

# **POLICY STATEMENT**

## **TO REGULATION 33-105**

### **RESPECTING UNDERWRITING CONFLICTS**

#### **PART 1**

#### **INTRODUCTION**

##### **1.1 Purpose**

The purpose of this Policy Statement is to state the views of the Canadian Securities Administrators ("CSA") on various matters relating to Regulation 33-105 respecting Underwriting Conflicts (the "Regulation"), and to provide market participants with guidance in understanding the operation of the Regulation and the policy concerns that lie behind some of the provisions of the Regulation. This Policy Statement includes, as Appendix A, a series of flow charts designed to illustrate the analysis required to be made in determining whether a party falls under certain of the defined terms of the Regulation and whether the requirements of the Regulation apply to a given distribution. The flow charts are for illustrative purposes only and, in all cases, reference should be made to the precise language of the Regulation.

##### **1.2 General Policy Rationale for the Regulation**

- (1) Two of the basic objectives of securities legislation are to ensure that investors purchasing securities in the course of a distribution purchase those securities at a price determined through a process unaffected by conflicts of interest, and receive full, true and plain disclosure of all material facts regarding the issuer and the securities offered. The Regulation is based upon the premise that those objectives are best achieved if the issuer and the underwriters deal with each other as independent parties, free of any relationship that might negatively affect the performance of their respective roles.
- (2) The Regulation seeks to protect the integrity of the underwriting process in circumstances in which there is a direct or indirect relationship between the issuer or selling securityholder and the underwriter that might give rise to a perception that they are not independent of each other in connection with a distribution. The Regulation imposes two basic requirements in those circumstances. First, full disclosure of the relationships giving rise to the potential conflict of interest is required to be given to investors, and second, an independent underwriter is required in certain circumstances to participate in the transaction.

#### **PART 2**

#### **GENERAL STRUCTURE OF THE REGULATION**

##### **2.1 Relationships of Concern**

- (1) The Regulation identifies three types of relationships between a specified firm registrant acting as underwriter on a distribution and the issuer or selling securityholder of securities in the distribution that give rise to concerns over conflicts of interest; each of these relationships may be subject to the requirements of the Regulation.
  - (a) The specified firm registrant as issuer or selling securityholder. This relationship represents the

relationship with the highest degree of conflict of the three recognized by the Regulation.

- (b) An issuer or selling securityholder that is a "related issuer" of the specified firm registrant. This relationship is created primarily as the result of cross-ownership between an issuer or selling securityholder and the specified firm registrant. Subsection 1.2(2) of the Regulation provides that an entity is a related issuer to another entity if one of them is an "influential securityholder" of the other, or each of them is a related issuer of the same third party.
  - (c) An issuer or selling securityholder that is not a related issuer of the specified firm registrant, but that has some other relationship with the specified firm registrant that would cause a reasonable prospective purchaser of the securities being offered to question if the specified firm registrant and the issuer or selling securityholder are independent of each other for the distribution. This type of issuer is a "connected issuer" of the relevant specified firm registrant.
- (2) The Regulation recognizes the relative degrees of relationships and the resulting potential for conflict by imposing additional requirements for distributions by registrants and their related issuers than for distributions by connected issuers.
  - (3) The term "independent underwriter" is defined in the Regulation to mean a specified firm registrant acting as direct underwriter in a distribution if the specified firm registrant does not have one of the relationships with the issuer or selling securityholder described in this section. The term "non-independent underwriter" is used in this Policy Statement to describe a specified firm registrant acting as direct underwriter that does have one of those relationships.

## **2.2 General Requirements of the Regulation**

The general requirements of the Regulation, contained in section 2.1, provide, in effect, that a specified firm registrant that would be a non-independent underwriter on a distribution may not act as a direct underwriter in the distribution, unless two requirements are satisfied or an exemption is available. The two requirements are the disclosure obligation, required by subsection 2.1(1) of the Regulation and discussed in section 2.3 of this Policy Statement, and the independent underwriter obligation, required by the combination of subsections 2.1(2) and (3) of the Regulation and discussed in section 2.4 of this Policy Statement. An exemption from the independent underwriter obligation is contained in section 3.2 of the Regulation and discussed in Part 3 of this Policy Statement.

