**ALBERTA SECURITIES COMMISSION**
**NOTICE**

**NATIONAL INSTRUMENT 33-105 AND COMPANION POLICY 33-105CP**
***UNDERWRITING CONFLICTS***

**AND**

**RECISSION OF PART 6 OF ASC POLICY 7.1 - *CONFLICTS OF INTEREST***

## 1. Implementation of Instrument and Recission of Existing Policy

The Alberta Securities Commission (the "Commission") has implemented National Instrument 33-105 *Underwriting Conflicts* ("NI 33-105") and Companion Policy 33-105CP (the "Policy"). In this Notice, NI 33-105 and the Policy will be referred to together as the "Instrument". The Instrument will take effect on January 3, 2002. The Commission will also rescind Part 6 of ASC Policy 7.1 - *Conflicts of Interest*, effective January 3, 2002.

The Instrument began as an initiative of the Canadian Securities Administrators (the "CSA") other than Québec . In Alberta, NI 33-105 has been implemented as a Commission rule and the Policy has been adopted as a Commission policy. NI 33-105 will be adopted as a rule in each of British Columbia, Ontario, Nova Scotia and Newfoundland, a Commission regulation in Saskatchewan, and a policy in all the other CSA jurisdictions.

In August of 2001, the Québec Commission (the "CVMQ") decided to adopt the Instrument in Québec. The CVMQ will be publishing the Instrument for comment in accordance with the requirements of Québec securities legislation concurrently with the publication of this Notice. In the event that the CVMQ determines that amendments need to be made to the Instrument as a result of the public comment process, the Instrument will take effect as a Multilateral Instrument in the other CSA jurisdictions and will not take effect in Québec. Interested parties are advised to contact staff at the CVMQ with questions regarding the status of the Instrument in Québec .

## 2. Substance and Purpose of the Instrument

NI 33-105 seeks to protect the integrity of the underwriting process by imposing regulatory requirements on distributions of securities where the relationship between the issuer or selling security holder and the registrant acting as underwriter gives rise to an actual or perceived conflict between the interests of the underwriter or the issuer and those of investors. NI 33-105 imposes certain disclosure requirements on those transactions and, in some cases, requires that an independent registrant participate.

The Companion Policy provides interpretive guidance.

## 3. Prior Publication and Public Comment

The Instrument was first published for comment in February 1998 at (1998) 7 ASCS 343 (the "1998 Draft"). Comments were received from three commenters. It was revised substantially and published for comment again in June 2001 (the "2001 Draft") on the ASC website at www.albertasecurities.com . A summary of the comments received on the 1998 Draft can be found in Appendix A to the Notice that accompanied the 2001 Draft.

The CSA received two comments on the 2001 Draft. The CSA has summarized them and responded to them in Appendix A to this Notice.

## 4. Summary of Changes to the Instrument from the 2001 Draft

There have been no material changes made to NI 33-105 from the 2001 Draft. There has been one amendment to the Companion Policy. A new Part 5, entitled "Control Measures" has been added. This amendment states that registrants are encouraged 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. The amendment is not intended to represent a new requirement or obligation for registrants. Accordingly, the CSA do not consider this amendment to be a material change to the Companion Policy.

## 5. Further Information

Questions may be referred to:

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**APPENDIX A**

**SUMMARY OF COMMENTS RECEIVED**
**ON**
**DRAFT NATIONAL 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 (the "1998 Draft Instrument") and proposed Companion Policy 33-105CP (the "1998 Draft Policy"). The CSA received submissions on the 1998 Draft Instrument and 1998 Draft Policy from three commenters. The names of these commenters and a summary of their comments, together with the CSA's responses, were previously published in the Appendix to the Notice of Proposed Changes to Proposed Multilateral Instrument 33-105.[1]

As a consequence of these comments and further consideration of the instruments, the CSA republished proposed Multilateral instrument 33-105 (the "2001 Draft Instrument") and proposed Companion Policy 33-105 (the "2001 Draft Policy") for a second comment period in June 2001.[2] This comment period ended August 22, 2001. During the comment period, the CSA received submissions on the 2001 Draft Instrument and 2001 Draft Policy from one commenter, Mr. Simon Romano (the "Commenter"), a partner with the law firm of Stikeman Elliott in Toronto. The CSA subsequently received an additional comment from Canaccord Capital Corporation ("Canaccord").

Copies of these 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, Suite 400, 300-5th Avenue SW, Calgary, Alberta, T2P 3C4 (403) 297-6454.

