required to be filed under subsection 7.5(2) shall be filed in duplicate and prepared in accordance with Form 45-501F2.

7.3 Fees for Form 45-501F1

(1) A report filed in Form 45-501F1 shall be accompanied by a fee equal to the greater of

(a) $100; and

(b) subject to subsection (2), the amount calculated using the formula,

A + B

where

"A" is 0.02 percent of the aggregate gross proceeds realized in Ontario from the distribution of securities, other than special warrants, for which the report filed in Form 45-501F1 is filed, and

"B" is 0.04 percent of the aggregate gross proceeds realized in Ontario from the distribution of special warrants for which the report filed in Form 45-501F1 is filed.

(2) The amount calculated under subsection (1) is considered to be $100 if the report filed in Form 45-501F1 is filed for,

(a) a trade in securities if there is no change in beneficial ownership of the securities as a result of the trade;

(b) a subsequent trade in securities acquired under an exemption from the prospectus requirement in clause 72(1)(b) or (q) of the Act or section 2.3; or

(c) a subsequent trade in securities acquired prior to *6* , 2001 under an exemption from the prospectus requirement in clause 72(1)(a), (c), (d), (l) or (p) of the Act or section 2.4, 2.5 or 2.11 of the Previous Rule.

7.4 Fees for Form 45-501F2 - A report filed in Form 45-501F2 shall be accompanied by a fee of $100.

7.5 Exempt Trade Reports

(1) Subject to subsections (7) and (8), if a trade is made in reliance upon the exemption from the prospectus requirement in section 2.3, other than a trade to a person or company referred to in paragraphs (p) through (s) of the definition of "accredited investor" in section 1.1, the seller shall, within 10 days of the trade, file a report in accordance with section 7.1.

(2) If a trade is made in reliance upon the conditions in subsection (2) or (3) of section 2.5 of MI 45-102 being satisfied, the seller shall, within 10 days of the trade, file a report in accordance with section 7.2.

(3) If a trade is made in reliance upon the conditions in subsection (2) or (3) of section 2.9 of MI 45-102 being satisfied, the seller shall comply with the requirements of subsections (4) to (7) of that section.

(4) If a trade is made under section 2.6, the issuer shall file the notice and pay the fees prescribed by section 20 of Schedule 1 to the Regulation as if the underlying security had been acquired in a distribution exempt from section 53 of the Act by subclause 72(1)(f)(iii) of the Act.

(5) If a trade is made under section 2.7, the exchange issuer shall pay the fees prescribed by section 21 of Schedule 1 to the Regulation as if the security had been acquired in a distribution exempt from section 53 of the Act by clause 72(1)(h) of the Act.

(6) If a trade is made under section 2.8, the issuer shall pay the fees prescribed by section 23 of Schedule 1 to the Regulation as if section 23 referred to section 2.8 instead of clause 72(1)(i) of the Act.

(7) A report is not required under subsection (1) where, by a trade under section 2.3, a bank, loan corporation or trust corporation acquires from a customer an evidence of indebtedness of the customer or an equity investment in the customer acquired concurrently with an evidence of indebtedness.

(8) Despite subsection (1), a report in respect of a trade in a security of a mutual fund or non-redeemable investment fund made in reliance upon the exemption from the prospectus requirement in section 2.3 may be filed not later than 30 days after the financial year end of the mutual fund or non-redeemable investment fund.

7.6 Fees for Accredited Investor Application - An application for recognition, or for renewal of recognition, as an accredited investor shall be accompanied by a fee of $500.

PART 8 TRANSITIONAL PROVISIONS

8.1 Accredited Investor Definition Includes Exempt Purchaser - The definition of "accredited investor" in section 1.1 includes, prior to *6* , 2001, a person or company that is recognized by the Commission as an exempt purchaser.

