



THE MANITOBA
SECURITIES
COMMISSION

MSC NOTICE 2003-52

NOTICE OF PROPOSED MULTILATERAL INSTRUMENT 55-103 AND COMPANION POLICY 55-103CP

INSIDER REPORTING FOR CERTAIN DERIVATIVE TRANSACTIONS (EQUITY MONETIZATION)

Notice of Rule and Policy

The Commission has, under section 143 of the *Securities Act* (the Act), made Multilateral Instrument 55-103 *Insider Reporting for Certain Derivative Transactions (Equity Monetization)* (the Multilateral Instrument) as a Rule under the Act, and has adopted Companion Policy 55-103CP *Insider Reporting for Certain Derivative Transactions (Equity Monetization)* (the Companion Policy) as a Policy under the Act.

The Multilateral Instrument and Companion Policy are initiatives of the Canadian Securities Administrators (the CSA). The CSA have developed the Multilateral Instrument and the Companion Policy to respond to concerns that the existing insider reporting requirements may not cover certain derivative-based transactions, including equity monetization transactions (described below), which satisfy one or more of the fundamental policy rationale for insider reporting. We believe that timely public disclosure of such transactions is necessary in order to maintain and enhance the integrity of and public confidence in the insider reporting regime in Canada.

The Multilateral Instrument is expected to be adopted as a rule in each of Alberta, Manitoba, Ontario, Québec and Nova Scotia, a Commission regulation in Saskatchewan, and a policy in most other jurisdictions represented by the CSA. The Companion Policy is expected to be implemented as a policy in most jurisdictions represented by the CSA. The British Columbia Securities Commission has participated in the development of the Multilateral Instrument and Companion Policy. However, it has decided to implement similar requirements by proclaiming amendments to the British Columbia *Securities Act* and providing exemptions in a BC Instrument instead. Consequently, it is not anticipated that British Columbia will adopt the Multilateral Instrument and Companion Policy.

It is expected that, subject to necessary Ministerial approvals, the Multilateral Instrument and the Companion Policy will come into force on February 28, 2004. In Québec, every regulation made under section 331.1 of the Québec *Securities Act* must be approved, with or without amendment, by the Minister. The regulation is scheduled to come into force in Québec on February 28, 2004.

The Companion Policy will come into force on the date that the Multilateral Instrument comes into force. The Multilateral Instrument and the Companion Policy are collectively referred to as the Proposed Materials.

The Commission published a draft version of the Multilateral Instrument (the Draft Instrument) and Companion Policy (the Draft Policy) on February 28, 2003.

The CSA received seven submissions in response to the request for comments published with the Draft Materials. The CSA have considered the comments contained in these submissions, and the final versions of the Multilateral Instrument and Companion Policy being published with this Notice reflect the decisions of the CSA in this regard. We have attached to this Notice as Appendix “A” a list of commenters together with a summary of the comments received and the responses of the CSA. We have attached to this Notice as Appendix “B” a blackline showing changes made to the Draft Materials subsequent to the publication of the Draft Materials for comment in February 28, 2003.

The CSA are of the view that none of the revisions made to the Draft Materials is material. Accordingly, the Multilateral Instrument and the Companion Policy are not being published for a further comment period.

Substance and Purpose of the Multilateral Instrument and Companion Policy

1. Purpose of the Multilateral Instrument

The Multilateral Instrument seeks to maintain and enhance the integrity of and public confidence in the insider reporting regime by:

- ensuring that insider derivative-based transactions which have a similar effect in economic terms to insider trading activities are fully transparent to the market;
- ensuring that, where an insider enters into a transaction which satisfies one or more of the policy rationale for insider reporting, the insider is required to file an insider report, even though the transaction may, for technical reasons, fall outside of the existing rules governing insider reporting; and
- reducing uncertainty relating to what arrangements and transactions are subject to an insider reporting requirement and what are not.

2. What are equity monetization transactions?

Equity monetization transactions are transactions which allow an investor to receive a cash amount similar to proceeds of disposition, and to transfer part or all of the economic risk and/or return associated with 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.)

