

## Multilateral CSA Staff Notice 45-321

### *Frequently asked Questions about the Investment Dealer Prospectus Exemption*

September 8, 2016

#### Introduction

The purpose of this notice is to answer some of the frequently asked questions (FAQs) on the prospectus exemption (the **investment dealer exemption** or **exemption**) adopted by the securities regulatory authorities in British Columbia, Alberta, Saskatchewan, Manitoba and New Brunswick (the **participating jurisdictions**) on January 14, 2016. Subject to certain conditions, the investment dealer exemption allows issuers listed on a Canadian exchange to raise money by distributing securities to investors who have obtained advice about the suitability of the investment from an investment dealer.

The participating jurisdictions adopted the exemption by way of

- BC Instrument 45-536 *Exemption from prospectus requirement for certain distributions through an investment dealer* in British Columbia;
- General Order 45-930 *Exemption from prospectus requirement for certain distributions through an investment dealer* in Saskatchewan;
- Blanket Order 45-503 *Exemption from prospectus requirement for certain distributions through an investment dealer* in Manitoba;
- Blanket Order 45-508 *Exemption from the Prospectus Requirement for Certain Distributions through an Investment Dealer* in New Brunswick; and
- Alberta Securities Commission Rule 45-516 *Prospectus Exemptions for Retail Investors and Existing Security Holders* in Alberta.

The list of FAQs below is not exhaustive, but it includes key issues and questions market participants have posed to us. Staff of the participating jurisdictions may update these FAQs from time to time as necessary.

#### Frequently asked questions

##### A. *Questions from issuers*

##### 1. **What is suitability advice?**

One of the key conditions of the investment dealer exemption is that the investor must have obtained advice regarding the suitability of the investment from a registered investment dealer. Under securities legislation, before a registered investment dealer accepts an order or recommends to a client the purchase, sale, exchange or holding of a security, it must ensure that the action is suitable for the client. To provide advice about the suitability of an investment, the investment dealer must comply with its know-your-client and know-your-product obligations under securities legislation.

The know-your-client obligation requires the dealer to accurately determine, among other things, the investor's

- current financial situation,
- investment knowledge,
- investment objectives and time horizon,
- risk tolerance, and
- investment portfolio composition and risk level.

The know-your-product obligation requires the dealer to understand the structure and features and assess the risks of the product.

A suitability determination entails ensuring that the product is suitable for the client using the results of the know-your-client and know-your-product processes.

## **2. Who can provide suitability advice?**

For the purposes of the exemption, only an investment dealer registered in the jurisdiction of the investor can provide suitability advice. For clarity, both the investment dealer firm and the individual investment representative must be registered in the jurisdiction.

The investment dealer providing the suitability advice does not need to be a dealer retained by the issuer to sell the securities.

A discount broker does not provide suitability advice and so is not an eligible investment dealer for the purposes of the exemption.

## **3. How can an issuer satisfy itself that an investor has received suitability advice?**

One of the key conditions of the exemption is that the investor has received suitability advice from a registered investment dealer. We have not prescribed how an issuer must satisfy itself that the investor has received the advice. Some of the different ways an issuer may be able to satisfy itself that this condition has been met are set out below.

- Have the investor represent in the subscription agreement that the investor received suitability advice. To satisfy its obligation, the issuer will want this representation to be informed and for it to be brought to the attention of, and confirmed by, the investor. A representation that the investor needs to initial or that is proximate to the signature block of the agreement is more likely to be noticed by the investor than one found in the middle of the subscription agreement.
- Ask the investor to specifically identify in the subscription agreement the name of the investment dealer that provided the suitability advice. If the issuer has concerns that the investor does not understand what suitability advice is or whether the investor received the advice from a registered investment dealer, the issuer would then be able to independently verify with the dealer.

- For brokered private placements, obtain a representation from the investment dealer that all investors have received suitability advice.

If an issuer has any reason to believe that an investor has not received suitability advice from an investment dealer, the issuer should not accept the subscription.

If an issuer wants to verify that an investment dealer is registered, they could check the CSA National Registration Search database ([www.securities-administrators.ca](http://www.securities-administrators.ca)). Alternatively, they could use IIROC's website ([www.iiroc.ca](http://www.iiroc.ca)) which lists all IIROC dealers or use IIROC's "AdvisorReport" to confirm specific registrations.

#### **4. Does the issuer need to conduct the offering on a brokered private placement basis?**

No. There is no requirement that an offering using this exemption be conducted on a brokered private placement basis.

In an offering conducted on a non-brokered private placement basis, an investment dealer may only be introducing a portion of the investors. The investment dealer providing the suitability advice must conduct the due diligence necessary to meet the know-your-client and know-your-product obligations.

#### **5. Is an offering document required?**

No offering document is required. However, if an issuer or dealer uses offering materials to sell the offering, the issuer must file the material on SEDAR under the document type "offering material" within the same SEDAR project number as the news release announcing the offering.

