ALBERTA SECURITIES COMMISSION
NOTICE

PUBLICATION FOR COMMENT
MULTILATERAL INSTRUMENT 33-105
UNDERWRITING CONFLICTS

On February 6, 1998, the Alberta Securities Commission (the "Commission") and other members of the Canadian Securities Administrators (the "CSA"), with the exception of the Commission des valeurs mobilières du Québec, published for comment proposed Multilateral Instrument 33-105 *Underwriting Conflicts* and related Companion Policy 33-105CP[1].

As a result of the comments received[2] and further discussion within the CSA, we[3] are proposing a number of amendments to the 1998 Drafts. These amendments are substantive and we are therefore publishing the revised Multilateral Instrument and Companion Policy for a second 60 day comment period that will conclude on August 22, 2001.

In this Notice, the versions of the proposed Multilateral Instrument and Companion Policy published in 1998 are called the "1998 Draft Instrument" and "1998 Draft Policy". The versions published with this Notice are called the "proposed Instrument" and "proposed Policy".

We expect that the proposed Instrument and proposed Policy will be implemented in Alberta, British Columbia, Saskatchewan, Manitoba, Ontario, Nova Scotia, New Brunswick, Prince Edward Island, Newfoundland, the Yukon Territory, the Northwest Territories and Nunavut. The proposed Instrument and proposed Policy will not be implemented in Québec.

Substance and Purpose of the Instrument

The proposed Instrument deals with distributions of securities where the relationship between the issuer or selling securityholder of securities and the registrant acting as underwriter may put the registrant in an actual or perceived position of conflict between its own interests or those of the issuer or selling securityholder, and those of investors. The proposed Instrument imposes disclosure requirements on

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[1] (1998) 7 ASCS 320.

[2] Comments were received from 3 commenters. See Appendix A to this Notice for a summary of the comments and the CSA responses.

[3] The securities regulatory authorities of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick, Nova Scotia, Newfoundland, Prince Edward Island, the Yukon Territory, the Northwest Territories, and Nunavut.

these transactions and, in some cases, requires that an independent underwriter participate in the distribution.

The purpose of the proposed Policy is to provide market participants with information on how we intend to interpret or apply the provisions of the proposed Instrument.

Summary of Changes to the Proposed Instrument from the 1998 Draft Instrument

The most significant differences between the proposed Instrument and the 1998 Draft Instrument include the following:

- The definition of related issuer has been extended to include partnerships and revised so that it is distinct from rather than expressed in relation to the concept of a "connected issuer".

- The independent underwriter requirement has been eliminated where the issuer or selling securityholder and the underwriter are connected.

- The definitions of "specified party" (an issuer in financial difficulty) and "minor debt relationship" have been deleted. This is a consequence of eliminating the independent underwriter requirement. The 1998 Instrument required an independent underwriter for connected issuers, but only where the issuer was a "specified party" and in a debt relationship with the underwriter that was not a "minor debt relationship". As a result of the elimination of the independent underwriter requirement for connected issuers in the proposed Instrument, these terms are now unnecessary.

- The application of the proposed Instrument, and the method of calculating the percentage of the transaction that an independent underwriter must distribute to transactions taking place in more than one jurisdiction in Canada or in both Canada and abroad, have been clarified.

- The proposed Instrument has been revised to make its intended application to special warrant distributions clear.

The proposed Policy reflects corresponding changes.

Request for Comments

You are invited to comment on MI 33-105 on or before August 22, 2001. Please send us two copies of your comments in the care of the Ontario Securities Commission and addressed as follows:

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
The Manitoba Securities Commission
Ontario Securities Commission
Office of the Administrator, New Brunswick
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Department of Government Services and Lands, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon
Registrar of Securities, Nunavut

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 800, Box 55
Toronto, Ontario M5H 3S8

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

Questions may be referred to any of:

Jane Brindle
Alberta Securities Commission
(403) 297-4482

Brenda Benham
British Columbia Securities Commission
(604) 899-6635
or 1-800-373-6393 (in B.C.)