8.2 Resale of a Security Acquired under Section 2.4, 2.5 or 2.11 of the Previous Rule - A trade in a security acquired under an exemption from the prospectus requirement in section 2.4, 2.5 or 2.11 of the Previous Rule is subject to section 2.5 of MI 45-102.

8.3 Resale of an Underlying Security of a Multiple Convertible Security, Convertible Security or an Exchangeable Security Acquired under Certain Exemptions - A trade in an underlying security acquired on conversion or exchange of a multiple convertible security, convertible security or exchangeable security, if any of the multiple convertible security, convertible security or exchangeable security was acquired under an exemption from the prospectus requirement in section 2.4, 2.5 or 2.11 of the Previous Rule, is subject to Section 2.5 of MI 45-102.

8.4 Resale of a Security Acquired by a Promoter under Section 2.3 or 2.15 of the Previous Rule - A trade by a promoter of an issuer in a security of the issuer acquired under an exemption from the prospectus requirement in section 2.3 or 2.15 of the Previous Rule is a distribution unless the conditions in subsection (2) or (3) of section 2.9 of MI 45-102 are satisfied.

8.5 Resale of a Security Acquired under Section 2.17 or Subsection 2.18(1) of the Previous Rule - A trade in a security acquired under an exemption from the prospectus requirement in section 2.17 of the Previous Rule, or in subsection 2.18(1) of the Previous Rule after the issuer has ceased to be a private issuer for purposes of the *Securities Act* (British Columbia), is subject to section 2.6 of MI 45-102.

FORM 45-501F1

Securities Act (Ontario)

Report under Section 72(3) of the Act or Section 7.5(1) of Rule 45-501

(To be used for reports of trades made in reliance upon
clause 72(1)(b) or (q) of the Act, or Section 2.3 of Rule 45-501)

1. **Full name and address of the seller.**

2. **Full name and address of the issuer of the securities traded.**

3. **Description of the securities traded.**

4. **Date of the trade(s).**

5. **Particulars of the trade(s).**

Name of Purchaser and Municipality and Jurisdiction of Residence	Amount or Number of Securities Purchased	Purchaser Price	Total Purchase Price (Canadian $)	Exemption Relied Upon

6. **The seller has prepared and certified a statement containing the full legal name and the full residential address of each purchaser identified in section 5 and a certified true copy of the list will be provided to the Commission upon request.**

7. **State the name and address of any person acting as agent in connection with trade(s) and the compensation paid or to be paid to such agent.**

8. **Calculation of Fees payable upon filing Form 45-501F1: (See section 7.3 of Rule 45-501 Exempt Distributions (Revised)).**

   Total Fees payable: $

9. Certificate of seller or agent of seller.

The undersigned seller hereby certifies, or the undersigned agent of the seller hereby certifies to the best of the agent's information and belief, that the statements made in this report are true and correct.

DATED at

this day of , 20___.

(Name of seller or agent - please print)

(Signature)

(Official capacity - please print)

(Please print name of individual whose signature appears above, if different from name of seller or agent printed above)

Notice Collection and Use of Personal Information

The personal information prescribed by this form is collected on behalf of and used by the Ontario Securities Commission for purposes of administration and enforcement provisions of the securities legislation in Ontario. All of the information prescribed by this form, except for the information contained in the statement required to be prepared and certified by the seller under section 6 of this form, is made available to the public under the securities legislation of Ontario. If you have any questions about the collection and use of this information, contact the Ontario Securities Commission at the address below:

Ontario Securities Commission
Suite 1903, Box 55,
20 Queen Street West
Toronto, Ontario M5H 3S8
Attention: Administrative Assistant to the Director of Corporate Finance
Telephone: (416) 593-8200
Facsimile: (416) 593-8177

Instructions:

1. In answer to section 7 give the name of the person or company who has been or will be paid remuneration directly related to the trade(s), such as commissions, discounts or other fees or payments of a similar nature. It is not necessary to include payments for services incidental to the trade such as clerical, printing, legal or accounting services.