## **2.3 Disclosure Obligation**

- (1) The disclosure obligation applicable to a distribution in which a non-independent underwriter participates, contained in subsection 2.1(1) of the Regulation, requires that the distribution be made under a prospectus or other document that contains the information described in Appendix C of the Regulation. This requirement is applicable both to transactions made under a prospectus and to those done by way of a private placement without a prospectus. Appendix C is designed to require full disclosure of the relationship between the underwriter and issuer or selling securityholder.
- (2) Market participants are reminded that section 10.1 of National Instrument 71-101, The Multijurisdictional Disclosure System exempts distributions under that National Instrument from the disclosure requirements of the Regulation.

## **2.4 Requirement for Independent Underwriter Involvement**

- (1) Subsection 2.1(2) of the Regulation provides that, in the case of a distribution of special warrants or a distribution made under a prospectus, a specified firm registrant may not act
  - (a) as an underwriter if the specified firm registrant is the issuer or selling securityholder in the

distribution; or

(b) as a direct underwriter if a related issuer of the specified firm registrant is the issuer or selling securityholder in the distribution.

(2) Subsection 2.1(3) of the Regulation provides that subsection 2.1(2) of the Regulation does not apply to a distribution otherwise caught by that subsection if there is an independent underwriter and if certain disclosure is made in a disclosure document or prospectus. The requirement for independent underwriter involvement is satisfied if at least one independent underwriter participates in the offering to the extent specified in subsection 2.1(3). Subsection 2.1(3) provides alternate threshold criteria for such involvement, depending upon whether the distribution is a "firm commitment" underwriting or a "best efforts agency" offering.

In the case of a firm commitment underwriting, an independent underwriter is required to underwrite not less than the lesser of

(a) 20 % of the dollar value of the distribution, and

(b) the largest portion of the distribution underwritten by a specified firm registrant that is not an independent underwriter.

In the case of a best efforts agency offering, an independent underwriter must receive a portion of the total agents' fees equal to an amount not less than the lesser of

(a) 20 % of the total agents' fees for the distribution, and

(b) the largest portion of the agents' fees paid or payable to a specified firm registrant that is not an independent underwriter.

(3) Subsection 2.1(3) of the Regulation requires the relevant disclosure document to disclose what role the independent underwriter played in the structuring, pricing and due diligence activities of the distribution. The Regulation does not specify what functions the independent underwriter must fulfil, because it is recognized that the appropriate role will vary according to the nature of the distribution and the issuer or selling securityholder, and because it is expected that the requirement to disclose the role actually played will impose a measure of market discipline on the process. Subsection 2.1(3) of the Regulation also requires the name of the independent underwriter to be disclosed.

(4) Section 2.2 of the Regulation sets out the rules for calculating the size of a distribution and the requirements for independent underwriter involvement. These rules deal with issues that may arise when distributions occur in more than one jurisdiction, or only partly in Canada.

(5) Market participants are directed to Regulation 44-102 respecting Shelf Distributions for applicable provisions on how the requirements of the Regulation are satisfied for shelf distributions.

## **PART 3**

### **EXEMPTION FROM INDEPENDENT UNDERWRITER REQUIREMENT**

#### **3.1 Exemption from Independent Underwriter Requirement**

Section 3.2 of the Regulation provides an exemption from the independent underwriter requirement for distributions of securities of a foreign issuer if more than 85 % of the dollar value of the distribution is effected outside of Canada or if more than 85 % of the agents' fees relating to the distribution are paid or payable outside

of Canada. This exemption is expected to be primarily used in the context of international offerings of major issuers.