We are concerned that, if an *insider* of a reporting issuer enters into a monetization transaction, and does not disclose the existence or material terms of this transaction, there is potential for harm to investors and the integrity of the insider reporting regime because:

- an insider in possession of material undisclosed information, although prohibited from trading in securities of the issuer, may be able improperly to profit from such information by entering into derivative-based transactions which mimic trades in securities of the reporting issuer;
- market efficiency will be impaired since the market is deprived of important information relating to the market activities of the insider; and
- requirements relating to the public reporting of such holdings (e.g., in an insider report or proxy circular) may in fact mislead investors, since the insider's publicly reported holdings no longer reflect the insider's true economic position in the issuer.

Although we believe that many such transactions fall within the existing rules governing insider reporting, we recognize that, in certain cases at least, there may be a genuine question whether the existing insider reporting rules apply. Accordingly, we have developed the Multilateral Instrument to address these concerns.

The Multilateral Instrument reflects a principles-based approach to monetization transactions. If an insider enters into a transaction which satisfies one or more of the policy rationale for insider reporting, but for technical reasons it may be argued that the insider falls outside of the existing insider reporting requirements, the insider will be required to file an insider report under the Multilateral Instrument. In this way, the market can make its own determination as to the significance, if any, of such arrangements.

3. Purpose of the Companion Policy

The purpose of the Companion Policy is to set forth the views of the CSA as to the manner in which the Multilateral Instrument is to be interpreted and applied.

4. Summary of the Multilateral Instrument and Companion Policy

A comprehensive summary of the Multilateral Instrument and the Companion Policy may be found in the Notice of Proposed Multilateral Instrument 55-103 *Insider Reporting for Certain Derivative Transactions (Equity Monetization)* published on February 28, 2003.

Summary of Changes to the Multilateral Instrument and Companion Policy

We have attached to this Notice as Appendix “A” a list of commenters together with a summary of the comments received and the responses of the CSA. We have attached to this Notice as Appendix “B” a blackline showing changes made to the Draft Materials subsequent to the publication of the Draft Materials for comment.

The CSA are of the view that none of the revisions made to the Draft Materials is material. Accordingly, the Multilateral Instrument and the Companion Policy are not being published for a further comment period.

Related Staff Notice

A CSA staff notice containing examples of various types of monetization arrangements, together with staff recommendations as to how such arrangements may be reported under the System for Electronic Disclosure by Insiders (SEDI), will be published on or before the time the Multilateral Instrument takes effect.

Text of Multilateral Instrument and Companion Policy

The texts of the Multilateral Instrument and Companion Policy follow.

DATED: November 28, 2003

Appendix “A”

Summary of Comments & Responses

Comment letters were received from the following commenters:

- Comment dated May 30, 2003 from Michael Padfield (Ontario Teachers’ Pension Plan)
- Comment dated May 30, 2003 from Ken Hugessen (Mercer Human Resources Consultants)
- Comment dated May 31, 2003 from Clint Calder (CIBC)
- Comment dated June 3, 2003 from Blake, Cassels & Graydon
- Comment dated June 5, 2003 from Osler, Hoskin & Harcourt
- Comment dated June 13, 2003 Adam J. Segal (Borden Ladner Gervais)
- Comment dated July 28, 2003 from Simon Romano (Stikeman Elliott)

We would like to thank the commenters for taking the time to provide comments on the Draft Materials. We have carefully considered these comments and have provided summaries of the comments and our responses in the following table.

#	Theme	Comments	Responses
MULTILATERAL INSTRUMENT 55-103 – SUMMARY OF COMMENTS			
1.	General Support for the Initiative	<p>Five of the seven commenters expressed general support for the initiative, although several of the commenters qualified their support by reference to the need to address matters raised in their comments.</p> <p>These comments are summarized below.</p>	We acknowledge the support of the commenters, and thank them for their comments. We have carefully considered their comments, and, where we believe it appropriate, amended the proposed instrument.
2.	General Support for the Initiative (Ontario Teachers' Pension Plan)	<p>We have reviewed [the proposed instrument] from our perspective as an active institutional investor that reviews and relies on the accuracy and timeliness of others' insider reporting, that is obliged from time to time to file its own insider reports concerning substantial investments, and that invests in a wide variety of securities and financial instruments involving numerous investment strategies.</p> <p>We are generally in favour of MI 55-103 and we agree with the CSA that timely public disclosure of equity monetization transactions is necessary in order to enhance the integrity of, and public confidence in, the Canadian insider reporting regime.</p>	We acknowledge the support of the commenter.
3.	General Support for the Initiative (Mercer Human Resource Consulting)	<p>[W]e support your proposal to require disclosure of stock hedges by insiders.</p> <p>As compensation consultants, we frequently design equity-based compensation programs that are designed to tie executives to the company's stock and, thus, to the shareholder experience. This equity exposure is typically a fundamental objective of the plans we design. While we understand the portfolio diversification, risk and financial security needs of the individual executives that cause executives to hedge their positions, such hedging defeats one of the central objectives of these plans. Similarly, we encourage our clients to adopt share ownership guidelines and disclose executives' progress in achieving the required ownership levels; again, undisclosed hedging leaves shareholders unaware of the true extent of the executive's exposure to the stock.</p>	We acknowledge the support of the commenter.