2. If the space provided for any answer is insufficient, additional sheets may be used and must be cross-referred to the relevant item and properly identified and signed by the person whose signature appears on the report.

3. Cheques must be made payable to the Ontario Securities Commission in the amount determined in section 8 above.

4. Please print or type and file two signed copies with:

Ontario Securities Commission
Suite 1900, Box 55,
20 Queen Street West
Toronto, Ontario M5H 3S8

FORM 45-501F2

Securities Act (Ontario)
Report under section 7.5(2) of Rule 45-501

1. **Full name and address of the seller.**

2. **Full name and address of reporting issuer whose securities were traded.**

3. **Particulars of the trade(s).**

Date of Trade	Type of Security	Amount or Number of Securities Traded	Selling Price

4. **Full name and municipality of residence of the party from whom the seller acquired the securities and the date of acquisition.**

5. **Certificate of seller or agent of seller.**

The undersigned seller hereby certifies, or the undersigned agent of the seller hereby certifies to the best of the agent's information and belief, that:

(1) the information given in this report is true and correct, and

(2) (a) no unusual effort has been made to prepare the market or create a demand for the securities, and

(b) no extraordinary commission or consideration has been or has been agreed to be paid in respect of the trade covered by this report.

Instructions:

1. If the space provided for any answer is insufficient, additional sheets may be used and must be cross-referred to the relevant item and properly identified and signed by the person whose signature appears on the report.

2. Cheques must be made payable to the Ontario Securities Commission in the amount prescribed in section 7.4 of Rule 45-501 Exempt Distributions (Revised).

3. Please print or type and file two signed copies with:

Ontario Securities Commission
Suite 1900, Box 55,
20 Queen Street West
Toronto, Ontario M5H 3S8

DATED at

this day of , 20___.

(Name of seller or agent - please print)

(Signature)

(Official capacity - please print)

(Please print name of individual whose signature appears above, if different from name of seller or agent printed above)

Notice Collection and Use of Personal Information

The personal information prescribed by this form is collected on behalf of and used by the Ontario Securities Commission for purposes of administration and enforcement provisions of the securities legislation in Ontario. All of the information prescribed by this form, except for the information contained in the statement required to be prepared and certified by the seller, is made available to the public under the securities legislation of Ontario. If you have any questions about the collection and use of this information, contact the Ontario Securities Commission at the address below:

Ontario Securities Commission
Suite 1903, Box 55,
20 Queen Street West
Toronto, Ontario M5H 3S8
Attention: Administrative Assistant to the Director of Corporate Finance
Telephone: (416) 593-8200
Facsimile: (416) 593-8177

FORM 45-501F3
FORM OF INFORMATION STATEMENT

Introduction

Ontario securities laws have been relaxed to make it easier for small businesses to raise start-up capital from the public. Many potential investors may view this change in securities laws as an opportunity to "get in on the ground floor" of emerging businesses and to "hit it big" as these small businesses grow into large ones.

Statistically, most small businesses fail within a few years. Small business investments are among the most risky that investors can make. This information statement suggests matters for you to consider in deciding whether to make a small business investment.

Risks and Investment Strategy

A basic principle of investing in a small business is: **NEVER MAKE A SMALL BUSINESS INVESTMENT THAT YOU CANNOT AFFORD TO LOSE IN ITS ENTIRETY**. Never use funds that might be needed for other purposes, such as a post-secondary education, retirement, loan repayment or medical expenses, and never borrow money to make such an investment. Instead use funds that you already have set aside and that otherwise would be used for a consumer purchase, such as a vacation or a stereo system.

Never let anyone convince you that the investment is not risky. Any such assurance is almost always inaccurate. Among other risk factors, small business investments generally are highly illiquid, even if they are not subject to any legal restrictions on their transferability. This lack of liquidity means that, if the company takes a turn for the worse or if you suddenly need the funds you have invested in the company, you may not be able to sell your securities.

