

**6.1.2 Notice and Request for Comments - Proposed OSC Rule 48-501 - Trading during Distributions, Formal Bids and Share Exchange Transactions and Proposed Rescission of OSC Policy 5.1, Paragraph 26 and OSC Policy 62-601 – Securities Exchange Take-Over Bids – Trades in the Offeror’s Securities**

**NOTICE AND REQUEST FOR COMMENTS**

**PROPOSED ONTARIO SECURITIES COMMISSION RULE 48-501 - TRADING DURING DISTRIBUTIONS,  
FORMAL BIDS AND SHARE EXCHANGE TRANSACTIONS**

**AND**

**PROPOSED RESCISSION OF ONTARIO SECURITIES COMMISSION  
POLICY 5.1, PARAGRAPH 26 AND ONTARIO SECURITIES COMMISSION POLICY 62-601 – SECURITIES EXCHANGE  
TAKE-OVER BIDS – TRADES IN THE OFFEROR’S SECURITIES**

**Introduction**

The Commission is publishing for comment proposed Ontario Securities Commission Rule 48-501 – *Trading during Distributions, Formal Bids and Share Exchange Transactions*. The proposed rule would impose trading restrictions on dealers and issuers involved in a distribution of securities and certain other transactions. The proposed rule will replace paragraph 26 of Ontario Securities Commission Policy 5.1 (Policy 5.1) and Ontario Securities Commission Policy 62-601 – *Securities Exchange Take-Over Bids – Trades in the Offeror’s Securities* (Policy 62-601).

**Substance and purpose of proposed rule**

The proposed rule governs the activities of dealers, issuers and others in connection with a distribution of securities, a securities exchange take-over bid, an issuer bid or an amalgamation, arrangement, capital reorganization or similar transaction. The proposed rule is intended to prescribe what is acceptable and otherwise restricts trading activities to preclude manipulative conduct by persons with an interest in the outcome of a distribution of securities or the other transactions set out above.

**Summary of proposed rule**

The proposed rule imposes a “restricted period” on two different groups: “dealer-restricted persons” and “issuer-restricted persons”. Dealer-restricted persons are defined in section 1.1 of the proposed rule as including a dealer, a related entity of a dealer, a partner, director, officer, or employee of a dealer or a related entity of a dealer, a person or company acting jointly or in concert with any of these persons or companies, or an investment fund or account managed by any of these persons or companies. An issuer-restricted person is defined in section 1.1 of the proposed rule as including an issuer, a selling security holder, an affiliated entity, an associated entity, a person or company acting jointly or in concert with any of these persons or companies or an investment fund or account managed by any of these persons or companies.

There are different restricted periods applicable to dealers and issuers. As a starting point, during the applicable restricted period, dealer-restricted persons and issuer-restricted persons are not permitted to bid for or purchase a restricted security. A restricted security is defined as:

- an offered security (which includes a security of the same class of security that is the subject of a distribution, a security offered in a securities exchange take-over bid or an issuer bid, a security issuable pursuant to an amalgamation, arrangement, capital reorganization or similar transaction), or
- a connected security (which includes a security into which the offered security is immediately convertible, exchangeable or exercisable).

A number of exemptions apply to the general trading restrictions in the proposed rule. In particular, the proposed rule provides an exemption to a dealer appointed to act as an underwriter, permitting the dealer to bid for or purchase a restricted security for market stabilization purposes. The price at which the bid or purchase can be made is the lesser of the maximum permitted stabilization price or the highest independent bid at the time.

The proposed rule provides an exemption where, due to the frequency and value of trading, there is low risk of manipulation. Specifically, trading restrictions are eliminated for dealers trading “highly-liquid securities”. To qualify as an “highly-liquid security” a security must trade an average of at least 100 times per day with an average trading value of \$1 million per trading day. There is no similar exemption proposed for issuers. This difference in treatment is based on the view that issuers should not be able to trade in their securities whether or not they are actively traded.

There are also exemptions for certain types of securities such as non-convertible debt securities and asset-backed securities that have an approved rating. These securities are traded on the basis of their yields and credit ratings, are largely fungible and therefore are less likely to be subject to manipulation.

The proposed rule also contains an exemption if a bid or purchase is made in compliance with the Universal Market Integrity Rules (UMIR). Paragraph 26 of Policy 5.1 contains an exemption if there is compliance with the Toronto Stock Exchange (TSX) rules on market stabilization. As TSX participating organizations are now subject to the UMIR, the proposed rule contains a similar exemption for participants complying with the UMIR. It should be noted that the UMIR provisions relating to trading restrictions during a distribution or during a securities exchange take-over bid are currently in the process of being revised to ensure consistency with the proposed rule.

