

**NOTICE****REQUEST FOR COMMENT:****PROPOSED AMENDMENTS TO  
NATIONAL POLICY 41-201 INCOME TRUSTS AND OTHER INDIRECT OFFERINGS**

This notice accompanies proposed amendments to National Policy 41-201 (the Policy), which we are publishing for a 60-day comment period. We invite comment on the proposed amendments to the Policy.

The Federal Department of Finance has recently announced proposals that would significantly change the tax treatment of income trusts and other indirect offering structures. We continue to monitor this development and will continue to consider the impact of these changes on income trusts and other indirect offering structures. Issuers should consider how these changes will impact them and clearly communicate the expected impact to their unitholders.

**Introduction**

All members of the Canadian Securities Administrators (the CSA or we) originally adopted the Policy in December 2004. Since then many issuers have made income trust offerings in Canada including a number of corporate issuers converting into income trusts. We are proposing amendments to the Policy that would provide additional clarification and guidance on our views about issues relating to income trusts and other indirect offerings.

**Summary and Discussion of the Proposed Amendments**

We have reorganized the Policy to more clearly group our expectations for the areas of distributable cash, prospectus offerings and continuous disclosure. The following discussion summarizes the key changes to the Policy.

**Part 2 – Distributable cash**

Part 2 now focuses the guidance specifically on distributable cash. Guidance regarding other disclosure issues and prospectus disclosure is now in Parts 3 and 4, respectively. Part 2 now includes guidance regarding distributable cash previously published in CSA Staff Notice 52-306 – *Non-GAAP Financial Measures* (Staff Notice 52-306) and CSA Staff Notice 41-304 – *Income Trusts: Prospectus Disclosure of Distributable Cash* as well as other additional guidance about distributable cash disclosure.

**(i) Section 2.1. What is distributable cash?**

As the term ‘distributable cash’ does not have a standardized meaning, we are concerned that issuers may take the view that, if they simply avoid using this specific term, the guidance regarding distributable cash in the Policy does not apply to their disclosure. We have clarified this issue by indicating that we intend the guidance regarding distributable cash contained in the Policy to apply to all disclosure about cash available for distribution, regardless of the terminology used.

**(ii) Section 2.6 What are our expectations about the format of the distributable cash reconciliation?**

We have provided more guidance about the presentation of distributable cash reconciliations that builds on the guidelines previously communicated in Staff Notice 52-306. We believe that these proposed presentation guidelines will improve transparency and will allow investors to more easily compare distributable cash reconciliations among income trusts. We also believe that the proposed disclosure will highlight adjustments that are of a more discretionary nature and that this information is useful to investors in analyzing the anticipated distributable cash amounts, particularly the sustainability of such amounts.

We also recommend that issuers refrain from including financial measures such as EBITDA, Adjusted EBITDA and Pro Forma Net Income in the distributable cash reconciliation. The guidelines also suggest some ways issuers can prepare their disclosure so that it is more easily compared to other income trusts. For example, issuers can group the line items that appear in their distributable cash reconciliations under one of four headings (A. Cash flows from operating activities, B. Non-recurring adjustments, C. Maintenance of productive capacity and D. Other adjustments including discretionary items).

**Part 3 – Other disclosure issues**

We have made a number of minor clarifying amendments to this part. For example, the amendments clarify that, when considering the guidance, issuers should consider how it applies to a range of documents they prepare, including continuous disclosure documents such as Annual Information Forms and Information Circulars.

To improve the organization and usability of the Policy, we relocated guidance about i) what continuous disclosure we expect about operating entities, ii) comparative financial information, iii) recognition of intangible assets and iv) insider reporting to Part 6 – *Continuous disclosure-specific issues*.

**(i) Section 3.7 What disclosure do we expect about an income trust's stability rating?**

We understand that some rating agencies are assigning stability ratings to income trusts on an unsolicited basis. These ratings are not based on discussions with the income trust but, rather, on publicly available information. We have amended this section to clarify that the guidance would not apply to unsolicited stability ratings.