Also, it is important to realize that, just because the proposed offering of securities is permitted under Ontario securities law does not mean that the particular investment will be successful. Neither the Ontario Securities Commission nor any other government agency evaluates or endorses the merits of investments. Anyone who suggests that the Ontario Securities Commission has endorsed the merits of the investment is breaking the law.

If you plan to invest a large amount of money in a small business, you should consider investing smaller amounts in several small businesses. A few highly successful investments can offset the unsuccessful ones. Even when using this strategy, **DO NOT INVEST FUNDS YOU CANNOT AFFORD TO LOSE IN THEIR ENTIRETY**.

Analyzing the Investment

Although there is no magic formula for making successful investment decisions, certain factors are often considered particularly important by professional venture investors. Some questions to consider are as follows:

1. How long has the company been in business? If it is a start-up or has only a brief operating history, are you being asked to pay more than the shares are worth?

2. Consider whether management is dealing unfairly with investors or putting itself in a position where it will be unaccountable to investors. For example, is management taking salaries or other benefits that are too large in light of the company's stage of development? Are outside investors putting up 80% of the money but receiving only 10% of the company's shares? Will outside investors have any voting power to elect representatives to the board of directors?

3. How much experience does management have in the industry and in small business? How successful were the managers in previous businesses?

4. Do you know enough about the industry to be able to evaluate the company and make a wise investment?

5. Does the company have a realistic business plan and do they have the resources to market the product or service successfully?

6. How reliable is the financial information, if any, that has been provided to you by the persons promoting investment in the company?

There are many other questions to be answered, but you should be able to answer these before you consider investing. If you have not been provided with the information needed to answer these and any other questions you may have about the proposed investment, make sure that you obtain the information you need from people authorized to speak on the company's behalf (*e.g.*, management or the directors) before you advance any funds or sign any commitment to advance funds to the company.

Making Money on Your Investment

The two classic methods for making money on an investment in a small business are: (1) resale of the securities in the public securities markets following a public offering; and (2) receiving cash or marketable securities in a merger or other acquisition of the company.

If the company is the type that is not likely to go public or be acquired within a reasonable time (*i.e.*, a family-owned or closely-held corporation), it may not be a good investment for you irrespective of its prospects for success because of the lack of opportunity to cash in on the investment. Management of a successful private company may receive a good return indefinitely through salaries and bonuses but it is unlikely that there will be profits sufficient to pay dividends commensurate with the risk of the investment.

Other Suggestions

It is generally a good idea to meet with management of the company face-to-face to size them up. Focus on experience and track record rather than a smooth sales presentation. If at all possible, take a sophisticated business person with you to help in your analysis.

Even the best venture offerings are highly risky. If you have a nagging sense of doubt, there is probably a good reason for it. Good investments are based on sound business criteria and not emotions. If you are not entirely comfortable, the best approach is usually not to invest. There will be many other opportunities. Do not let anyone pressure you into making a premature decision.

Conclusion

Greater numbers of public investors are "getting in on the ground floor" by investing in small businesses. When successful, these enterprises enhance the economy and provide jobs for its citizens. They also provide investment opportunities. However, an opportunity to invest must be considered in light of the inherently risky nature of small business investments.

In considering a small business investment, you should proceed with caution, and above all, never invest more than you can afford to lose.

COMPANION POLICY 45-501CP TO
ONTARIO SECURITIES COMMISSION RULE 45-501
EXEMPT DISTRIBUTIONS

PART 1 PURPOSE AND DEFINITIONS

1.1 **Purpose** - This policy statement sets forth the views of the Commission as to the manner in which certain provisions of the Act and the rules relating to the exemptions from the prospectus and registration requirements are to be interpreted and applied.

