1.1.5 OSC Staff Notice 55-701 - Automatic Securities Disposition Plans and Automatic Securities Purchase Plans

ONTARIO SECURITIES COMMISSION
STAFF NOTICE 55-701

AUTOMATIC SECURITIES DISPOSITION PLANS AND AUTOMATIC SECURITIES PURCHASE PLANS

Purpose

Staff of the Ontario Securities Commission (staff or we) have recently received a number of questions on behalf of insiders who wish to establish an "automatic securities disposition plan" (sometimes referred to as a "pre-arranged structured sales plan") (an ASDP) with their broker.

We have compiled a list of the most frequently asked questions (the FAQs) and have set out our responses to such questions below.

This notice represents staff's views on the interpretation of certain requirements of Ontario securities law that apply to ASDPs. Although the focus of this notice is on ASDPs, we would generally consider the views set out below as also being applicable to "automatic securities purchase plans" (ASPPs) as described in National Instrument 55-101 *Insider Reporting Exemptions* (NI 55-101). Accordingly, unless otherwise indicated, a reference in this notice to a "plan" should be read as referring to both an ASDP and an ASPP.

This notice is intended to be a temporary notice pending the development by staff of the Canadian Securities Administrators (the CSA) of a CSA Staff Notice in relation to ASDPs and similar plans generally. We expect that the proposed CSA Staff Notice will also address additional questions, such as the application of certain requirements of Canadian securities legislation to insiders who wish to establish a managed account where full discretionary authority over the securities in the account rests with the manager of the account. Questions relating to managed accounts are beyond the scope of this notice.

In the meantime, we would remind issuers, insiders and other market participants that there may be differences in the securities law requirements of the other CSA jurisdictions that apply to automatic securities plans, and that the specific requirements of the other jurisdictions' securities legislation should be reviewed prior to establishing an ASDP or ASPP.

Background

We have recently received a number of enquiries on behalf of insiders who wish to establish an ASDP with their broker.

These types of plans typically involve an insider instructing a broker to sell securities from the insider's holdings in accordance with a pre-arranged set of instructions. The plans typically contemplate that the broker will continue to sell the securities regardless of whether a "blackout period"

established by the issuer may be in effect and regardless of whether the insider may be in possession of material undisclosed information about the issuer at the time of the sale.

The most common questions that we have received in relation to ASDPs are as follows:

- If an insider sells securities of a reporting issuer under an ASDP at a time when the insider has knowledge of material undisclosed information about the issuer, can the insider rely on the exemption contained in subsection 175(2)(b) of the regulations? In other words, is an ASDP an "other similar automatic plan" for the purposes of the exemption in s. 175(2)(b), with the result that the insider is exempt from the prohibition in subsection 76(1) of the Act and liability under section 134 of the Act?

- Is there a disclosure obligation at the time the insider enters into the ASDP?

- Does the insider have to file an insider report each time there is a disposition under an ASDP? Or can the insider rely on the insider reporting exemption for "automatic securities purchase plans" (ASPPs) in NI 55-101 which allows an insider to file a report on an annual basis rather than a transaction-by-transaction basis?

We have responded to these questions as follows.

1. Is the exemption in s. 175(2)(b) of the regulations available?

Although the exemption in s. 175(2)(b) refers to plans that are typically established by the issuer, staff take the view that this is not a necessary element under Ontario securities law, and an "other similar automatic plan" can include a plan established by an insider and the insider's broker, provided that the plan is "automatic", as discussed below, and the other conditions to the exemption are satisfied. (It should be noted, however, that securities legislation in other jurisdictions may limit this exemption to plans established by the issuer.)

We accept that a plan is "automatic" where the insider is able to demonstrate that the insider no longer has the ability to make decisions relating to trading in the securities in the plan and cannot make "discrete investment decisions" through the plan. (For more information on the concept of "discrete investment decisions", please see, for example, sections 5.2 and 5.5 of the Companion Policy to NI 55-101).

