

## Corporate Securities

MARCH 5, 2003

### **New Insider Reporting Requirement for Equity Monetization Transactions**

#### **Overview**

In response to concerns that the existing insider reporting requirements may not apply to derivative-based transactions, the Canadian Securities Administrators (the "CSA") have recently released proposed Multilateral Instrument 55-103 - Insider Reporting for Certain Derivative Transactions (Equity Monetization) (the "Instrument"). Pursuant to the Instrument, insiders would be required to file insider reports in respect of derivative-based transactions, including equity monetization transactions. Submissions on the proposed Instrument will be accepted until May 31, 2003.

The objectives of the Instrument are to improve the market transparency of insider transactions involving derivatives, to ensure that insider reports are filed with respect to transactions which satisfy the policy rationale for insider reporting but which are not technically governed by the existing insider reporting rules, and to reduce the uncertainty surrounding which arrangements and transactions are subject to an insider reporting requirement. The Instrument reflects the view that timely public disclosure of all insider transactions is necessary in order to maintain the integrity of the insider reporting regime in Canada.

As further discussed below, it is important to note that once adopted, the Instrument will have a retroactive effect with respect to monetization arrangements entered into before the effective date of the Instrument. Insiders who have entered into unreported monetization transactions still in effect will be subject to a reporting requirement when the Instrument comes into force.

#### **Equity Monetization Transactions Defined**

Equity monetization transactions are those which allow an investor to receive a cash amount similar to proceeds of disposition: The investor transfers part or all of the economic risk and/or return associated with the securities of an issuer, without actually transferring the legal and beneficial ownership of such securities. The term "monetization" generally refers to the conversion of an asset, such as securities, into cash. A typical transaction would involve an insider selling a call option contract against shares of the company owned by the insider. The insider continues to own the shares but has "cashed out" his or her position.

The CSA believes that absent the disclosure of these transactions, the investing public may be misled by the publicly reported holdings of insiders. The reported holdings would no longer reflect an insider's true economic position in an issuer if the insider has entered into an unreported monetization transaction.

#### **The Insider Reporting Requirement**

The Instrument does not prohibit insiders from entering into monetization transactions, but imposes a reporting requirement with respect to such transactions. Insiders of a reporting issuer are required to disclose the existence and material terms of equity monetization transactions to the public. Specifically, insiders must file an insider report under the Instrument if they enter into an agreement, arrangement or understanding of any kind which:

- changes the insider's "economic exposure" to the reporting issuer, or
- changes the insider's "economic interest in a security" of the reporting issuer.

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The Instrument also contains a number of broad exemptions from the reporting requirement, which include:

- an agreement, arrangement or understanding which does not involve, directly or indirectly, a security of the reporting issuer (which includes a put, call or option to purchase or sell securities of the issuer) or a derivative which involves a security of the reporting issuer;
- an agreement, arrangement or understanding in the nature of a compensation arrangement such as a phantom stock plan, deferred share unit (“DSU”) plan or stock appreciation right (“SAR”) plan which would otherwise be caught by the Instrument if:
  - the existence and material terms of the compensation arrangement are disclosed in any public document (such as the annual audited financial statements of the issuer or an annual filing made under any provision of Canadian securities legislation); or
  - the material terms of the compensation arrangement are set out in a written document, and the alteration to economic exposure or economic interest occurs as a result of the satisfaction of a pre-established condition or criteria described in the document, and does not involve a discrete investment decision by the insider;
- a person or company exempt from the insider reporting requirements, to the same extent and on the same conditions as are applicable to such exemption;

- a person or company who has obtained exemptive relief in a jurisdiction from the insider reporting requirements of that jurisdiction, to the same extent and on the same conditions as are applicable to such exemptive relief; and
- a transfer, pledge or encumbrance of securities by a person or company for the purpose of giving collateral for a debt made in good faith so long as there is no limitation on the recourse available against the person or company for any amount payable under such debt.

If an insider is required to file a report under the Instrument, the same form of insider report is to be used as is filed in the case of an ordinary purchase or sale of securities.

## **The Effect of the Requirement on Pre-existing Arrangements**

In certain circumstances, the Instrument requires that insiders disclose the existence of monetization arrangements that were entered into *before* the eventual effective date of the Instrument. An insider will be required to file a report under the Instrument if, prior to the effective date, the insider: (i) entered into an agreement, arrangement or understanding in respect of which the insider would have been required to file an insider report under this Instrument if it had been entered into on or after the effective date, and (ii) the agreement, arrangement or understanding remains in effect on or after the effective date. Insiders in these circumstances will be required to file an insider report within ten days from the effective date of the Instrument.

The CSA takes the position that it is necessary for the Instrument to address pre-existing arrangements which continue in force after the effective date of the Instrument so the market can determine whether an insider’s publicly reported holdings truly reflect the insider’s economic position in the reporting issuer.

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We invite you to contact any member of the Goodmans securities team to discuss the proposed insider reporting requirements or to help you prepare comments on the Instrument.

## **Toronto**

**Sheldon Freeman** 416.597.6256  
sfreeman@goodmans.ca  
**Allan Goodman** 416.597.4243  
agoodman@goodmans.ca  
**Stephen Halperin** 416.597.4115  
shalperin@goodmans.ca  
**Tim Heeney** 416.597.4195  
theeney@goodmans.ca  
**Jonathan Lampe** 416.597.4128  
jlampe@goodmans.ca  
**Dale Lastman** 416.597.4129  
dlastman@goodmans.ca  
**David Matlow** 416.597.4147  
dmatlow@goodmans.ca  
**Neill May** 416.597.4187  
nmay@goodmans.ca  
**Stephen Pincus** 416.597.4104  
spincus@goodmans.ca  
**William Rosenfeld** 416.597.4145  
wrosenfeld@goodmans.ca

**Meredith Roth** 416.597.6260  
meroth@goodmans.ca  
**Neil Sheehy** 416.597.4229  
nsheehy@goodmans.ca  
**Jeffrey Singer** 416.597.4283  
jsinger@goodmans.ca  
**Bob Vaux** 416.597.6265  
rvaux@goodmans.ca  
**Kenneth Wiener** 416.597.4106  
kwiener@goodmans.ca  
**Vancouver**  
**Paul Goldman** 604.608.4550  
pgoldman@goodmans.ca  
**Steven Robertson** 604.608.4552  
srobertson@goodmans.ca  
**Bruce Wright** 604.608.4551  
bwright@goodmans.ca  
**Hong Kong**  
**Leo Seewald** 852.2522.1061  
lseewald@goodmans.ca

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