1.2 **Definitions** - In this Policy, "private placement exemptions" means the prospectus and registration exemptions available for

(a) sales of securities of closely-held issuers under section 2.1 of Rule 45-501; and

(b) sales of securities to accredited investors under section 2.3 of Rule 45-501.

PART 2 EXEMPTIONS FROM THE REGISTRATION AND PROSPECTUS REQUIREMENTS OF THE ACT

2.1 **Interaction of Private Placement Exemptions** - The Commission recognizes that a seller of securities may, in connection with any distribution of securities, rely concurrently on different private placement exemptions. The Commission notes that where the seller is paying or incurring selling or promotional expenses in connection with the distribution, the seller may not be able to rely on the exemption in section 2.1. In particular, the seller would not be able to rely on the exemption in section 2.1 if it has engaged the services of an underwriter or a sales agent in connection with the distribution, unless the underwriter or sales agent does not participate in, or receive compensation for trades made in reliance on the exemption in section 2.1. Accordingly, sellers seeking to rely concurrently on the exemptions in sections 2.1 and 2.3 must ensure that any underwriter or sales agent engaged to effect trades in reliance on section 2.3 are not involved in, or compensated for, trades made in reliance on section 2.1.

2.2 **Accredited Investor Status For Individuals**

(1) Paragraph (m) of the "accredited investor" definition in section 1.1 of Rule 45-501 refers to individuals who beneficially own financial assets having an aggregate net realizable value that, before taxes but net of any related liabilities, exceeds $1,000,000. As a general matter, it should not be difficult to determine whether financial assets are beneficially owned by an individual in any particular instance. However, financial assets held in a trust or in other types of investment vehicles for the benefit of an individual may raise questions as to whether the individual beneficially owns the financial assets in the circumstances. The Commission is of the view that the following factors are indicative of beneficial ownership of financial assets:

(a) physical or a constructive possession of evidence of ownership of the financial asset;

(b) entitlement to receipt of any income generated by the financial asset;

(c) risk of loss of the value of the financial asset; and

(d) the ability to dispose of the financial asset or otherwise deal with it as the individual sees fit.

By way of example, securities held in a self-directed RRSP for the sole benefit of an individual would be beneficially owned by that individual. In general, financial assets in a spousal RRSP would also be included for purposes of the threshold test. However, financial assets held in a group RRSP under which the individual would not have the ability to acquire the financial assets and deal with them directly would not meet this beneficial ownership requirement.

(2) The Commission notes that paragraphs (m) and (n) of the "accredited investor" definition are designed to treat spouses as an investing unit such that either spouse may qualify as an accredited investor if both spouses, taken together, beneficially own the requisite amount of financial assets or earn the requisite net income. As well, the financial asset test and the net income test prescribed in paragraphs (m) and (n), respectively, are to be applied only at the time of the trade such that there is no obligation on the seller to monitor the purchaser's continuing qualification as an accredited investor after the completion of the trade.

2.3 **Closely-Held Issuer Exemption**

(1) The exemption in section 2.1 relating to securities of closely-held issuers is available to the closely-held issuer itself in respect of an issue of its own securities and to any holder of the issuer's securities in respect of a sale of the securities. A closely-held issuer may issue its own securities in reliance upon the exemption in section 2.1 so long as it is able to meet the criteria for the availability of the exemption in that section. In particular, a closely-held issuer may no longer use the closely-held issuer exemption once it has received aggregate proceeds of $3,000,000 from trades made in reliance upon the exemption. However, a holder of securities of a closely-held issuer may rely upon the exemption in section 2.1 in connection with any resale of the securities so long as the issuer

continues to be a closely-held issuer after the resale. The issuer does not cease to be a closely-held issuer solely because it has raised $3,000,000 in aggregate proceeds using the exemption.