The CSA have considered these comments received and thank the Commenter for providing his comments. The CSA have made a number of minor amendments to the 2001 Draft Instrument and 2001 Draft Policy which reflect these comments. The CSA have determined that these

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1 In Ontario, at (2001), 24 OSCB 3808 (June 22, 2001).

2 In Ontario, at (2001), 24 OSCB 3805 (June 22, 2001).

amendments do not represent material changes to the 2001 Draft Instrument or the 2001 Draft Policy. Accordingly, in the jurisdictions that have previously published the Draft Instruments, the instruments are not 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*

The Commenter noted that his comments represented his personal comments and not those of his firm. The Commenter prefaced his comments by noting that the 2001 Draft Instrument generally represented a very welcome addition to the regulatory landscape governing underwriting conflicts.

### *1. Participation by Québec*

The Commenter noted that it would be very helpful if the reasons why the QSC was not proposing to adopt MI 33-105 were specified in some detail in order that parties may know where they are likely to experience divergence, if anywhere.

*CSA Response*

As noted previously, at the time of the publication of the Draft Instruments, it was not anticipated that the Draft Instruments would be proposed for adoption by the Québec Commission. However, since the publication of the 2001 Draft Instrument and Policy, the Québec Commission has determined that the underwriting conflicts regime contemplated by the National Instrument and the Companion Policy represents an acceptable regime for adoption in the Province of Québec. Accordingly the 2001 Draft Instrument has been renamed National Instrument 33-105 to reflect participation by all of the CSA jurisdictions.

### *2. Distinction between issuers and selling securityholders*

The Commenter noted that the distinction between issuers and selling securityholders, while clear in the definition of “connected issuer”, may not be clear in the definition of “related issuer”. In addition, the Commenter noted that the distinction may be lost in the words “of or by” in subsection 2.1(1) and by the word “or” in subsection 2.1(1) and paragraphs 2.1(2)(a) and (b). The Commenter further noted that, as presently drafted, it would appear that the instrument could apply in the case of a purely secondary transaction, in which the registrant had a connected or related relationship with the issuer, but not the selling securityholder, and questioned whether it was intended that the instrument apply in this case.

*CSA Response*

The CSA have not amended the National Instrument in response to this comment. The CSA note that, in the case of a secondary market transaction, where the registrant has a connected or related relationship with the issuer, it may generally be expected that the registrant will also have a connected or related relationship with the selling securityholder.

It is a precondition to the application of subsections 2.1(1) and 2.1(2) of the National Instrument that there be a *distribution* of securities. Accordingly, in the case of a secondary market transaction, subsections 2.1(1) and (2) will only apply where the selling securityholder holds a sufficient number of securities of the issuer materially to affect the control of that issuer. Consequently, the selling securityholder will generally be an "influential securityholder" of the issuer, and a "related issuer" of the issuer.

The extended definition of "connected issuer" in section 1.1 of the National Instrument provides that a selling securityholder distributing securities may be a "connected issuer" of a registrant if the selling securityholder, or a related issuer of the selling securityholder, has a relationship with, *inter alia*, the registrant that may lead a reasonable prospective purchaser of the securities to question if the registrant and the selling securityholder are independent of each other for the distribution.

Accordingly, if the registrant has a connected or related relationship with the issuer, with the result that a reasonable prospective purchaser may question the independence of the registrant vis-à-vis the issuer, it will generally be the case that "...the selling securityholder or a related issuer of the selling securityholder has a relationship with [the prescribed group of persons and companies, including the registrant] that may lead a reasonable prospective purchaser of the securities to question if the registrant and the *selling securityholder* are independent of each other for the distribution".

Where the registrant has a connected or related relationship with the issuer, but does not have either a related or connected relationship with the selling securityholder, the CSA believe that, in many cases, the National Instrument should continue to have application to the distribution of securities. The CSA note that, while the distribution of securities is made by a selling shareholder, rather than the issuer, the pricing and due diligence activities undertaken by the registrant will nevertheless relate to the connected or related issuer.

Finally, the CSA note that this comment would appear to apply also to the 1998 Draft Instrument. The CSA believe that the proposed underwriting conflicts regime set out in the 1998 Draft Instrument is well understood by market participants, and has served as the basis for a significant number of exemptive relief applications. In the course of reviewing these applications, the CSA have not been made aware of any significant concern on the part of market participants with respect to this issue. However, in the event this issue later proves to be of general concern to market participants, the CSA may revisit this issue in a future amendment to the National Instrument.