## **PART 4**

### **COMMENTARY ON RELATIONSHIPS DESCRIBED IN THE REGULATION**

#### **4.1 Related Issuers**

- (1) Common ownership is the traditional measure of a non-arm's length relationship in which a conflict of interest is seen to arise. The definition of "related issuer", together with the definitions of "influential securityholder" and "professional group", contain the test used in the Regulation for these non-arm's length relationships.
- (2) The Regulation provides that two persons are related issuers of each other if one of them is an influential securityholder of the other, or if each of them are related issuers to a third person.
- (3) The term "influential securityholder" is defined to include relationships between an issuer and another person or, in some cases, a professional group, that involve specified thresholds of share ownership or rights to elect directors, as summarized in subsection (4).
- (4) Briefly stated, a person or professional group ("A") is an influential securityholder of an issuer ("I") under the definition of "influential securityholder" in the following circumstances.
  - (a) A owns or controls 20 % of the voting or equity securities of I (paragraph (a) of the definition), or controls or is a general partner of the issuer, if the issuer is either a general partnership or a limited partnership.
  - (b) A owns or controls 10 % of the voting or equity securities of I and either
    - (i) A is entitled to nominate 20 % of the directors of I or has officers, directors or shareholders that constitute 20 % of the directors of I; or
    - (ii) I is entitled to nominate 20 % of the directors of A or has officers, directors or shareholders that constitute 20 % of the directors of A (paragraph (b) of the definition).
  - (c) I owns or controls 10 % of the voting or equity securities of A (other than a professional group) and either
    - (i) A is entitled to nominate 20 % of the directors of I or has officers, directors or shareholders that constitute 20 % of the directors of I; or
    - (ii) I is entitled to nominate 20 % of the directors of A or has officers, directors or shareholders that constitute 20 % of the directors of A (paragraph (c) of the definition).

Paragraph (c) of the definition contains no reference to professional groups in recognition of the fact that it is not possible to hold a voting or equity interest in such an entity nor does such an entity have a board of directors.
  - (d) If a professional group is an influential securityholder of I within paragraphs (a) or (b) of the definition, then the specified firm registrant that is part of that professional group will also be an influential securityholder of I (paragraph (d) of the definition).

- (5) It is noted that under subsection 1.2(2) of the Regulation only a person can be a related issuer of another person; therefore, a professional group cannot be a related issuer of a person even if it is an influential securityholder of that person. Professional groups have been included in the definition of "influential securityholder" in order to allow paragraph (d) of the definition of "influential securityholder" to operate; this ensures that the specified firm registrant that is part of a professional group that is an influential securityholder of a person is itself an influential securityholder, and therefore a related issuer, of that person.
- (6) The CSA note the following matters relating to the "influential securityholder" tests:
- (a) The definition of "influential securityholder" requires an aggregation of all securities held, directly or indirectly beneficially owned and ones over which the holder has the right to direct the voting.
  - (b) Paragraphs 1.2(2)(a) and (b) provide that A is a related issuer of B if A is an influential securityholder of B or if B is an influential securityholder of A. Paragraph 1.2(2)(c) of the Regulation ties together all related issuers by providing that two persons that are related issuers of a third person are related issuers of each other. The following examples illustrate the operation of paragraph 1.2(2)(c).
    - (i) If A is an influential securityholder of B, meaning that A is a related issuer of B under paragraph 1.2(2)(a), and B is an influential securityholder of C, meaning that C is a related issuer of B under paragraph 1.2(2)(b), then A is a related issuer of C, since both A and C are related issuers of the same person, B.
    - (ii) If D is an influential securityholder of both E and F, meaning that D is a related issuer of both E and F, then E and F are related issuers of each other.
  - (c) There is no provision in the Regulation for "diluting" indirect ownership interests in making calculations. Therefore, if A owns 45 % of the voting shares of B that in turn owns 22 % of the voting shares of C, all three of A, B, and C are related issuers of each other.
  - (d) The operation of paragraph 1.2(1)(a) of the Regulation requires, in effect, the calculation of a person's percentage ownership in another person to be done twice; first, only the outstanding voting or equity securities held would be counted, and, second, if the 10 % or 20 % ownership level is not reached, the calculation should be repeated on a fully diluted basis, assuming all convertible or exchangeable securities of the relevant class issued and outstanding were converted or exchanged.

