CSA/ACVM

Canadian Securities Administrators | Autorités canadiennes en valeurs mobilières

CANADIAN SECURITIES ADMINISTRATORS NOTICE 46-301

Proposal for Uniform Terms of Escrow
Applicable to Initial Public Distributions

The Canadian Securities Administrators (the "CSA") have developed a revised proposal (the "Proposal") for uniform terms of escrow that would apply to initial public distributions of securities by prospectus ("IPOs"). While the Proposal itself has not been published, this Notice summarizes key elements of the Proposal and highlights changes from the earlier proposal entitled "Proposal for a National Escrow Regime Applicable to Initial Public Distributions" (the "1998 Proposal") that was published for comment in May 1998.

The CSA will develop and publish for comment a national instrument and related documents based on the Proposal. Until a national instrument is implemented as a rule or policy in a local jurisdiction, current escrow policies in the jurisdiction will remain operative. However, securities regulatory staff will be guided by the Proposal as outlined in this Notice in connection with IPOs for which a preliminary prospectus is filed after the date of this Notice in exercising their discretion to accept escrow arrangements consistent with the Proposal in lieu of escrow arrangements under existing policies. No provision is being made at this time for conversion of the terms of escrow arrangements that predate this Notice.

Background

1. CSA Objectives

The CSA's goals in developing the Proposal were to establish clear, consistent, understandable and administratively efficient terms of escrow that appropriately balance regulatory objectives of facilitating capital formation in Canada and protecting investors, in part by encouraging continued interest and involvement in an issuer, for a reasonable period after its IPO, by those principals whose continuing role would reasonably be considered relevant to an investor's decision to subscribe to the issuer's IPO.

2. The 1998 Proposal

Much of the framework of the Proposal is derived from the 1998 Proposal.

The 1998 Proposal set out the terms of a largely self-administering escrow regime under which most equity securities owned by principals of an issuer would be escrowed at the time of the issuer's IPO, and released from escrow in tranches over a period of 3 or 6 years depending on whether the issuer qualified as an established issuer or emerging issuer on the basis of financial tests. Principals included directors and senior officers and other insiders with holdings of voting securities exceeding 10% of the voting securities of the issuer outstanding prior to the issuer's IPO, but excluded a category of "passive" investors.

Important Changes from 1998 Proposal

The CSA considered very seriously the public comments received on the 1998 Proposal. Many of the significant changes reflected in the Proposal are intended to address concerns raised by commenters while fulfilling the purpose of escrow.

Among the more important changes from the 1998 Proposal, the new Proposal incorporates:

- shorter escrow periods and faster escrow releases;
- simpler escrow classifications for issuers that are based on listing categories of Canadian exchanges;
- an expanded exempt category that includes all issuers conditionally listed or listed on The Toronto Stock Exchange (the “TSE”) in its exempt category, in addition to issuers conditionally listed or listed on the TSE, the Montreal Exchange (the "ME"), the Winnipeg Stock Exchange (the “WSE”) or the Canadian Venture Exchange (the "CDNX") that raise minimum gross proceeds of $75 million in their IPO;
- changes to the category of "principals" whose securities are subject to escrow, including:
    - raising from 10% to 20% the threshold for inclusion solely on the basis of ownership and/or control of voting securities;
    - removing problematic distinctions between classes of investors; and
    - assessing principal status on the basis of percentage ownership and/or control of securities being calculated immediately after completion of the issuer’s IPO rather than immediately before the IPO;
- permitted sales to the public by secondary distribution at the time of an issuer’s IPO, of securities held by a securityholder that is or would otherwise be a principal, on conditions designed to couple flexibility for principals with full disclosure and fairness to IPO investors; and
- changes to permitted transfers within escrow.

Summary of the Proposal

- The Proposal would apply to an IPO whether conducted by the issuer or as a secondary offering.
- A securities regulatory authority may impose escrow requirements additional to those described in this Notice if no underwriter is involved in an IPO, an issuer's equity securities will not be listed on a Canadian exchange upon completion of its IPO, or in other exceptional circumstances.
- Equity securities owned or controlled by principals (except for the exempt portion of each principal’s holdings, incentive options and securities sold in a permitted secondary offering) would be escrowed at the time of the issuer’s IPO.
- Principals would include all persons or companies that, on completion of the issuer's IPO, fall in one of the following categories:
    - directors and senior officers of the issuer or of a material operating subsidiary of the issuer, as listed in the IPO prospectus;
    - promoters of the issuer during the two years preceding the IPO;

- those who own and/or control more than 10% of the issuer's voting securities immediately after completion of the IPO if they also have appointed or have the right to appoint a director or senior officer of the issuer or of a material operating subsidiary of the issuer;

- those who own and/or control more than 20% of the issuer's voting securities immediately after completion of the IPO; and

- associates and affiliates of any of the above.

- At the time of its IPO, an issuer will be classified for purposes of escrow as an "exempt issuer", an "established issuer" or an "emerging issuer".

- Uniform terms of automatic timed-release escrow would apply to principals of exchange-listed issuers, differing only according to the classification of issuer:

  - for exempt issuers -- those conditionally listed or listed on the TSE in its exempt category, and those conditionally listed or listed on the TSE, the ME, the WSE or the CDNX that raise minimum gross proceeds of $75 million in their IPO: no escrow;

  - for established issuers -- those conditionally listed or listed on the TSE in its non-exempt category, on Tier 1 of the CDNX, or on the ME or the WSE that meet requirements equivalent to the CDNX's Tier 1 requirements: escrow releases in equal tranches at 6-month intervals over 18 months (*i.e.*, 25% of each principal's holding released in each tranche) with 25% of each principal's holding exempt from escrow; and

  - for emerging issuers -- those conditionally listed or listed on Tier 2 of the CDNX, or on the ME or the WSE that meet requirements equivalent to the CDNX's Tier 2 requirements but not Tier 1 requirements -- escrow releases in equal tranches at 6-month intervals over 36 months (*i.e.*, 15% of each principal's holding released in each tranche) with 10% of each principal's holding exempt from escrow.

- An emerging issuer that achieves established issuer status during the term of its escrow would "graduate", resulting in a catch-up release and accelerated release of any securities remaining in escrow under the faster schedule applicable to established issuers as if the issuer had originally been classified as an established issuer.

- Escrowed securities could generally not be transferred or otherwise dealt with during escrow. Permitted transfers or dealings within escrow would include: (i) transfers to continuing or, upon their appointment, incoming directors and senior officers of the issuer or of a material operating subsidiary, with approval of the issuer's board of directors; (ii) transfers to an RRSP or similar trusteed plan provided that the only beneficiaries are the transferor or the transferor's spouse or children; (iii) transfers upon bankruptcy to the trustee in bankruptcy; and (iv) pledges to a financial institution as collateral for a *bona fide* loan, provided that upon a realization the securities remain subject to escrow. Tenders of escrowed securities to a take-over bid would be permitted provided that, if the tenderer is a principal of the successor issuer upon completion of the take-over bid, securities received in exchange for tendered escrowed securities are substituted in escrow on the basis of the successor issuer's escrow classification.

- A securityholder that is or would otherwise be a principal would be permitted to sell all or any portion of its securities of the issuer to the public at the time of the issuer's IPO provided that the secondary distribution is disclosed in the issuer's IPO prospectus and either:
    - the issuer's IPO is firmly underwritten; or
    - all securities offered in the IPO by the issuer are sold before any sale is completed under the secondary offering and no director, officer or promoter of the issuer or of a material operating subsidiary or any of their affiliates and associates, is a seller under the secondary offering.

For further information, contact:

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