***3. Definition of "Connected Issuer"***

The Commenter expressed the view that the definition of "connected issuer" was unduly broad, and that the words “may lead” in the definition ought to be replaced with the words "would lead". The Commenter noted that section 4.2 of the 2001 Draft of the Companion Policy used the words "would lead".

*CSA Response*

The CSA have not amended the National Instrument in response to this comment. This aspect of the definition of "connected issuer" remains unchanged from the definition found in the 1998 Draft Instrument, and a similar comment was raised in response to the publication of that instrument and was considered by the CSA at that time.

The CSA note that, as a consequence of the amendments previously made to the National Instrument, the independent underwriter requirement contained in subsection 2.1(2) of the National Instrument applies only in the case of distributions involving a related issuer. Where there is a connected issuer relationship, but not a related issuer relationship, the National Instrument simply requires that certain prescribed disclosure be made. The CSA are of the view that, where there exists a relationship between an issuer or selling shareholder and the registrant that may lead a reasonable prospective purchaser of the securities to question the independence of the registrant, such disclosure is appropriate. In view of the disclosure-based approach to regulating actual or perceived conflicts of interest, the CSA believe that the standard represented by the word "may" is widely understood by and is not unduly onerous towards market participants.

***4. Definition of "Independent Underwriter"***

In view of the amendments to the 2001 Draft Instrument which essentially create a disclosure-only regime for connected issuers, the Commenter questioned whether the definition of “independent underwriter” should be amended to refer only to related, and not connected, issuers.

*CSA Response*

The CSA have not amended the National Instrument in response to this comment. The National Instrument seeks to protect the integrity of the underwriting process in circumstances in which there is a perceived or actual conflict of interest between the issuer or selling securityholder and the registrant by requiring full disclosure of the relationships giving rise to the potential conflict of interest, and, in the case of a distribution involving a related issuer, by requiring an independent underwriter to participate in the transaction.

By definition, a registrant which is in a connected issuer relationship with an issuer, will not be considered to be independent of that issuer, since the definition of "connected issuer" requires that there exist "a relationship that may lead a reasonable prospective purchaser of the securities to question if the registrant and the issuer are independent of each other for the distribution."

***5. Qualification of securities other than by prospectus***

The Commenter noted that in the 1998 Draft Instrument, the independent underwriter requirement (found in subsection 2.1(b) of the 1998 Draft Instrument) applied only in the case of a "distribution made under a prospectus", whereas in the 2001 Draft Instrument the independent underwriter requirement (found in subsections 2.1(2) and (3) of the 2001 Draft Instrument) applied in the case of "a distribution of special warrants or a distribution made under a prospectus".

The Commenter questioned whether, in view of this extension of the independent underwriter requirement to include distributions involving special warrants, the independent underwriter requirement should also be extended to include situations where securities are qualified other than by way of a prospectus, such as by way of a securities exchange issuer bid or an amalgamation circular.

*CSA Response*

The CSA have not amended the National Instrument in response to this comment. The independent underwriter requirement contained in subsections 2.1(2) and 2.1(3) of the National Instrument applies only in the case of a distribution involving special warrants or a distribution made under a prospectus. In the case of other forms of distributions, there is no specific requirement in the National Instrument for independent underwriter involvement. The CSA amended subsections 2.1(2) and 2.1(3) expressly to make reference to a distribution of special warrants for the reason that, in substance, the distribution represents a distribution under a prospectus.

***6. Calculation rules***

The Commenter noted that section 2.2 of the National Instrument sets out different tests for Canadian issuers (i.e., non-foreign issuers) and foreign issuers, and suggested that this distinction may place Canadian issuers at a disadvantage. As an alternative, the Commenter proposed that Canadian issuers be able to select either the “full deal” or “Canada-only” approach.

*CSA Response*

The CSA have not amended the National Instrument in response to this comment. The CSA believe that the regime contained in the National Instrument represents an appropriate and balanced approach to regulating underwriting conflicts in connection with distributions of securities in Canada. As a consequence of the amendments previously made to the 2001 Draft Instrument, the requirement for independent underwriter involvement in a distribution of special

warrants or a distribution made under a prospectus has been limited to those cases where the registrant is the issuer or selling shareholder, or where a related issuer of the registrant is the issuer or selling shareholder.

Where the registrant, or a related issuer of the registrant, is the issuer or selling securityholder in the distribution, the CSA believe that participation by an independent underwriter in the distribution represents an important means of protecting the integrity of the underwriting process. In these cases, the CSA believe that the interest of investors in an underwriting process free of any actual or perceived conflict outweighs the potential inconvenience to issuers from involving independent underwriters in the distribution.