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4.	General Support for the Initiative (Oslers)	We agree with the initiative of the Canadian Securities Administrators (“CSA”) to ensure that there is disclosure by insiders of a disposition of their economic interest in, or economic exposure to, securities of the reporting issuer of which they are an insider. Such disclosure is important for the public marketplace, particularly where an insider’s previously reported ownership of securities of a reporting issuer has been modified by the insider such that the insider is no longer exposed, in whole or in part, to the economic performance of the reporting issuer, as reflected in the share price of the securities owned by the insider.	We acknowledge the support of the commenter.
5.	General Concerns with the Initiative – Jurisdiction (CIBC)	... although it is likely not intended, implementation of the Proposed Rule could have the effect of imposing provincial regulatory requirements on banks and other federally regulated financial institutions. Such requirements could have an unintended disclosure impact on the business of banking, particularly routine lending activities.	To the extent the proposed instrument may have an impact on lending activities of federally regulated entities, we believe such impact will be minimal. We believe that a disclosure requirement for insider derivative-based transactions that have a similar economic effect to insider trading transactions is necessarily incidental to an insider reporting system.
6.	General Concerns with the Initiative – Application to pre-existing arrangements (CIBC)	<p>We find the retroactive effect of the Proposed Instrument to be quite troubling and inappropriate. Although the Proposed Policy attempts to justify the retroactive application of the reporting requirements, we feel that it is highly unusual to have new requirements apply retroactively. Many insiders may have entered into various transactions (such as lending arrangements involving limited recourse pledges) without filing insider reports based on a reasonable expectation (and based on legal advice) that such transactions were not subject to the insider reporting requirements.</p> <p>Although the Proposed Policy states that it is just attempting to clarify when the insider reporting requirements will apply (since they may not have applied in the past for “technical” reasons), there will be cases where some types of transactions were clearly not caught by the previous insider reporting requirements. Accordingly, the effect of Section 2.3 will be to retroactively change the law in this area.</p>	<p>We do not agree with the suggestion that the instrument has a “retroactive effect”. If an insider entered into a monetization arrangement prior to the effective date of the instrument, and the arrangement was properly not subject to a reporting requirement at that time, the proposed instrument does not change that fact.</p> <p>The focus of the proposed instrument is exclusively on insider reports filed <i>on and after</i> the effective date of the proposed instrument. If an insider files an insider report subsequent to the effective date, and the insider report will not convey an accurate picture of the insider’s true economic position vis-à-vis the issuer due to a pre-existing monetization arrangement that remains in effect, the insider must disclose the existence and material terms of this arrangement.</p> <p>In developing the proposed instrument, we considered whether it would be appropriate to provide for a general</p>