Barbara Shourounis
Saskatchewan Securities Commission
(306) 787-5842

Tanis J. MacLaren
Ontario Securities Commission
(416) 593-8259

Text of Proposed Multilateral Instrument and Companion Policy

The text of the proposed Multilateral Instrument and Companion Policy follows, together with footnotes that are not part of the Multilateral Instrument or Companion Policy but have been included to provide background and explanation.

DATED: June 22, 2001

APPENDIX A

SUMMARY OF COMMENTS RECEIVED
ON
DRAFT MULTILATERAL INSTRUMENT 33-105
AND
DRAFT COMPANION POLICY 33-105CP
AND
RESPONSE OF THE CANADIAN SECURITIES ADMINISTRATORS

1. INTRODUCTION

On February 6, 1998, the Canadian Securities Administrators (the "CSA") published for comment proposed Multi-Jurisdictional Instrument 33-105 Underwriting Conflicts (now referred to as proposed Multilateral Instrument 33-105) and proposed Companion Policy 33-105CP.

In this Appendix, the versions of the proposed Multilateral Instrument and Companion Policy published in 1998 are called the "1998 Draft Instrument" and "1998 Draft Policy", respectively. The versions published with this Notice are called the "proposed Instrument" and "proposed Policy", respectively.

The CSA received submissions on the 1998 Draft Instrument and 1998 Draft Policy from three commenters, as follows:

1. Canadian Bar Association - Ontario (letter dated May 29, 1998);
2. BCE Inc. (letter dated May 15, 1998); and
3. Ladner Downs (letter dated August 4, 1998).

Copies of the comment letters may be viewed at the office of Micromedia, 20 Victoria Street, Toronto, Ontario (416) 312-5211 or (800) 387-2689; the office of the British Columbia Securities Commission, 12th Floor, 701 West Georgia Street, Vancouver, British Columbia (604) 899-6500; and the office of the Alberta Securities Commission, 10025 Jasper Avenue, Edmonton, Alberta (403) 427-5201.

The CSA have considered the comments received and thank all commenters for providing their comments. The 1998 Draft Instrument and 1998 Draft Policy have been amended to reflect a number of the comments and are being republished for further comment.

The following is a summary of the comments received, together with the CSA's responses and, where applicable, the proposed changes in response to the comments.

2. GENERAL COMMENTS

General

Each of the commenters commented favourably on the initiative of the CSA to reform the existing underwriting conflict rules. One commenter indicated that the 1998 materials represented an "improvement over the current regulatory regime by clarifying a number of ambiguities in the current regulatory framework". Another commenter stated that "the Proposal is a thoughtful and careful balancing by the CSA of the various factors that come into play when dealing with underwriting conflicts. The Proposal contains both a sound analysis of these factors, and helpful analytical tools to assist underwriters, issuers and their counsel in determining whether connected or related issuer relationships exist, and if so, what the appropriate response to such relationships is. We support the principles in the Proposal...." Finally, another commenter commended the CSA for proposing the adoption of a clearer conflict regime, although the commenter had concerns over the scope of the regime.

Harmonization

A commenter noted with disappointment that the proposed Instrument and Policy are not being proposed for adoption at this time by the CVMQ. The commenter also noted that, assuming Bill 187 is adopted, Quebec would take an approach with respect to conflicts that would be entirely different from the approach set out in the 1998 Draft Instrument and from the position that has been taken in the past by the CVMQ. The commenter stated that "obviously, this would not be consistent with the attempt of the CSA in recent years to harmonize securities regulations in Canada and would not, unfortunately, promote efficiency in Canada's capital markets".

CSA Response

The CSA are committed to harmonization across Canada wherever possible, while recognizing that on some occasions, regional concerns or issues prevent complete uniformity across Canada.

Need for an Independent Underwriter

A commenter stated that the 1998 Draft Instrument did not adequately recognize the practical realities involved in introducing independent underwriters into underwriting syndicates in cases where timing is critical. The commenter noted that in bought deals, the structuring and pricing of the distribution and related due diligence have often been settled or completed prior to the lead underwriter selecting an independent underwriter. The commenter questioned why an independent underwriter is required for any distribution and suggested that the requirement for an independent underwriter may give a false sense of security to potential investors. The commenter stated that "provided that adequate disclosure is made of potential underwriting conflicts, we question why investors should not be able to evaluate for

themselves, based on all of the information in the prospectus, whether to subscribe for the securities that are the subject of the distribution".