**Part 4 – Offering-specific issues**

This part contains guidance about determining the offering price of an issuer's units, prospectus liability (including promoter liability) and disclosure of vendor accountability in offering documents. While the guidance in this part is substantially unchanged from the original policy, there are proposed changes to the prospectus regime that may impact the liability of promoters and vendors in prospectus offerings by income trusts and other indirect offerings.

The rules regarding prospectus offerings are currently being substantially amended. Among the proposed amendments are provisions indicating who is required to sign the income trust's prospectus certificate page. These proposed amendments will require the chief executive officer and the chief financial officer of the business of the issuer, together with any two trustees of the issuer (on behalf of the trustees of the issuer), to sign the prospectus certificate page of an income trust.

The proposed prospectus amendments in most jurisdictions will also include a prospectus certification requirement for parties classified as 'substantial beneficiaries of the offering'. As currently proposed, this prospectus certification requirement would generally apply to vendors in income trust prospectus offerings.

The proposed changes to the prospectus regime also require operating entities to certify information contained in an offering document where the issuer does not consolidate financial information concerning the operating entity in its financial statements, and is required, or has undertaken, to file or otherwise provide to its security holders separate financial statements of the operating entity.

**Part 5 – Sales and marketing materials**

**(i) Section 5.1 What are our concerns about sales and marketing materials?**

We are concerned that issuers may be communicating yield expectations to investors without subsequently disclosing a comparison of these figures to actual results. In connection with their ongoing approach to disclosure, issuers should carefully consider yield expectations previously communicated to investors through sales and marketing materials or otherwise. Whether and to what extent an issuer meets those yield expectations are important aspects of overall disclosure of performance. Issuers should include in their interim and annual MD&A a comparison between the expected yield figure previously disclosed and the actual yield.

**(ii) Section 5.2 What information do we expect the green sheets to contain?**

We are proposing amendments to the disclosure surrounding the presentation of distributable cash figures which we believe should accompany all disclosures of distributable cash. This means that simply disclosing a distributable cash amount, in a green sheet, press release or other disclosure document, without the appropriate additional disclosure, would not conform to the guidance in the Policy.

**Part 6 - Continuous disclosure-specific issues**

This part contains much of the guidance from the original policy regarding continuous disclosure matters.

**(i) Section 6.1 What continuous disclosure do we expect about the operating entity?**

We describe in the Policy the undertakings filed by the issuer to provide unitholders with comprehensive information about the operating entity on an ongoing basis. The amendments regarding undertakings clarify that the financial statements of the operating entity are to be prepared in accordance with the same generally accepted accounting principles as are used by the issuer and accompanied by management's discussion and analysis prepared by the operating entity in accordance with Form 51-102F1. We have added specific wording with our proposed amendments to clarify our existing expectations in this regard.

These undertakings are most commonly provided in connection with an income trust's initial public offering. We have clarified that issuers should provide these undertakings in connection with any direct or indirect acquisition by an issuer of an interest in an operating entity. We also added similar clarification in connection with the undertaking relating to insiders and insider reporting obligations in section 6.4 of the Policy.

**(ii) Section 6.2 Comparative financial information**

This section of the Policy provided guidance on the financial statement and MD&A disclosure we expected in the income trust's first year after becoming a reporting issuer but did not focus on interim reporting. We have found that income trusts often became reporting issuers on a date within a given interim period. Our proposed amendments now clarify the relevant MD&A disclosure that income trusts should provide about the trust and the predecessor business in its first interim MD&A.

**(iii) Section 6.3 Recognition of intangible assets**

This section now includes a discussion about the GAAP requirements to recognize all intangible assets acquired in a business combination and describe in any offering document the method used to value the intangible assets.