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		<p>We believe that such an action should not be taken lightly and should be reconsidered. In the event the CSA is not open to reconsidering this approach, then at a minimum we would recommend that the Proposed Policy include other examples of where the CSA has retroactively imposed regulatory requirements and state more compelling reasons why retroactive application of the requirements is necessary in this case.</p>	<p>“grandfathering” provision that would exempt from disclosure pre-existing arrangements. We concluded that this was not appropriate for several reasons:</p> <ol style="list-style-type: none"> 1) In view of the fact that many monetization arrangements are long-term arrangements, a grandfathering provision would effectively defeat the basic objective of the initiative: to ensure that insider reports filed after the effective date convey a true picture as to the insider’s economic position vis-à-vis the issuer in question. If a grandfathering provision were adopted, there would be no way to determine whether any insider report filed after the effective date accurately reflected the insider’s true economic position. 2) While we recognize that some insiders may have entered into transactions without filing insider reports based on an expectation that such transactions were not then subject to the insider reporting requirements, we do not believe that it would be reasonable to assume that such arrangements could never become subject to a reporting requirement, particularly in view of the long-term nature of such arrangements. 3) We recognize that, in many cases, insiders who have entered into unreported transactions have not done so with an intent to mislead the market. Nevertheless, we believe that continued non-disclosure of these transactions may inadvertently have this effect. We believe that insiders generally will be supportive of an initiative that ensures that this is not the case.
7.	<p>General Concerns with the Initiative – Application to pre-existing arrangements (Oslers)</p>	<p>... The Notice accompanying the Multilateral Instrument states that if “insiders are not required to disclose such pre-existing arrangements, the market will have no way of determining whether an insider’s publicly reported holdings truly reflect the insider’s economic position in the insider’s reporting issuer”.</p> <p>We agree with this statement. Nevertheless we have a</p>	<p>We remain of the view that, if insiders are not required to disclose pre-existing arrangements that remain in force, the market will have no way of determining whether an insider’s publicly reported holdings truly reflect the insider’s economic position in the insider’s reporting issuer.</p> <p>In view of the fact that many monetization arrangements</p>

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		<p>grave concern with requiring reporting of pre-existing arrangements. At the time such arrangements were entered into, there was no requirement to make public disclosure of them. It is likely this was a consideration to certain insiders who entered into the arrangement. There may have been a concern that disclosure of the insider's disposal of its economic exposure to the share performance of the issuer could cause a downward effect on the trading price of the shares. We agree that the Multilateral Instrument seeks to ensure this transparency, precisely so that the market price of the shares reflects such a disposition, and we agree that this result should take effect for every transaction going forward. However, if disclosure of pre-existing arrangements causes a decrease in share price now, then it is current investors who will suffer the economic consequence. It does not, in our view, seem right that they bear any risk of loss arising as a result of the disclosure. More importantly, the insider, who long ago hedged his/her/its economic exposure to the share price of the issuer, will be the one person or entity who will not bear any economic risk or impairment from the disclosure.</p>	<p>are long-term arrangements, the market's ability to evaluate the significance of insider reports will be seriously impaired for many years to come.</p> <p>With respect to the concern that disclosure of a pre-existing arrangement may cause a decrease in share price now, with the result that it is current investors who will suffer the economic consequences of disclosure, we believe that such cases will be rare.</p> <p>In many cases, we believe that it is unlikely that disclosure of the fact that an insider has previously monetized securities will have a significant impact on the trading price of the securities today. Where, for example, the insider entered into the pre-existing arrangement for reasons that are unrelated to the issuer or the insider's views of its prospects, disclosure of the arrangement should have little or no impact on the issuer's share price today.</p> <p>If it is the case that disclosure of the pre-existing arrangement will have a significant impact on the trading price, then we believe that this is information that should be available to <i>all</i> market participants, and not just to the insider, the insider's advisors, and other persons who may be aware of the specific transaction in question. In these circumstances the market price does not reflect all relevant information. Continued non-disclosure of a pre-existing arrangement may harm new investors who base their investment decision on the fact that the insider appears to have an ownership position in the issuer.</p>
8.	<p>General Concerns with the Initiative – Application to pre-existing arrangements (Mercer)</p>	<p>Under the current proposal, individuals would be required to disclose any hedging instruments outstanding on the date the instrument becomes effective. This would effectively require disclosure of instruments established when the need to disclose was less clear ... We agree with the argument that indefinite failure to disclose existing arrangements can result in a misleading representation of an individual's true exposure to the stock ...</p>	<p>In developing the proposed instrument, we considered whether it would be appropriate to provide for a delayed effective date that would apply to pre-existing arrangements. In view of the fact that, as a result of the public comment and review process, it was unlikely that the instrument would be in force prior to January 2004, we concluded that this was not appropriate.</p>