CSA Response

The CSA remain of the view that the presence of an independent underwriter in certain circumstances provides protection for investors from abuses arising from conflicts of interest that disclosure alone cannot provide. The CSA note, of course, that one of the functions of an independent underwriter is to provide some discipline in the process of preparing the disclosure document, thereby ensuring that the adequate disclosure is made of underwriting conflicts, and that the disclosure is otherwise complete and accurate.

However, following further consideration of the 1998 Draft Instrument, the CSA have amended the proposed Multilateral Instrument to eliminate the requirement for independent underwriter involvement for most distributions. Under the proposed Instrument, an independent underwriter will only be required for distributions of special warrants and distributions made under a prospectus, where the registrant is acting as a direct underwriter, and the issuer or selling securityholder in the distribution is a related issuer of the registrant. As with the 1998 Draft Instrument, the proposed Multilateral Instrument recognizes the relative degrees of concern, and the resulting potential for conflict, associated with distributions by i) registrants, ii) related issuers of registrants, and iii) connected issuers of registrants, and imposes additional requirements for distributions which fall in the first two of these categories. The CSA is satisfied that, in recognition of the lesser potential for actual or perceived conflict associated with connected issuer distributions, the requirement of full disclosure of potential underwriting conflicts is sufficient to address this concern.

Alternative Proposal

A commenter proposed an alternative conflicts regime to the one contemplated by the 1998 Draft Instrument. The commenter made this proposal out of a concern that the conflict regime contemplated by the 1998 Draft Instrument was excessively far-reaching and burdensome for some issuers. The commenter stated that a conflict regime should not "excessively and unjustly disrupt the distribution process carried out by financially healthy senior 'POP' issuers".

The following is an outline of the general problems that the commenter submitted were raised by the 1998 Draft Instrument, and the proposed alternative regime:

- The commenter submitted that several of the definitions in the 1998 Draft Instrument are too broad in scope. It was noted that the definition of "connected issuer" was based on the existence of a "relationship" between an issuer and its underwriters (and other related parties). The commenter stated that this definition is "much too broad"

and should be made more specific in order that it be less subjective and to reduce the potential for abuse.

- The commenter stated that the definitions of "related issuer" and "influential securityholder" contained in the 1998 Draft Instrument have far-reaching effects for a large corporate group. The commenter stated that, in the case of a distribution by it or any other company of the group that is a related issuer of it, the issuer of the securities would be required to verify whether any company of the group (i.e., in excess of 250 companies) has a relationship with an underwriter or a related issuer of an underwriter of the type contemplated by the 1998 Draft Instrument. The commenter stated that this was "unfeasible and totally unacceptable".

- The commenter submitted that a preferable approach would be to have the proposed Instrument focus only on relationships involving important related issuers of the issuer. The commenter proposed that, except in exceptional circumstances, the definition of a "related issuer" of an issuer be limited to a direct or indirect subsidiary (not an affiliate) representing at least 20 percent of the issuer's consolidated assets or revenues. The commenter indicated that the 20 percent threshold was the level associated with equity accounting.

- The commenter submitted that the holding by an underwriter or related entity of investment grade negotiable securities, such as commercial paper, debentures, notes and preferred shares, should not be considered in determining whether an issuer is a "related issuer" or a "connected issuer" of the underwriter. The commenter stated that because of the active secondary market for most of those securities, the holding of investment grade negotiable securities does not create a relationship between an issuer and another entity that is relevant to the conflicts concerns of the proposed Instrument.

- In addition, the commenter submitted that the holding of securities other than investment grade negotiable securities below certain thresholds by an underwriter or related entity should automatically be considered not to create a connected issuer relationship with an issuer. The commenter suggested the use of one or more of the following thresholds:

    - if the amount of indebtedness owed by an issuer to one or more underwriters or their related issuers does not exceed 10 percent of the issuer's consolidated equity;

    - if the distribution for which the determination is made is less than a certain minimal size, perhaps 10 percent of the issuer's consolidated equity or an amount equal to the issuer's annual dividend on its common and preferred shares; or

- if the percentage of the proceeds of the distribution to be used to repay debt owed to an affiliate of an underwriter was less than some specified amount, perhaps 10%.

