THE UPDATE

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Corporate Securities

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Proposed National Policy 51-201

Disclosure Standards for Public Companies

Overview

The Canadian Securities Administrators (the "CSA") recently released for comment an important draft policy addressing a practice commonly known as "selective disclosure" whereby a public company shares material information with certain market participants, such as research analysts or institutional investors, without publicly disclosing the information. The proposed National Policy 51-201 (the "Policy") follows the adoption by the United States Securities and Exchange Commission of Regulation FD ("Fair Disclosure")* last year. In contrast with Regulation FD, the Policy notes that in Canada existing provincial securities legislation dealing with insider trading and tipping sets out a specific and comprehensive code which prohibits selective disclosure. Accordingly, the Policy does not promulgate any new rules but instead describes the existing timely disclosure requirements; provides interpretative guidance on the existing legislative prohibition against selective disclosure; highlights disclosure with a high degree of risk; describes materiality; and provides various "best disclosure" practices that can be adopted by public companies.

National Policy Statement No. 40 - Timely Disclosure would be rescinded when the Policy comes into force.

Key Provisions

I. Disclosure

The Policy reiterates the fundamental principle that every investor should have equal access to material information that may affect investment decisions. Under existing legislation, a company is required to immediately disclose a "material change" in its business. Subject to certain exceptions, the existing legislation also prohibits a public company and any person or company in a special relationship with the company from informing ("tipping") anyone of a material fact or material change before that information has been generally disclosed.

A. Selective Disclosure in the Necessary Course of Business

The legislation does provide for permitted selective disclosure in the "necessary course of business" so as not to interfere with a company's every day business. The draft Policy provides interpretive guidance in this area. The exception is said to generally cover communications with

- vendors, suppliers or strategic partners; employees, officers and board members;
- lenders, legal counsel, auditors, financial advisors and underwriters;
- parties to negotiations (e.g. in connection with a private placement or acquisition);
- labour unions and industry associations;
- government agencies and non-governmental regulators; and
- credit rating agencies.

Specifically, the Policy states that this exception would **not** generally permit a company to make selective disclosure of material information to the media, analysts, institutional investors or other market professionals.

* For an overview of Regulation FD, please see Goodmans Client Communication of February 21, 2000.

The Policy also states that disclosures under this exception must be made on the understanding that the recipient will not disclose the information before it has been publicly disclosed.

B. "Generally Disclosed"

The tipping prohibitions do not apply to information that has otherwise been generally disclosed. The Policy notes that insider trading court decisions state that information is deemed to have been generally disclosed if it has been disseminated in a manner calculated to effectively reach the marketplace and public investors have been given a reasonable amount of time to analyze the information. The Policy suggests that the "generally disclosed" requirement may be satisfied by (i) news releases through widely circulated services; and (ii) announcements made through press conferences or conference calls provided that the public has been provided with appropriate notice of the date and time of the event, a general description of the subject matter to be discussed, the means of accessing the event, and whether and for how long the company will make a replay of the event available over its website. Significantly, though the Policy recognizes the importance and usefulness of information technology in improving communications to the marketplace, it specifically states in the Policy that the posting of information on a company's website will not *by itself* satisfy the "generally disclosed" requirement as internet access is not yet sufficiently widespread.

C. What is Material

Citing stock exchange policies, the Policy sets out examples of the types of information likely to be considered material under securities legislation. These include:

- capital reorganizations and mergers and acquisitions;
- significant acquisitions or dispositions;
- the borrowing or lending of a significant amount of funds or any mortgaging or encumbering in any way of a company's assets;
- the development of a new product or any development which affects a company's resources, technology, products or markets;
- the entering into or loss of a significant contract or other developments relating to a major customer or supplier;
- a significant change in near-term earnings prospects, in capital investment plans or corporate objectives or in management; significant litigation; and
- events regarding a company's securities (e.g. a default under a financing).

II. High Risk Disclosure Practices

A. Dealing with Analysts

The Policy sets out certain specific high risk disclosure practices. While acknowledging the valuable contribution that research analysts can make in keeping the markets informed, the Policy cautions that companies need to be sensitive to the risks involved in private meetings with analysts and should have a firm policy of providing only non-material and publicly disclosed information to analysts. The Policy suggests that selective disclosure to analysts can be avoided by including in a company's regular periodic disclosures details about topics of interest to analysts, such as expanding the scope of MD&A disclosure with interim financial statements. This could have practical benefits including greater analyst following, more accurate analyst forecasts with fewer revisions, less range among analysts' forecasts and increased investor interest.