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		<p>We would suggest that to the extent that the instrument will apply to all instruments outstanding at the effective date, sufficient time be provided prior to the effective date to allow individuals to unwind their hedging arrangements, if they so desire. We would suggest that the effective date be at least 6 months after the date the final rule is published.</p>	
9.	<p>General Concerns with the Initiative – Application to pre-existing arrangements (Romano)</p>	<p>Pre-effective date equity monetizations should, if they will be required to be disclosed, not be subject to post-effective date reporting under ss.2.3 and 3.2 if they have already been reported prior to the effective date. In other words, insiders that filed insider reports with respect to an equity monetization should not be required to incur the cost and expense of another filing. In any event, 90 days or longer should be given for a s.3.2 filing, especially for non-residents of Canada. Ten days is too short.</p>	<p>If, prior to the coming into force of MI 55-103, an insider has appropriately filed an insider report on SEDI in respect of the transaction, it will not be necessary for the insider to make a second filing on SEDI pursuant to s. 3.2 of the proposed instrument.</p> <p>If an insider has previously filed an insider report in respect of a monetization transaction under the former paper-based system, it will be necessary for the insider to make a filing under SEDI to ensure that the transaction is disclosed on SEDI.</p>
10.	<p>General Concerns with the Initiative – Insider Report Form/SEDI (CIBC)</p>	<p>[W]e suggest that the CSA not introduce such a broad and sweeping change to the insider reporting obligations without at the same time carefully considering the reporting methodology. Special consideration should be made as to whether the current reporting form is sufficiently flexible to allow an insider to accurately complete the report in all of the circumstances now contemplated by the Proposed Instrument and whether such form will be an effective means of communicating to the market what action the insider has taken and how the particular action will change the insider’s “economic exposure” to a reporting issuer or “economic interest in a security”.</p> <p>On the latter point, given that many insiders may enter into equity monetizations, but still retain voting rights and</p>	<p>We have carefully considered the question of reporting methodology, and note that some insiders have filed insider reports, both in paper format and on SEDI, in respect of monetization transactions. We also note that insider reports in respect of monetization transactions are routinely filed in the U.S.</p> <p>CSA staff have prepared a staff notice to assist insiders who have entered into such transactions and to promote consistency in filings. The notice contains a number of examples of arrangements and transactions involving derivatives together with examples of how staff believe that insiders should report these arrangements and transactions. The staff notice will be published on or before the time the Multilateral Instrument takes effect.</p>

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		<p>certain upside and downside exposure to the securities being monetized, or even cash-settle the monetization and thereby retain full economic interest in the securities, we would be concerned that certain disclosure, if not clarified by means of a specialized form (or even a separate form), may result in confusing and misleading disclosure. We would also submit that the CSA may wish to consider the US approach to reporting such transactions.</p>	
11.	<p>General Concerns with the Initiative – Limited Scope of Initiative (Romano)</p>	<p>MI 55-103 CP should in my view address the disclosure required by control block holders engaging in equity monetizations (see s.2.8 of MI 45-102), and the obligation of 10%-plus shareholders to update early warning reports if they wish to engage in equity monetization when the possibility of doing so was not disclosed in a prior early warning report (thus potentially triggering the “change in another material fact” disclosure obligation under OSA s.101(2)).</p>	<p>We agree that monetization strategies potentially have implications for other areas of securities law, such as the control block distribution rules and the early warning rules.</p> <p>The focus of this initiative has been the insider reporting system. Accordingly, we have not addressed the other comments raised by the commenter in the companion policy. These comments will be considered as part of our ongoing review of such arrangements and in the context of the proposed Uniform Securities Legislation initiative.</p>
12.	<p>Definition of “Economic Exposure” (Oslers)</p>	<p>[W]e believe that ... the CSA has cast too broad a net. The Multilateral Instrument subjects an excessively wide range of activities to scrutiny and then includes several very broadly drafted exemptions to distinguish activities which are not intended to be caught by the Multilateral Instrument.</p> <p>The principal problem with the approach taken in the Multilateral Instrument is that the definition of “economic exposure”, ..., is overly broad in making reference to “the economic, financial or pecuniary interests of the reporting issuer.” ...</p> <p>The result is that a large number of transactions with insiders will be subject to scrutiny under the Multilateral Instrument which have nothing to do with transactions which can be the subject of an equity monetization.</p> <p>In our view, a more focussed view of the transactions to which the Multilateral Instrument should apply should be</p>	<p>We originally considered a substantive reporting test similar to the test proposed by the commenter, but concluded that the test arguably was overbroad, for the reason that certain agreements, such as shareholder agreements, escrow agreements and lock-up agreements, “involve” securities (or an interest in securities) of the reporting issuer but are not relevant to an insider reporting system. If a test similar to that proposed by the commenter were adopted as the substantive reporting requirement, we believe it would then be necessary to include an exemption based on whether the agreement altered the insider’s economic exposure to the insider’s reporting issuer, which would be the converse of the current approach.</p>