## 4.2 Connected Issuers

- (1) One relationship described in section 2.1 of this Policy Statement as being of concern in connection with conflict matters is that of an issuer that is a connected issuer, but not a related issuer, to a specified firm registrant in a distribution. This relationship historically has led to some difficulties of interpretation under analogous provisions of securities legislation. The definition of "connected issuer" in the Regulation provides that the test for whether an issuer/selling securityholder and specified firm registrant are "connected" is whether the relationship between the issuer or selling securityholder (or their related issuers) and a specified firm registrant (or its related issuers) would lead a reasonable prospective purchaser of the securities to question the independence of such parties for purposes of the distribution.
- (2) The test contained in the definition requires that the question of independence, or lack of independence, of a specified firm registrant be determined with reference to the activities of concern in a distribution and from the viewpoint of a reasonable prospective purchaser. The key issues in making that assessment are
  - (a) whether the investor would perceive that the relationship would interfere with the ability or inclination

of the specified firm registrant to do proper due diligence, or to ensure complete disclosure of all material facts related to the issuer or affect the price placed on the securities being distributed; and

- (b) whether the investor would perceive that the relationship would make the issuer or selling securityholder more subject to influence in the disclosure, due diligence or pricing process from the underwriter or its related issuer.

In either case, would the result be that some party's interests are perceived to be favoured to the detriment of those of investors?

- (3) As in the case of related issuers, a relationship of concern may arise directly between the issuer or selling securityholder and the specified firm registrant or indirectly through one or more related issuers of either the issuer or selling securityholder or the specified firm registrant or any of them.

### 4.3 Issues Relating to "Connected Issuer" Relationships

- (1) The definition of "connected issuer" is designed to catch relationships of concern between the issuer/selling securityholder and the specified firm registrant that are not related issuer relationships. For example, if a significant shareholder of the specified firm registrant is the chairman of the board of directors of the issuer and another related issuer of the specified firm registrant owns a large number of preferred shares that are to be repaid out of the proceeds of a distribution, the issuer may be a connected issuer of the specified firm registrant for the purposes of the distribution. In each case, the issuer, specified firm registrant and their advisers will have to weigh the totality of the relationships between the issuer and the specified firm registrant against whether a prospective purchaser might question the independence of the issuer and dealer to determine if there is a connected issuer relationship.
- (2) The mere existence of a debtor/creditor relationship between the issuer and the specified firm registrant, or any of their respective related issuers, does not necessarily give rise to a connected issuer relationship. The test is whether in the circumstances the relationships among the parties might, in the view of a reasonable prospective purchaser, affect their independence from one another. Factors that may be relevant in reaching the conclusion in cases in which the relationship is debtor/creditor may include the size of the debt, the materiality of the amount of the debt to both the creditor and debtor, the terms of the debt, whether the lending arrangement is in good standing, and whether the proceeds of the issue are being used for repayment of the debt.
- (3) Preference shares are not presently treated by Canadian GAAP as liabilities on the balance sheet of issuers, although they may be held by investors as an alternative to making loans or holding securities more conventionally thought of as debt. If there is cross-ownership of a material number of preference shares, there may be a relationship of concern between the issuer or selling securityholder and the specified firm registrant. Factors to be considered include the terms of the preference shares (whether the shares are term preferred shares, redeemable at the option of the holder, or represent relatively permanent capital of the issuer or selling securityholder) and the materiality of the shareholding to the issuer or selling securityholder or to the preference shareholder.
- (4) Most relationships of concern are likely to arise through debtor/creditor relationships or cross-ownership. However, in some circumstances there may be other relationships between the issuer or selling securityholder and the underwriter that raise concerns. These other business relationships would have to be material to the issuer, selling securityholder, underwriter or one or more of their related entities and give rise to some special interest in the continued viability of the other entity or the success of the distribution over and above that of other entities with a similar relationship with that company. The following relationships, among others, could be material in this context.

- (a) A relationship in which an issuer was a joint venture partner with a person that owed money to a

related party of a specified firm registrant could raise conflict issues. In circumstances in which the joint venture party needed funds to be able to satisfy its obligations to the related party of the specified firm registrant, and those funds would be provided by the issuer following a distribution, there is the possibility that the specified firm registrant might be motivated in an underwriting for the issuer by interests other than those of an independent underwriter.

- (b) A relationship in which an issuer's supplier was a related party of a specified firm registrant could also raise conflict issues, particularly if the financial condition of the issuer could put the supply arrangements in jeopardy. The specified firm registrant could be motivated to act inappropriately in raising equity for the issuer.
- (c) Franchise relationships could also raise conflict issues. An issuer that is a franchisor might need to raise funds to support its franchisees or to keep the entire franchise arrangement in place. If the specified firm registrant was a related party of creditors of the franchisees that were dependent upon a successful offering to raise such funds, the independence of the specified firm registrant might be compromised.