The Policy highlights as high risk another common activity involving analysts whereby companies review earnings estimates prepared by analysts and selectively confirm the estimates or comment on the accuracy of the estimates, whether directly or indirectly, through implied "guidance". The Policy notes that, unlike Regulation FD, there is no exception to the tipping provisions for disclosures made to an analyst under a confidentiality agreement. Analysts who get an advance private briefing subject to such an agreement are said to have an unfair advantage.

B. Earnings Guidance

The recent trend by some companies to provide earnings guidance by voluntarily disclosing in press releases or on their websites their own "financial outlook" (which typically contain certain forecast information such as expected revenues, net income, earnings per share and R&D spending) is also said to be high risk. The Policy encourages companies to be open about their future proposals but it cautions that there must be a reasonable basis for any such statements and there must be included the appropriate statement of risks and cautionary language, such as a statement that the information is forward-looking; the factors that could

cause actual results to differ materially; and a statement of the material factors or assumptions used. The cautionary language should be substantive and tailored to the specific future estimates or opinions being forecasted and should also identify and quantity the risks.

III. Best Disclosure Practices

A. Corporate Disclosure Policy

Very importantly, the Policy sets out certain "best disclosure" practices that the CSA believes companies can adopt to help ensure good disclosure practices and compliance with securities legislation. The Policy advocates a company establish a written corporate disclosure policy which provides a process for disclosure and promotes an understanding of legal requirements among a company's directors, officers and employees. The company policy ought to be widely distributed and periodically reviewed and updated, with responsibility of functions clearly assigned within the company to those who will oversee and co-ordinate the policy. Every disclosure policy should address:

- how materiality is determined;
- a policy for the review of analyst reports, the procedure for releasing earnings announcements and conduct related to analyst calls, investors meetings and the media;
- conduct at industry conferences;
- electronic media and the corporate website;
- the use of forecasts and other forward-looking information;
- the response to unintentional selective disclosures and market rumours;
- a policy on trading restrictions; and
- a policy on "quiet periods".

B. Analyst Conference Calls

With respect to analyst conference calls and investor conferences, the Policy suggests the following disclosure model when making a planned disclosure of material corporate information:

- issue a news release containing the information (for example, quarterly financial results) through a widely circulated news or wire service;
- provide advance public notice by news release of the date and time of the call, the subject matter of the call and the means for accessing it;
- hold the analyst conference call in an open manner, permitting investors to listen either by telephone or through internet webcasting; and
- provide dial-in and/or web replay for a reasonable period of time after the conference call.

C. Draft Analyst Reports

The Policy also recommends the establishment of a separate policy to respond to the current trend among companies to comment on draft analyst reports, mindful of the serious risk, noted above, of a "tipping" violation if a company expresses comfort with an analyst's model or earning estimates. If a company policy allows for review at all, the policy should provide for limited review with a view to identifying only publicly disclosed factual information that may affect an analyst's model or to pointing out inaccuracies or omissions with reference to publicly available information about the company.

D. Quiet Periods

The Policy recommends that companies observe a "quiet" period between the end of a quarter and release of a quarterly (or annual) earnings announcement. During a quiet period, companies will typically not comment on the status of the current quarter's operations or expected results, or make any comments as to whether the company will meet, exceed or fall short of either the analysts' or its own earnings estimates. Quiet periods vary by company. Some companies adopt a quiet period beginning at the start of the third month of the quarter and ending upon the issuance of the earnings release. Other companies wait until two weeks before the end of the quarter or even the first day of the month following the end of the quarter to start the quiet period. Whatever quiet period a company adopts, the Policy suggests companies consider stopping **all** communications with analysts, institutional investors and other market professionals during the period, not just communications involving the quarterly results.

E. Insider Trading Policies and Blackout Periods

The Policy suggests companies consider adopting an insider trading policy that provides for a senior officer to approve and monitor the trading activity of all insiders. The insider trading policy should prohibit purchases and sales at any time by insiders who are in possession of material non-public information. The Policy should also provide for trading "blackout periods" when trading by employees (not just management) may not take place (for example a blackout period

which surrounds regularly scheduled earnings announcements). A company's blackout period may mirror the quiet period described above.

F. Electronic Communications

For electronic communications, the Policy recommends a company establish a team responsible for creating and maintaining the company's website, which should be kept up to date and accurate. Any outdated information should be removed to an archive which allows the public to continue accessing information that may have historical or other value. In addition, a company should post on the investor relations part of the website all supplemental information given to analysts, institutional investors and other market professionals, including data books, fact sheets, slides of investor presentations and other materials distributed at analyst or industry presentations.

The deadline for commenting on the draft Policy is July 25, 2001. We encourage you to contact one of our lawyers listed below if you would like to discuss the draft Policy or if you would like help in preparing a submission.

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