Offering material is defined in the exemption as being a document purporting to describe the business and affairs of an issuer that has been prepared primarily for delivery to and review by a prospective purchaser so as to assist the prospective purchaser to make an investment decision in respect of the securities.

The one exception to the filing requirement is a subscription agreement. Although a subscription agreement could be considered to be "offering material", we do not require it to be filed.

#### **6. Where can the issuer offer the securities?**

As the exemption is only available in British Columbia, Alberta, Saskatchewan, Manitoba and New Brunswick, the securities can only be offered in those jurisdictions. The issuer could sell the securities in other jurisdictions provided that another exemption from the prospectus requirement is available in those other jurisdictions.

## **7. What securities can be issued?**

An issuer can use the exemption to issue the following types of securities:

- a listed security,
- a unit consisting of a listed security and a warrant to acquire a listed security, and
- a security convertible into a listed security at the security holder's sole discretion.

For this purpose, a listed security means a class of equity securities of the issuer that is already listed on an exchange. For most issuers, this means their common shares.

An issuer would be able to use the exemption to issue convertible debentures if those debentures are convertible into a listed security at the security holder's sole discretion. If the convertible debentures can also be converted at the issuer's discretion, the issuer would not be able to use the exemption.

The exemption is not available to issue a security convertible into an unit comprised of a listed security and a warrant to acquire a listed security.

## **8. Is a risk acknowledgement form necessary?**

No. Investors are not required to sign a risk acknowledgement form.

In order for an issuer to use this exemption, the purchaser must have obtained suitability advice from an investment dealer. When determining suitability, the investment dealer has to consider the risks of the investment and determine whether it is suitable for the purchaser.

## **9. Are there any required filings?**

An issuer using the exemption must issue and file a news release that includes:

- reasonable detail of the proposed distribution and proposed use of gross proceeds including:
  - the minimum and maximum number of securities proposed to be distributed and the minimum and maximum aggregate gross proceeds of the distribution; and
  - a description of the principal purposes, with approximate amounts, for which the issuer will use the gross proceeds, assuming both the minimum and maximum offering;
- disclosure of any material fact about the issuer that has not been generally disclosed; and
- a statement that there is no material fact or material change about the issuer that has not been generally disclosed.

As described earlier, the issuer must file any offering material that it uses in connection with the offering.

The issuer must also file a report of exempt distribution within 10 days of the distribution of the securities. The required form of report is Form 45-106F1.

**10. The news release must include “reasonable detail” of the proposed use of gross proceeds. What does an issuer need to include to meet the requirement for “reasonable detail”?**

To meet the requirement for reasonable detail, an issuer will generally have to provide specific allocations for all of the principal uses of the gross proceeds. We would not generally consider an allocation to “general corporate purposes” to be sufficient.

**11. Can an issuer use the exemption concurrently with other exemptions?**

Yes. An issuer can use the exemption concurrently with other prospectus exemptions. For instance, we expect an issuer may want to use this exemption concurrently with other prospectus exemptions such as the accredited investor exemption or the existing security holder exemption if the issuer wants to sell to investors outside of British Columbia, Alberta, Saskatchewan, Manitoba and New Brunswick.

**B. *Questions from investment dealers***

**1. How much due diligence must an investment dealer conduct in order to provide suitability advice for purposes of the exemption?**

For this exemption, we do not expect the investment dealer to do anything other than what it is required to do under securities legislation when it makes a recommendation or accepts an order from a client for a trade.

Under securities legislation, an investment dealer must provide suitability advice every time it makes a recommendation to a client or accepts an order. In order to provide the suitability advice, the investment dealer needs to conduct its know-your-client and know-your-product procedures.

The know-your-client obligation requires the dealer to accurately determine, among other things, the investor’s

- current financial situation,
- investment knowledge,
- investment objectives and time horizon,
- risk tolerance, and
- investment portfolio composition and risk level.

The know-your-product obligation requires the dealer to understand the structure and features and assess the risks of the product.

A suitability determination entails ensuring that the product is suitable for the client using the results of the know-your-client and know-your-product processes.

The investment dealer also has an obligation to comply with all IIROC rules.

**2. Does the investment need to be “suitable” for an investor to participate?**

No. There is no requirement that the dealer give a positive recommendation that the investment is suitable for the client. The requirement is simply that the investment dealer provide the investor with advice about whether the investment is suitable.

**3. What does the investment dealer need to do to document the suitability advice when the advice is that the investment is not suitable for an investor?**

If the advice is that the investment is not suitable, the investment dealer must take appropriate measures to deal with the unsuitable investment. The dealer must, at a minimum, advise the client against proceeding with the investment. Appropriate measures may include providing the investor with cautionary advice and documenting the details of the cautionary advice, or recommending changes to other investments within the account. Dealers must maintain records to demonstrate the extent of their compliance with applicable securities legislation. This includes records that demonstrate compliance with the suitability obligation. Further information is available in IIROC Rule 1300.1 and in IIROC Notice 12-0109 (both are available at [www.iiroc.ca](http://www.iiroc.ca)).

If you have any questions about these FAQs or the exemption generally, please contact any of the following CSA staff:

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