## **PART 5 CONTROL MEASURES**

### **5.1 Control Measures**

The CSA encourage registrants to adopt written internal control measures to ensure that, in connection with the distribution of securities of a "related issuer" or a "connected issuer", they deal with the issuer as an independent party, as if acting at arm's length. Although this recommendation is not intended to be prescriptive, registrants should note that they may be asked, in the normal course of inspections, whether such control measures have been adopted and a copy thereof may be requested in the course of such inspections.

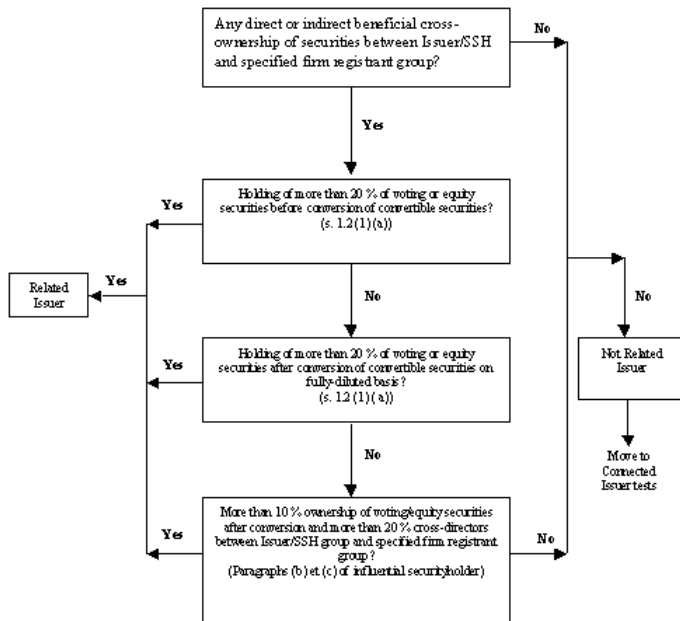
## **PART 6 APPENDICES**

### **6.1 Appendices**

To illustrate the analysis required to be made in determining the application of the Regulation to a distribution, Appendices A-1, A-2, A-3 and A-4 have been included in this Policy Statement. Appendices A-1 and A-2 assist in determining whether parties are related issuers. Appendix A-3 assists in determining whether parties are connected issuers to registrants. Appendix A-4 provides a general analysis of whether, or how, the Regulation applies to a given distribution.

## **APPENDIX A-1 RELATED ISSUER**

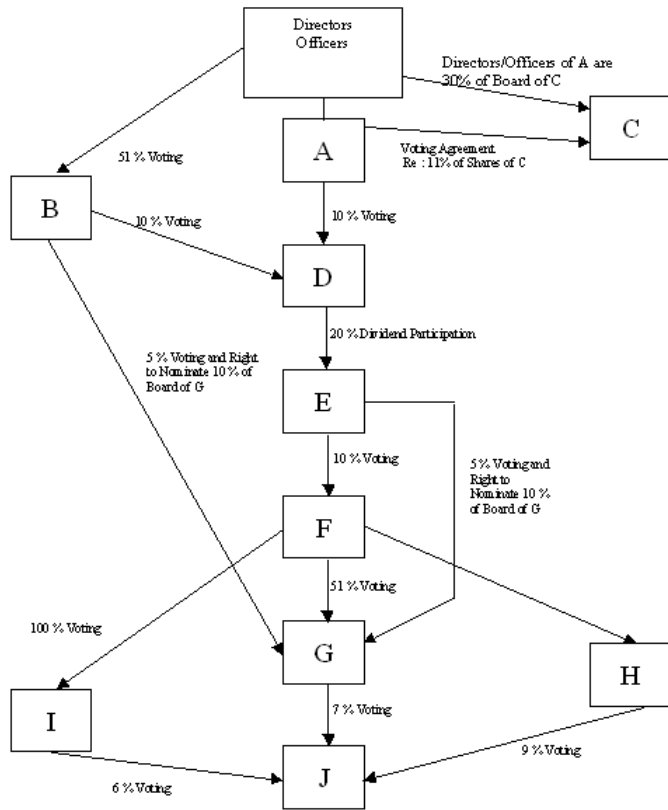
Relevant provisions: s.1.1: "influential securityholder" & s.1.2(1), (2)