However, the National Instrument also recognizes that it will not always be appropriate to impose the full range of Canadian securities regulatory requirements on international offerings by foreign issuers. Such requirements may unnecessarily duplicate requirements to which the foreign issuer is already subject. In other cases, imposing such requirements may result in foreign issuers choosing to avoid Canadian capital markets altogether. Consequently, in order to facilitate international offerings within Canada, the CSA is generally prepared to relax certain regulatory requirements where the degree of connection with Canada is reduced, and the CSA is satisfied that the interest of investors in being able to participate in such offerings outweighs the concern over the lesser degree of regulation. Accordingly, section 3.2 of the National Instrument provides that if more than 85 percent of the offering takes place outside of Canada, the independent underwriter requirement does not apply. Similarly, where an offering is made only partly in Canada, and where the issuer qualifies as a "foreign issuer", in calculating the size of the distribution and the required degree of involvement by an independent underwriter, it is only necessary to look to the size of the distribution in Canada.

***7. Definition of "Influential Securityholder"***

a) The Commenter expressed the view that, with respect to the definition of “influential securityholder”, it may be very difficult, if not impossible, to determine the holdings of all employees of a large registrant in a particular company at any given time, and felt that this was excessive.

b) The Commenter also noted that, as a consequence of the “power to direct the voting of" concept, managed funds would appear to be caught. The Commenter was of the view that this was inconsistent with National Instrument 62-103 and the alternative monthly reporting system, which is designed to relieve passive institutional investors from the need to monitor their positions on a daily basis.

c) The Commenter further felt that the definition was unnecessarily complex, and proposed, as an alternative, a single 20% standard.

d) The Commenter further questioned whether it was necessary, in section 1.2(1)(a)(ii), to include securities which are not currently exercisable.

e) Finally, the Commenter felt that, the definition of “registrant”, by adding the words “or required to be registered”, seems to complicate the analysis tremendously by requiring all business activities to be reviewed.

*CSA Response*

The CSA have not amended the National Instrument in response to these comments. The CSA note that, other than the addition of subparagraphs (a)(iii) and (a)(iv), which prescribe when a person or company or professional group will be an "influential securityholder" of an issuer that is a partnership, the definition of "influential securityholder" is essentially unchanged from that found in the 1998 Draft Instrument.

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

a) The relevant part of the definition of "influential securityholder" found in the National Instrument is based on proposals put forward by the Joint Securities Industry Committee on Conflicts of Interest (the "Hagg Committee")[3] in their final report published in September 1997. The Hagg Committee's final report recommended that the concept of a "professional group" be introduced into the rules governing underwritings by related or connected issuers. The concept of "professional group" was recommended to deal with the perception that, even though the amount of stock of an issuer held by a registrant firm may be small, the combined holding of that issuer's shares by individuals within that firm, including directors, officers, brokers and corporate finance personnel, may be significant. The final report recommended that the conflict of interest rules relating to underwritings be applicable to holdings by a professional group of 20 percent or more of an issuer.

The CSA accept the conclusions and recommendations of the Hagg Committee in this regard and accordingly, in determining whether a person or company or professional group comes within the definition of "influential securityholder", it will be necessary for registrants to monitor the holdings of its employees. The CSA do not believe that this represents an inappropriate requirement and note that the Investment Dealers Association of Canada (the "IDA") proposed by-laws contain similar requirements.

The CSA also note that it is the practice of dealers to review the trading of securities by all employees as part of normal compliance procedures.

(b) The CSA do not believe that the definition of "influential securityholder" is inconsistent with National Instrument 62-103 -- The Early Warning System and Related Take-Over Bid and Insider Reporting Issues. The CSA note that under NI 62-103, the list of eligible institutional

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[3] In 1996, the Investments Dealers Association of Canada, and the Montreal, Toronto, Calgary and Vancouver Stock Exchanges formed the Joint Security Industry Committee on Conflicts of Interest to examine the potential conflicts of interest that occur when dealers participate in emerging company investments. The Joint Committee (often referred to as the “Hagg Committee” after its Chairman, John Hagg, of Northstar Energy Corporation) delivered its final report in September 1997.

investors does not include dealers. Accordingly dealers would not ordinarily be exempt from the requirement to keep track, on a daily basis, of the shares of companies that they own or vote. To the extent that dealers act as portfolio managers for managed funds, the National Instrument would have application.