In preparing the proposed rule, we note that, effective March 4, 1997, the United States Securities and Exchange Commission adopted Regulation M (Reg M) which brought about certain changes to trading practice rules governing securities offerings which were previously contained in SEC Rules 10b-6, 10b-6A, 10b-7, 10b-8 and 10b-21. One of the reasons behind the changes was to relax restrictions in cases where either the risk of manipulation is small or the costs of the restrictions are disproportionate to the purposes they serve. We considered the approach taken in Reg M and adopted certain concepts, where appropriate.

### Specific requests for comment

We are seeking comment on all aspects of the proposed rule. We also request specific comment on the matters identified below.

1. Definition of “dealer-restricted person” and “issuer-restricted” person

The definitions of “dealer-restricted person” and “issuer-restricted person” include a person or company that is acting jointly or in concert with a person or company that is a dealer-restricted person or an issuer-restricted person.

**We request comment on whether it would be difficult to track if a person or company was “acting jointly or in concert” with the particular person or company and, therefore, should be included in the dealer-restricted group or the issuer-restricted group. We also request comment on whether further guidance is necessary in the interpretation of the phrase “acting jointly or in concert”.**

2. Definition of “highly-liquid security”

It is proposed that no restrictions be imposed on dealers for a “highly-liquid security”. The proposed definition is:

“highly-liquid security” means a listed security or quoted security that

- (a) has traded in total on one or more marketplaces as reported on a consolidated market display during a 60-day period ending not earlier than 10 days prior to the commencement of the restricted period,
  - (i) an average of at least 100 times per trading day, and
  - (ii) with an average trading value of \$1,000,000 per trading day, or
- (b) is subject to Regulation M under the 1934 Act and is considered to be an “actively-traded security” thereunder;”

Reg M exempts actively-traded securities based on a two-part test: size of public float and average daily trading volume. In particular, securities must have an average daily trading value of at least \$1 million and a public float for common equity securities of the issuer of at least \$150 million.

The exemption in the proposed rule focuses on the number of trades per day and the average daily trading value rather than the test in Reg M which is based on size of public float and average daily trading value. The reason for using the number of trades per day and the average daily trading value is that it is a simpler test which may be determined based on more readily available information.

**We request comment on whether the proposed rule should include criteria based on the size of public float, similar to Reg M, and whether this information or that in the proposed definition would be difficult to obtain or calculate on a consistent basis.**

3. Commencement of Restricted Period

The proposed rule would not impose any restrictions if a security traded an average of at least 100 times per trading day and has an average daily trading value of \$1 million. Restrictions on trading begin on the later of *two days* prior to the determination of the offering price or on the day that a dealer reaches an understanding to participate in the distribution of securities. The two day period is consistent with paragraph 26 of Policy 5.1 and the current market stabilization provision in UMIR. Restrictions end when the distribution is terminated.

Reg M has a three-tier approach to the restricted period. Reg M does not impose any restrictions if a security has an average daily trading value of at least \$1 million and a public float for common equity securities of the issuer of at least \$150 million. Restrictions on trading begin *one* business day prior to the determination of the offering price or such time that a person becomes a distribution participant (defined in Reg M) in the case of issuers with an average daily trading value of at least \$100,000 and a public float of \$25 million. For all other securities, restrictions begin *five* business days prior to the determination of the offering price or such time that a person becomes a distribution participant. The restricted period ends upon a distribution participant's completion of participation in the distribution.

**We request comment on whether there should be multiple restricted periods depending on the size of the issuer, similar to Reg M.**

4. Termination of Restricted Period

The proposed rule contemplates that the restricted period ends when the selling process ends and all stabilization arrangements relating to the offered security terminate. We note that the proposed amendments to the equivalent UMIR Rule provide additional provisions interpreting the termination of the restricted period:

- “(a) the selling process shall be considered to end:
  - (i) in the case of a distribution pursuant to a prospectus, if a receipt has been issued for the final prospectus by the applicable securities regulatory authority and the Participant has allocated all of the securities to be distributed under the prospectus to subscribers and delivered to each subscriber a copy of the prospectus as required by applicable securities legislation,
  - (ii) in the case of a wide distribution, if trades which are the subject of the wide distribution have been executed on or reported to the Exchange or QTRS in respect of all of the offered securities, and
  - (iii) in the case of an offering of special warrants, the Participant has allocated all of the securities to be distributed under the offering to subscribers and have delivered to each subscriber a copy of all offering documents required to be provided to subscribers in connection with such offering; and
- (b) stabilization arrangements shall be considered to have terminated in the case of a syndicate of underwriters when, in accordance with the syndicate agreement, the lead underwriter determines that the syndicate agreement has been terminated such that any purchase or sale of a restricted security by a Participant after the time of termination is not subject to the stabilization arrangements or otherwise made jointly for the Participants that were party to the stabilization arrangements”

**We request comment on whether the determination of the end of the restricted period is sufficiently clear as proposed in the rule or whether further clarification such as that proposed in the amendments to the UMIR provisions would be helpful.**

5. Research Activities

In certain circumstances dealers may carry out research activities. An exemption from the prohibitions in the proposed rule and section 53 of the Securities Act is proposed for compilation reports relating to a substantial number of issuers in the issuer's industry. This is similar to an exemption provided in Regulation M. There is also an exemption for research activities relating to issuers the securities of which are exempt from the prohibitions of the proposed rule.