(2) The Commission notes that a closely-held issuer will be in a position to facilitate the use of the exemption in section 2.1 for the resale of its securities by limiting the number of its security holders using the share transfer restrictions in its constating documents or in an agreement with its security holders. Once the issuer no longer meets the closely-held issuer definition, a resale of securities acquired under the exemption in section 2.1 may only be made in reliance upon another exemption or by complying with the relevant provisions of Multilateral Instrument 45-102 Resale of Securities.

(3) The Commission notes that the restriction on the use of the exemption in section 2.1, which refers to aggregate proceeds of $3,000,000, is based on the aggregate of all proceeds received by the issuer at any time from trades made in reliance upon the exemption in section 2.1. Proceeds received by the issuer from trades made in reliance upon other exemptions, including exemptions available prior to the date when the exemption in section 2.1 first became available, are not relevant. In particular, the proceeds realized by the issuer from trades to accredited investors need not be included in determining whether the $3,000,000 threshold would be exceeded in respect of any proposed trade under section 2.1. However, if the issuer has not filed a report on Form 45-501F1 in respect of a trade with an accredited investor where such a filing is required, it will be presumed that the trade was made in reliance upon section 2.1, in which case the proceeds of that trade must be counted for purposes of the aggregate proceeds limit.

(4) The Commission notes that the term "common enterprise" is intended to operate as an anti-avoidance mechanism to the extent that multiple business entities are organized for the purposes of financing what is essentially a single business enterprise in order to benefit from continued or excessive use of the closely-held issuer exemption. The Commission takes the view that commonality of ownership combined with commonality of business plans will be particularly indicative of a "common enterprise".

2.4 **Sunset of Pooled Fund Rulings** – Prior to the implementation of Rule 45-501 in revised form, the Commission granted numerous rulings under subsection 74(1) of the Act providing exemptive relief from the registration and prospectus requirements to pooled fund issuers in respect of, among other things, the sale of additional pooled fund interests to investors that have previously purchased pooled fund interests under an exemption. In general, these rulings contained a "sunset" provision stating that the ruling would terminate following the adoption of a rule regarding trades in securities of pooled funds. The Commission considers that the accredited investor exemption in section 2.3 of Rule 45-501, which exempts sales of pooled funds to certain types of accredited investors, provides the appropriate relief from the registration and prospectus requirements for trades in additional pooled fund interests to existing investors. Accordingly, the Commission takes the view that these rulings expire upon implementation of revised Rule 45-501.

2.5 **Trades on an Amalgamation, Arrangement or Specified Statutory Procedure** - Clause 72(1)(i) of the Act provides an exemption for trades in securities in connection with a statutory amalgamation or arrangement or other statutory procedure. The Commission is of the view that the reference to statute in that clause refers to any statute of a jurisdiction or foreign jurisdiction under which the amalgamating entities have been incorporated or created and exist and under which the transaction is taking place.

2.6 **Three-Cornered Amalgamations** - Certain corporate statutes permit a so-called "three-cornered merger or amalgamation" under which two companies will amalgamate or merge and security holders of the amalgamating or merging entities will receive securities of a third party affiliate of one amalgamating or merging entity. Section 2.8 of Rule 45-501 exempts these trades as the exemption applies to any trade made in connection with an amalgamation or merger.

2.7 **Other Exemptions** – There are various other exemptions from the prospectus and registration requirements that are available to sellers of securities in prescribed circumstances. The Commission notes, in particular, that certain exemptions previously contained in Rule 45-501 as it read when it was originally adopted are now contained in Multi lateral Instrument 45-102 Resale of Securities ("MI 45-102"). Market participants engaged in the purchase and sale of securities under exemptions from the prospectus and registration requirements should read MI 45-102 together with Rule 45-501 to ensure that they have duly considered all regulatory requirements applicable to exempt distributions of securities in Ontario.