## APPENDIX A-2 RELATED ISSUER - INFLUENTIAL SECURITYHOLDER

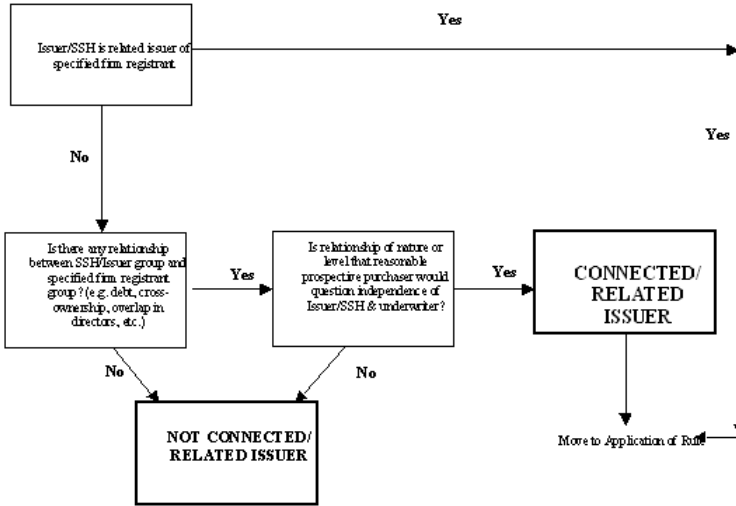
All of A-J are Related Issuers of Each Other  
Relevant provisions: s.1.1: "influential securityholder" & s.1.2(1), (2)



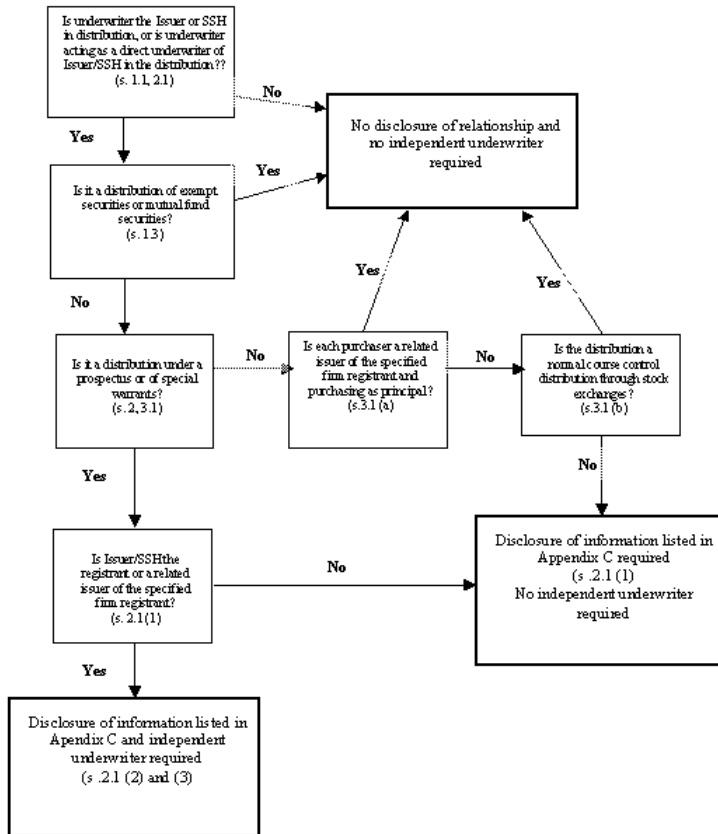


### APPENDIX A-3 CONNECTED/RELATED ISSUER

Relevant provisions: s.1.1: "connected issuer"



## APPENDIX A-4 APPLICATION OF RULE



Décision 2005-PDG-0274 -- 24 août 2005  
 Bulletin de l'Autorité : 2005-08-26, Vol. 2 n° 34

**Amendments**

Decision 2009-PDG-0127 -- September 4, 2009  
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