CSA Response

Although the CSA have not adopted the suggestions of the commenter in the proposed Instrument, the CSA appreciate the comments.

The CSA's specific responses to the comments are as follows.

In respect of the definition of "connected issuer", the CSA are of the view that the only appropriate way to define the definition is through use of the concept of "relationship". Although, as the commenter suggests, the concept is broad, the CSA believe that the concept is necessary to capture the wide range of possible relationships that could lead to concerns over conflicts of interest.

The CSA do not accept the suggestion that the application of the proposed Instrument should be restricted to "material" subsidiaries or some similar concept. The issue being addressed by the proposed Instrument is the possibility of conflicts of interest arising in connection with the distribution of securities of an issuer; these conflicts could arise because of the influence of a parent company of the issuer, for instance, even if the issuer was very small in relation to the size of the parent. The CSA recognize the wide ranging application of the proposed Instrument in the case of a large corporate structure like that of the commenter, and will entertain applications for exemption from the application of the normal rules in appropriate circumstances.

The CSA do not agree with the suggestion that investment grade negotiable securities should be excluded from the conflicts regime. The CSA are not willing to delegate, in effect, the application of its rules concerning conflicts of interest to rating agencies.

The CSA do not agree with the suggestion that certain holdings of securities below certain thresholds should be excluded from the operation of the regime. The CSA note that the proposed Instrument has been designed to eliminate the need for an independent underwriter, in non-related issuer relationships. The CSA believe that these exemptions should substantially reduce the need for independent underwriters in distributions.

Special Warrants and "Two-Step" Transactions

Two submissions addressed the application of the 1998 Draft Instrument to special warrant transactions and other "two-step" transactions.

A commenter submitted that the proposed Instrument should state, for the purposes of clarity, that special warrant and other similar financings are deemed not be distributions made under a prospectus for the purposes of the proposed Instrument. Another commenter, on the other hand, submitted that it is appropriate to require an independent underwriter for a special warrant transaction at both the private placement stage and the prospectus certification stage, on the basis that a special warrant transaction is essentially a priced public financing.

The latter commenter provided a detailed and thoughtful analysis of the appropriate application of the proposed Instrument to a particular type of "two-step" transaction. The following is an outline of the analysis and recommendations:

- The comments related to two-step transactions that are used to effect the purchase of an existing business by institutional investors. The transactions are characterized by an initial private placement of convertible or exchangeable securities, followed by the qualification, by way of a prospectus, of underlying securities derived from the conversion or exchange of the initial private placement securities. In those transactions, the institutional investors put up the first tranche of the purchase price through a private placement; that acquisition is usually followed by a public offering that provides the second tranche of the required equity financing.

- The commenter submitted that there are two main reasons why it is unnecessary or impractical to have participation by an independent underwriter in the first step of a business acquisition two-step transaction. The first reason is that the transaction is negotiated by the underwriter with sophisticated parties that are at arm's length – the vendor of the business and institutional investors. An independent underwriter is not required to ensure that the terms negotiated by arm's length parties are appropriate; that issue is best left to the parties themselves. The second reason is the practical difficulty in involving an independent underwriter in the transaction; in a heavily negotiated transaction, an independent dealer will add little value being brought into the transaction at a late stage.

- The commenter submitted that there is an even weaker case for requiring the involvement of an independent underwriter in the second, or prospectus, stage of a business acquisition two-step transaction. At that point, the business transaction has been negotiated and an independent underwriter has no ability to change the business terms of the transaction. Further, it would be unfair to expose the independent underwriter to accept liability for prospectus disclosure, as this liability would be to sophisticated institutional purchasers with whom they have had no dealings and for a transaction in which they were not involved.

- The commenter therefore proposed that an independent underwriter not be required for a two-step transaction if
  - the transaction involved the acquisition of a business (whether by the purchase of assets, securities or otherwise) by or on behalf of an issuer that is not a reporting issuer at the time the transaction is agreed to; and
  - the majority by value of investors at the private placement stage are 'qualified institution buyers', who are not themselves related to or connected with the issuer or the non-independent underwriters in the transaction. The commenter provided a list of proposed qualified institutional buyers, including insurance companies, financial institutions, governments and governmental bodies and others.