PART 3 CERTIFICATION OF FACTUAL MATTERS

3.1 **Seller's Due Diligence** - The Commission will normally be satisfied that a seller has exercised reasonable diligence for the purposes of the certificate required in Form 45-501F1, which, among other things, discloses the specific exemption(s) used by the seller, if the seller relies on statutory declarations or written certifications from the purchasers, unless the seller has knowledge that any facts set out in the declarations or certifications are

incorrect**.** In circumstances where a seller has recently obtained a statutory declaration or a written certification from a purchaser with whom a further trade is being made, the seller may continue to rely upon the recently obtained statutory declaration or certification unless the seller has reason to believe that the statutory declaration or certification is no longer valid in the circumstances. Ultimately, it is the seller's responsibility to ensure that its trades in securities are made in compliance with applicable securities laws.

PART 4 OFFERING MEMORANDA

4.1 Use of Offering Memoranda in Connection with Private Placements

(1) Part 4 of Rule 45-501 provides for the application of the statutory right of action referred to in section 130.1 of the Act if an offering memorandum is delivered to a prospective investor in connection with a trade made in reliance upon a prospectus exemption in section 2.1 or 2.3 of Rule 45-501. In this case the statutory right of action must be described in the offering memorandum and a copy of the offering memorandum must be delivered to the Commission. Although there is no obligation to prepare an offering memorandum for use in connection with a trade made in reliance upon any prospectus exemption, business practice may dictate the preparation of offering material that is delivered voluntarily to purchasers in connection with exempt trades under section 2.1 or 2.3. This offering material may constitute an "offering memorandum" as defined in the Act. The statutory right of rescission or damages applies when the offering memorandum is provided voluntarily in connection with exempt trades made under section 2.1 or 2.3, including an exempt trade to a government or financial institution that is an accredited investor. However, a document delivered in connection with a sale of securities made otherwise than in reliance upon the above-noted exemptions does not give rise to the statutory rights of action or the obligations of Part 4.

(2) The Commission does not prescribe what an offering memorandum should contain apart from the description of the applicable statutory right of action and the requirements relating to future oriented financial information as contemplated by proposed National Instrument 52-101 Future-Oriented Financial Information (if and when it comes into force).

(3) The Commission cautions against the practice of providing preliminary offering material to certain prospective investors before furnishing a "final" offering memorandum unless the material contains a description of the statutory right of action available to purchasers in situations when the statutory right of action applies and a description is required. The only material prepared in connection with the private placement for delivery to investors, other than a "term sheet" (representing a skeletal outline of the features of an issue without dealing extensively with the business and affairs of the issuer), should consist of an offering memorandum describing the statutory right of action and complying in all other respects with Ontario securities law.

PART 5 RESTRICTIONS ON FIRST TRADES

5.1 Incorporation of Multilateral Instrument 45-102 Resale of Securities - Part 6 of the Rule imposes resale restrictions on securities acquired under certain exemptions from the prospectus requirements. Different types of resale restrictions are imposed depending upon the nature of the prospectus exemption under which the securities were distributed. In each case, the applicable resale restrictions are incorporated by reference to a specific section of Multilateral Instrument 45-102 Resale of Securities. Sellers of securities are reminded that these resale restrictions need not apply if the seller is able to rely upon another prospectus exemption in the Act or in a Commission rule in respect of the resale of the securities in question.

PART 6 COMMISSION REVIEW

6.1 Review of Offering Material - Although sellers of securities who rely upon the private placement exemptions are required to deliver to the Commission copies of offering material that they use in connection with the exempt trades if the offering material constitutes an "offering memorandum" as defined in the Act, the offering material is not generally reviewed or commented upon by Commission staff.

6.2 Other Regulatory Approvals - Given the self-policing nature of exempt distributions and the fact that offering memoranda are not routinely reviewed by Commission staff, the decision relating to the appropriate disclosure in an offering memorandum rests with the issuer, the selling securityholder and their advisors. If Commission staff becomes aware of an offering memorandum that fails to disclose material information relating to the securities that are the subject of the transaction, staff may seek to intervene to effect remedial action.