#### **(iv) Section 6.5 MD&A**

##### **(a) Subsection 6.5.1 Risks and uncertainties**

We have observed that disclosure regarding the provisions for the replacement and maintenance of capital assets is often inadequate in the income trust context. We have expanded on the guidance in the original policy about disclosure of risks and uncertainties and to indicate that issuers should provide a detailed risk factor discussion about the potential commitment to replace and maintain capital assets.

##### **(b) Subsection 6.5.2 Discussion of distributed cash**

In order to assess the sustainability of distributions, unitholders need information about the source(s) of the distributed cash that they receive. Whether the issuer borrowed amounts to finance distributions, and whether distributions include amounts that are not properly classified as a return on investment, is information that assists the investor in making assessments of the health of the business. An issuer that is distributing cash in excess of its cash flows from operating activities may be making distributions at the expense of its productive capacity and sustainability of future distributions.

This subsection includes guidance on how existing MD&A disclosure requirements can be met to address these concerns. We include an example and related disclosure guidance that provides transparency about the relationship between historical distributions and cash flows from operating activities and net income (loss).

#### **Part 7 Corporate governance**

We clarified some provisions of this part relating to the disclosure of differences between corporate law protections and those provided by an issuer's declaration of trust. We note that the Uniform Law Conference of Canada has undertaken a project to consider whether legislation governing income trusts should be developed and has released a draft Uniform Income Trusts Act. We also note the project undertaken by the Canadian Coalition for Good Governance to consider governance issues for income trusts. We will continue to monitor these projects and consider any findings and recommendations that come from them.

#### **Other Issues**

We added another part to the Policy to address more miscellaneous matters.

i) We remind issuers that they should exercise caution when selecting a name to ensure that it does not inadvertently suggest that the issuer is an investment fund or mutual fund.

ii) The Canadian Performance Reporting Board (CPRB) of the Canadian Institute of Chartered Accountants also published for comment a draft interpretive release providing guidance on reporting distributable cash in MD&A by income trusts and other flow-through entities. Many aspects of the CPRB proposal are consistent with the guidance contained in this Policy, as amended.

The primary difference between the CPRB's and the CSA's approach is that, under the CPRB approach, allowable adjustments to cash flow from operating activities are specifically defined whereas the CSA approach is more disclosure based. Existing CSA guidance as well as our proposed amendments to NP 41-201 permit issuers more discretion in determining acceptable adjustments in the calculation of distributable cash. One specific difference in these approaches relates to adjustments for the maintenance of productive capacity. The CPRB guidance limits these adjustments to cash outflows that are capitalized under GAAP. Our guidance contemplates that issuers would assess their current and future cash needs in determining the appropriate amount to include in the determination of distributable cash for the maintenance of productive capacity. However, like the CPRB proposal, both approaches require detailed explanations behind all adjustments made. We look forward to discussing with the CPRB the comments that they receive on their distributable cash guidance.

#### **Reliance on Unpublished Studies, Etc.**

In developing the Policy, we did not rely on any significant unpublished study, report, decision or other written materials.

#### **Comments**

Please provide your comments by March 6, 2007 by addressing your submission to the securities regulatory authorities listed below. **We will not consider comments received after March 6, 2007.**

Address submissions to the following securities regulatory authorities:

Ontario Securities Commission  
Alberta Securities Commission  
British Columbia Securities Commission  
Autorité des marchés financiers  
Saskatchewan Financial Services Commission  
The Manitoba Securities Commission  
Nova Scotia Securities Commission

You do not need to deliver your comments to all of the CSA member commissions. Please deliver your comments to the following, and they will be distributed to all other jurisdictions by CSA staff.

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If you are not sending your comments by e-mail, please send a diskette containing your comments (in DOS or Windows format, preferably Word).

We cannot keep submissions confidential because securities legislation in certain provinces requires that a summary of the written comments received during the comment period be published.

Please refer your questions to any of:

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**January 5, 2007.**