The CSA further note that NI 62-103 was generally designed to reduce the scope of the obligation to put in place a system to aggregate share positions across financial conglomerates on a daily basis. In contrast, the National Instrument would require both the issuer and the dealer to determine the scope of their relationship at the time of the underwriting (i.e., a discrete point in time, rather than on a continuous basis). This requirement is not new to the National Instrument. Rather, since the introduction of the underwriting conflicts regime in the late 1980s, issuers and registrants have been required to make this determination.

Finally, the CSA note that this comment is similar to that previously raised by another commenter in response to the request for comments in respect of the 1998 Draft Instrument. The CSA believe that the earlier response, reproduced below, remains appropriate.

> 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.

(c) The CSA believe that the definition of "influential securityholder" in the National Instrument represents a significant improvement over the existing standard in the securities legislation of the jurisdictions, which is based on the concept of "influence". A single test based on a simple 20% ownership threshold would fail to capture those situations where factors other than direct ownership might allow a person or company to exercise significant leverage over an issuer. The CSA believe that the definition of "influential securityholder" is simpler and clearer than the present test based on "influence" yet nonetheless flexible enough to address these other circumstances.

The CSA further note that the definition of "influential securityholder" is essentially unchanged from the 1998 Draft Instrument. Since the publication of the 1998 Draft Instrument for comment, the CSA have had the opportunity to consider a considerable number of applications for discretionary relief based on the proposed regime, including the key concept of "influential securityholder". In view of this large number of applications, the CSA believe that market participants have not encountered significant difficulties in working within this regime, and believe that this regime reflects an effective and workable approach to regulating underwriting conflicts.

d) For the purposes of the determination described in subsection 1.2(1) of the National Instrument, if a security is outstanding at the time of the determination but is not then convertible or exchangeable, the CSA would not ordinarily consider it necessary to include these securities in the determination.

e) The CSA do not believe that the definition of registrant in the National Instrument is unduly complicated and note that the words “or required to be registered” generally appear within the definition of "registrant" within the securities legislation of the CSA jurisdictions.

***8. Exempt Securities***

The Commenter further questioned whether section 1.3(a) of the 2001 Draft Instrument was intended also to include exempt securities that are restricted in regulations or rules, such as subordinated bank debt.

*CSA Response*

Section 1.3 of the National Instrument only exempts those securities described in that section. Other than an amendment to reflect the fact that it is now anticipated that the instrument will be adopted in Québec, section 1.3 of the National Instrument remains unchanged from the 1998 Draft Instrument. The CSA believe that the exemption created by section 1.3 is clear on its terms. The CSA will consider applications for exemptive relief in respect of other classes of securities which may be analogous to the classes of securities described by section 1.3 on a case-by-case basis.

***9. Management Fees***

The Commenter questioned the use of the term “management fees” in subparagraph 2.1(3)(a)(ii) and section 2.2 of the instrument, and suggested that the term “agents’ fees” or “commissions” may be preferable. The Commenter further questioned whether, in section 2.2 of the instrument, the test was to be assessed against deal value, or fees received in Canada, or both, and noted that these measures could diverge.

*CSA Response*

The CSA agree with the first comment and have amended the National Instrument and Companion Policy accordingly.

With respect to the second comment, the CSA do not believe that section 2.2 is unclear. Section 2.2 should be read in context with subsection 2.1(3). Subparagraph 2.1(3)(a)(ii) provides that, in the case of a distribution in which “each registrant acting as direct underwriter acts as agent and is not obligated to act as principal”, the degree of independent underwriter involvement is to be measured by reference to agents’ fees. Accordingly, in the case of an agency deal, section 2.2 requires that the calculation be based on the aggregate management fees.

***10. Valuation Requirement***

The Commenter proposed that section 4.1 should be amended to permit the valution of the issuer referred to in that section to be prepared by valuators who are members of the Canadian Institute of Chartered Business Valuators (the "CICBV"). The Commenter further expressed the view that the reference to a "distribution other than under a prospectus" in subparagraph 4.1(a)(iv) of the instrument should extend to take-over bids and mergers and sought clarification in this regard.

*CSA Response*

The CSA agree with these comments, and have amended the National Instrument to make reference to valuations prepared by members of the CICBV.

***11. Appendix C***

The Commenter expressed the view that item 6(e) seemed difficult to answer, particularly in the absence of a definition of "financial position", and suggested that a materiality qualification would assist registrants and issuers in making this determination.