Accordingly, we will generally accept that a plan is an "automatic" plan for the purposes of s. 175(2)(b) of the regulations if it meets the following conditions:

a) At the time of entry into the plan, the insider is not in possession of any material undisclosed information in relation to the issuer.

b) At the time of entry into the plan, in the case of plans that have not been established by the issuer, the insider provides the broker with a certificate from the issuer confirming that the issuer is aware of the plan and certifying that, to the best of its knowledge, the insider is not in possession of material undisclosed information about the issuer.

c) The trading parameters and other instructions are set out in a written plan document at the time of the establishment of the plan.

d) The plan contains meaningful restrictions on the ability of the insider to vary, suspend or terminate the plan that have the effect of ensuring that the insider cannot profit from material undisclosed information through a decision to vary, suspend or terminate the plan.

e) The plan provides that the broker is not permitted to consult with the insider regarding any sales under the plan and that the insider cannot disclose to the broker any information concerning the issuer that might influence the execution of the plan.

f) The plan to purchase or sell securities was given or entered into in good faith and not as part of a plan or scheme to evade the insider trading prohibitions.

Where an insider's ability to vary, suspend or terminate the plan is not meaningfully restricted, we would likely question whether the plan may genuinely be regarded as an "automatic" plan for the purposes of s. 175(2)(b) of the regulations. This is because the insider retains discretionary authority over the securities in the plan and may be in a position to profit from material undisclosed information by varying, suspending or terminating the plan. For example, if an insider of an issuer establishes an ASDP and then comes into possession of material undisclosed information that is favourable to the issuer, the insider may profit from that information by terminating the plan. Similarly, if the insider comes into possession of material undisclosed information that is adverse to the issuer, the insider could vary the instructions to accelerate the dispositions. In both cases, we would likely take the view that the insider was making discrete investment decisions through the plan.

Where a plan contains meaningful restrictions on the ability to vary, suspend or terminate the plan, we will generally accept that the plan is an "automatic" plan for the purposes of s. 175(2)(b). We have previously advised insiders and their advisers that a simple requirement that the insider represent to the broker that the insider is not in possession of material undisclosed information at the time of the variation, suspension or termination would likely not be sufficient. Meaningful restrictions could include, for example, a requirement that the insider notify the issuer and the public (via a SEDI filing) of a change in instructions which filing would include a representation that the insider

is not in possession of any material undisclosed information.

2. *Is there a disclosure obligation at the time the insider enters into the ASDP?*

Staff take the view that this will depend on the particular circumstances of the plan. In making this determination, the following questions should be considered:

- Where the plan is established by the issuer, the issuer should consider whether establishing the plan constitutes a "material change", thereby triggering a news release and a material change report.

- Similarly, the issuer and the insider should consider whether the establishment of the plan constitutes a "material fact", with the result that no person with knowledge of the material fact can trade so long as it has not been generally disclosed. In discussions with staff, insiders and their advisers have in some cases expressed the concern that public disclosure of the plan at the time the plan is established may have a negative impact on share price as it will indicate that a large block of securities may shortly come onto the market. We note that this concern would appear to suggest that the establishment of the plan constitutes a material change and/or a material fact.

- The insider should consider whether entering into the arrangement involves a change in "direct or indirect … control or direction" over the insider's securities. If yes, then an insider report is required at the time the arrangement is entered into by virtue of s. 107(2) of the *Securities Act* (Ontario).

- The insider should consider whether entering into the arrangement involves a change in the insider's "economic interest" in a security of the reporting issuer, or the insider's "economic exposure to the reporting issuer". If yes, then entering into the arrangement will trigger a disclosure requirement under MI 55-103 *Insider Reporting for Certain Derivative Transactions (Equity Monetization)*, unless an exemption in that instrument is available.

Where the issuer and insider conclude that there is no legal requirement to disclose the existence of the plan at the time the plan is established, it may nevertheless be advisable to disclose the existence of the plan on a voluntary basis. Disclosure about the plan may eliminate questions about apparent trading activity by insiders during blackout periods and periods when the insiders may have access to material undisclosed information.

3. *Does the insider have to file an insider report each time there is a disposition under an ASDP?*

Generally the insider (or the broker on behalf of the insider) will be required to file insider reports each time there is a disposition under an ASDP. We recommend that the insider include a statement in the general remarks section that the sale is pursuant to an ASDP.

NI 55-101 allows for reporting on an annual basis for certain acquisitions of securities under an ASPP. As a result of recent amendments to NI 55-101, effective April 30, 2005, insiders can now report certain "specified dispositions" in connection with an ASPP on an annual basis. An ASDP is not an ASPP since it is designed to facilitate dispositions not acquisitions. However, if an insider wishes to make an application for exemptive relief, and is able to demonstrate that the plan is genuinely an automatic plan and the insider cannot make discrete investment decisions through the plan, staff may be prepared to recommend exemptive relief to allow the insider to file reports on an annual basis.

June 2, 2006