CSA Response

The CSA have amended the proposed Instrument to clarify their position that the requirements of the proposed Instrument are applicable in connection with the issuance of special warrants in a special warrant transaction. The proposed Instrument now provides that section 2.1 applies to the issue of special warrants. The CSA have also added a definition of a "special warrant" to the proposed Instrument.

The CSA have not made any changes to reflect the issues raised about the use of two-step transactions in connection with business acquisitions. In the experience of the CSA, transactions of this nature have taken a variety of forms and structures. Accordingly, the CSA are of the view that the appropriate response to such transactions at this time is to review such transactions on a case-by-case basis in the context of an application for exemptive relief. The CSA will consider this issue going forward, and may propose that such transactions be the subject of a multilateral instrument at a later date.

3. COMMENTS ON SPECIFIC PROVISIONS OF THE 1998 DRAFT INSTRUMENT

Part 1 - Definitions, Interpretation and Application

Definition of "related party" and "professional group"

A commenter expressed concern over the inclusion of the concept of "professional group" in the determination of whether an entity is a related party to another entity. The commenter stated that it would appear from the definition of "professional group" "that in order for a registrant to determine whether it is related to an issuer, the registrant would be required to send a memorandum to each of the persons or companies referred to under the definition of 'professional group', to wait for a response and to tabulate the results. This is a fairly cumbersome process, especially when the timing of the distribution is critical...".

CSA Response

The CSA have made no changes in response to this comment. The CSA note that registrants are required to monitor on an ongoing basis the constitution of a professional group under existing and proposed self-regulatory organization rules.

Definitions of "specified party" and "minor debt relationship"

A commenter indicated its agreement with the concept of "specified party" and the exemption from the requirement for an independent underwriter for issuers that were not specified parties. The commenter made a number of suggestions as to how certain aspects of this exemption and the definition of "specified party" could be clarified or otherwise improved.

CSA Response

The CSA have deleted the definitions of "specified party" and "minor debt relationship" in Part 1 of the Proposed Instrument, and the exemption from the requirement for independent underwriter involvement based on these definitions in Part 3 of the Proposed Instrument. As noted above, the CSA have amended the Proposed Instrument to eliminate the requirement for independent underwriter involvement where the issuer or selling securityholder in the distribution is a connected issuer of the registrant, but is not a related issuer of the registrant. Since the exemption from the requirement for independent underwriter involvement previously found in section 3.2 of the 1998 Draft Instrument was only available where the issuer or selling securityholder was a connected issuer but not a related issuer, and since the requirement for independent underwriter involvement is now restricted to issuers or selling securityholders which are related issuers, the exemption found in section 3.2 of the 1998 Draft Instrument is no longer necessary, and has been deleted.

Section 3.1

A commenter submitted that a connected issuer that is exempted from the independent underwriter requirements on the basis of the exemption found in section 3,2 of the 1998 Draft Instrument should also be exempted from the disclosure requirements of the proposed Instrument.

CSA Response

In response to this comment, the CSA made no changes. Disclosure of connected issuer relationships is crucial to the regime contemplated by the proposed Instrument. The CSA also note that disclosure of relationships is fundamental to all conflict of interest regimes.

Section 4.2

A commenter stated that this section does not appear to address offerings made by prospectus supplements under the shelf procedures. It was suggested that provision should be made for the granting of exemptions on an expedited basis for this type of offering.

CSA Response

The application of the proposed Instrument to shelf distributions has been addressed in National Instrument 44-102 Shelf Distributions. The issue was addressed in section 6.5 of National Instrument 44-102, which came into force December 31, 2000. The CSA added subsection 2.4(5) to the proposed Policy to refer to National Instrument 44-102, which contains the applicable requirements on how the National Instrument applies to shelf distributions.

Appendix C

A commenter argued that the valuation requirements in section 12 of Appendix C are not warranted, given the other disclosure mandated by the Appendix and the limited circumstances in which such requirement applies. The commenter also stated that if the CSA wish to maintain the valuation requirement, the requirement would be better included in the Instrument itself rather than in a schedule.

CSA Response

The CSA agree with the latter part of this comment and have moved the valuation provision into the proposed Multilateral Instrument as section 4.1.