*CSA Response*

The CSA have not amended the National Instrument in response to this comment. Item 6(e) remains unchanged from the 1998 Draft Instrument. Since the publication of the 1998 Draft Instrument, the CSA have received a large number of applications whereby applicants have sought relief from the independent underwriter requirement as set out in the regulations and have undertaken to provide the disclosure contemplated by that draft instrument. Accordingly, the CSA believe that market participants have been able to understand and are able to comply with the disclosure requirements contained in Appendix C, and that greater uncertainty would result from an amendment to this appendix.

**The Canaccord Comment**

The CSA have received an additional comment from Canaccord Capital Corporation ("Canaccord"). Although this comment was received outside of the comment period, the CSA were able to consider the comment and have summarized the comment and the CSA response below.

Canaccord expressed its view that the amendments to Part 2 of the 2001 Draft Instrument which generally restrict the requirement for independent underwriter involvement to distributions in which a related issuer relationship exist were of significant concern. This commenter noted that, when the underwriting conflicts regime as it presently exists was first enacted in the late 1980s, there were a large number of independent investment dealers. However, many of these dealers have now disappeared, with most having been acquired by the banks. This commenter further expressed its belief that the banks were increasingly integrating their lending activities with the investment banking activities of their subsidiaries, and were now engaging in "tied selling",

suggesting that the banks have indicated to corporate issuers that they would only lend to such issuers if they also received the most profitable investment banking fees.

Canaccord further expressed its belief that, in many cases where there exists a connected issuer relationship but not a related issuer relationship, such as the case of an issuer in financial difficulty seeking to make a public offering in order to reduce or eliminate indebtedness to one or more banks, simple disclosure relating to the relationship was not sufficient, and an independent underwriter should be involved. This commenter suggested that an independent underwriter would provide some balance on whether the issue, pricing, size and targeted capital structure was appropriate. This commenter disputed the suggestion that an independent underwriter would not provide protection for the reason that it would simply be co-opted.

*CSA Response*

The CSA have not amended the National Instrument in response to this comment. The amendments to Part 2 of the 2001 Draft Instrument referred to by this commenter were made following careful consideration by the CSA of the comments and recommendations contained within the Reports of the Canadian Securities Administrators Committee on Conflicts of Interest in Underwriting,[4] and the Hagg Report, the overall experience of the CSA with the present underwriting conflicts regime since its inception in 1987, and the experience of the CSA in considering applications for discretionary relief based on the underwriting conflicts regime contained in the 1998 Draft Report.

As explained in Part 2 of the Companion Policy, the National Instrument identifies a hierarchy of relationships between a 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:

(a) The registrant as issuer or selling securityholder;

(b) An issuer or selling securityholder that is a "related issuer" of the registrant; and

(c) An issuer or selling securityholder that is a "connected issuer" of the registrant.

As described in the Companion Policy, the National Instrument 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. The relationship described in (a) represents the relationship with the highest degree of conflict of the three recognized by the Instrument. Conversely, the relationship described in (c) represents the relationship with the least degree of conflict.

Ultimately, in their review of the appropriate regulatory response to concerns raised by a

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[4] The Committee Report and the Dissent Report were published in Ontario on July 7, 1995 at (1995), 18 OSCB 3157 and (1995), 18 OSCB 3195, respectively.

connected issuer relationship, the question before the CSA was whether these concerns could be adequately addressed by mandating certain specified disclosure about this relationship, or whether a greater degree of regulatory intervention was required. This question, and the concerns raised by the commenter, received extensive consideration by the CSA. The CSA eventually concluded that, in the case of a connected issuer relationship, a disclosure-based approach was sufficient, and it was not necessary to regulate the composition of the underwriting syndicate involved in the distribution.

The CSA note that, where a registrant is in a position of actual or perceived conflict of interest, the registrant is under a duty at law generally not to allow this conflict of interest in any way to interfere with the registrant's performance of its obligations in the underwriting process. As reflected by the new Part 5 of the Companion Policy, registrants are encouraged to adopt appropriate internal control measures to ensure that this is in fact the case. The CSA are of the view that, where a connected issuer relationship exists, and particularly where the issuer would be considered a "specified party" as that term is defined in the 1998 Draft Instrument, in many cases it may be prudent for the registrant to involve an independent underwriter in order to demonstrate that it has in fact complied with its obligations generally not to be influenced by such conflict of interest.

Finally, with respect to the concern that certain financial sector participants may be engaging in unlawful or anticompetitive activities, the CSA believe that appropriate recourse may be had to the federal and provincial statutes which directly regulate such activities.