**We request comment on whether or not research activities should be specifically permitted during the restricted period. If so, we are also requesting comment on whether the proposed exemptions are sufficient and whether the conditions applicable to the use of the exemptions are appropriate.**

6. Exemptions

The proposed rule contains a number of exemptions. For example, as set out above, there is an exemption to dealers for highly-liquid securities. Issuers, on the other hand, have a more limited number of exemptions available to them. The different approach for dealers and issuers is based on the issuers' and selling security holders' stake in the offering and generally their lesser need to engage in securities transactions.

**We request comment on the limited exemptions provided to issuers and the different exemptions available to issuers in Reg M.**

**We request comment on whether any other exemptions for dealer-restricted persons or issuer-restricted persons should be included in the proposed rule.**

7. Short Sales

The proposed rule contains an exemption permitting a dealer-restricted person to cover a short sale entered into prior to the dealer-restricted period. However, it is not contemplated that dealer-restricted persons be able to cover short sales entered into during the restricted period. Reg M prohibits the covering of short sales entered during certain periods of time if the purchase of offered securities is from an underwriter, broker or dealer participating in the offering.

**We request comment on whether there should be an exemption allowing a dealer-restricted person to cover short sales entered into during the restricted period and, if so, whether any conditions, such as those in Reg M, would be appropriate.**

**Authority for the proposed rule**

Paragraph 143(1)13 of the Act authorizes the Commission to make rules regulating the trading or advising in securities to prevent trading or advising that is fraudulent, manipulative, deceptive or unfairly detrimental to investors.

Paragraph 143(1)18 authorizes the Commission to make rules designating activities, including the use of documents or advertising, in which registrants or issuers are permitted to engage or are prohibited from engaging in in connection with distributions.

Paragraph 143(1)53 authorizes the Commission to make rules providing for exemptions from or varying the requirements of section 62, 65 or 71 of the Securities Act.

**Alternatives considered**

Three alternatives were considered. The first alternative was to rescind paragraph 26 of Policy 5.1 and Policy 62-601 and not replace them with any instrument. The second alternative was to reformulate paragraph 26 of Policy 5.1 and Policy 62-601 as a policy with necessary revisions to ensure that no provisions of a legislative nature were included. The third alternative was to reformulate paragraph 26 of Policy 5.1 and Policy 62-601 as a rule. The first alternative was rejected as it would leave the Commission with inadequate means to regulate market stabilization and other trading activities during distributions and other transactions. Proposed additions to the Act (which have received Royal Assent but are not yet in force) will prohibit activities which are fraudulent or intended to manipulate the market. The proposed rule provides clarification of those activities that are acceptable and those that are not and creates exemptions to permit certain activities, such as market stabilization, to take place. The second alternative was rejected as the most important elements of paragraph 26 of Policy 5.1 and Policy 62-601 are legislative in nature and accordingly the reformulation of those provisions into a policy would result in a much less effective instrument for regulating trading activities. As a result, the Commission has concluded that the third alternative of adopting the proposed rule is the best alternative.

**Anticipated costs and benefits**

At the time that paragraph 26 of Policy 5.1 was first introduced, the Commission noted that the paragraph was:

“...intended to ensure that the secondary market for [distributed] securities is, during the distribution period, an independent pricing mechanism free from influence on the price of the security being distributed that may result from bids or purchases of such security (or related securities) by persons participating in the distribution and other persons who have a financial or other stake in the distribution.”

The proposed rule will ensure that those benefits continue.

## Request for Comments

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The proposed rule will not impose any material costs on participants in a distribution that are not already imposed on them as a result of paragraph 26 of Policy 5.1. Those costs are substantially in the form of costs imposed on issuers, selling security holders and dealers of ensuring compliance with the substantive requirements. We are of the view that the benefits to investors of the proposed rule substantially outweigh any indirect costs that may result from compliance costs incurred by participants.

### Proposed Rescission of Policies

The Commission proposes to rescind paragraph 26 of Policy 5.1 and Policy 62-601. The policies are being rescinded as the subject matter of the policies is covered by the proposed rule.

### Comments

You are asked to provide your comments in writing and to send them on or before November 27, 2003 to:

John Stevenson, Secretary to the Commission  
Ontario Securities Commission  
20 Queen Street West  
Suite 800, Box 55  
Toronto, Ontario  
M5H 3S8

We request that you submit a diskette containing your submission. As the Act requires that a summary of written comments received during the comment period be published, confidentiality of submissions cannot be maintained.

If you have questions, you may contact:

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### Text of the Proposed Rule

The text of the proposed rule follows. Also included is a chart comparing the proposed rule with the proposed amendments to the Universal Market Integrity Rules.