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		<p>adopted. As a suggestion, we submit that the following, which basically is the converse of the exemption in subsection 2.2(a), if adopted as the substantive reporting requirement would meet all of the concerns that the Multilateral Instrument is seeking to address:</p> <p style="padding-left: 40px;">an agreement, arrangement or understanding which involves, directly or indirectly, an interest in a security of the reporting issuer or a derivative in respect of which the underlying interest is or includes as a material component a security of the reporting issuer.</p> <p>The reporting obligation which this Multilateral Instrument is attempting to impose should only apply to changes in the insider’s economic exposure to the performance of the reporting issuer.</p>	
13.	<p>Definitions – “Economic Exposure” and “Economic Interest in a Security”</p> <p>(CIBC)</p>	<p>We believe that the “economic exposure” definition is overly subjective and largely redundant as the “economic interest in a security” definition would cover substantially the same ground. In addition, we feel that the “economic exposure” definition is too broad and is not limited to dealings in securities of the reporting issuer. ... Although the Proposed Policy attempts to set out the justification for requiring both tests, we do not feel that any of the stated reasons are compelling. The example given of an insider entering into a “naked short” is not particularly helpful in that most insiders would be prohibited from entering into such short sales (either because of internal policies or because of governing legislation which prohibits such transactions) and, in any event, it is submitted that such a sale would likely be caught by the existing insider reporting requirements.</p>	<p>Although we would agree that there is some overlap between the “economic interest” test and the “economic exposure” test, we do not believe that they are identical. Indeed, the commenter’s suggestion that the economic exposure test is overly broad implicitly acknowledges this.</p> <p>We believe that there may be certain transactions that should be subject to a reporting requirement but that arguably may not be caught by the “economic interest” test alone.</p> <p>For example, if an insider holds <i>no</i> securities of a reporting issuer, the insider would appear to be free to engage in derivative-based transactions that replicate trades, because arguably the insider does not have an economic interest in any security which may be altered by the transaction. We do not believe that it should be automatically assumed that such transactions will in all cases be prohibited and/or subject to existing reporting requirements.</p> <p>Secondly, the “economic interest” test may not catch certain derivative-based compensation arrangements that</p>

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			<p>we believe should be subject to a disclosure requirement. If a compensation arrangement allows for an exercise of discretion similar to the exercise of discretion contemplated by a conventional stock option plan, we believe that this exercise of discretion should be transparent to the market. If the arrangement provides for a payout in the form of cash reflecting the change in value of a security, rather than a payout in the form of a security, there may be a question as to whether the arrangement involves a “security”. In this case, we would question whether such an arrangement would be caught by the “economic interest” test.</p> <p>Thirdly, the economic exposure test requires consideration of related financial positions. If an insider, for example, holds a long position and an offsetting short position, the acquisition of the short position arguably does not directly affect the insider’s economic interest in the long position. Arguably the insider retains his or her economic interest in the long position (viewed in isolation). It is only through consideration of the related offsetting positions together that the insider may be said to have changed his or her economic position. The insider has neutralized his or her economic exposure to the issuer.</p>
14.	Definitions – “Economic Exposure” and “Economic Interest in a Security” (CIBC)	We recommend that the last four lines of the definition of “economic interest in a security” be amended to read “and includes, without limitation, the extent to which such person or company has the right, directly or indirectly, to profit or share in any profit derived from a transaction in such security”. We believe the other words are unnecessary and obscure the intent of the definition.	We have simplified the definition of “economic interest in a security”. The definition now reads “economic interest in a security” means (i) a right to receive or the opportunity to participate in a reward, benefit or return from the security, or (ii) exposure to a loss or a risk of loss in respect of the security. This amendment is intended to facilitate readability, and is not intended to alter the substantive meaning of the definition of “economic interest in a security”. We have deleted the reference to “pecuniary interest” and the

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			closing language from the definition that was based on the definition of “pecuniary interest” in SEC Rule 16a-1(a)(2), as we believe that the current definition is broad enough to cover this language.
15.	Definitions – “Security of a Reporting Issuer” (Blakes)	We believe that the reference in clause (b) of the definition of “security of a reporting issuer” to “a security, the market price of which varies materially with the market price of a security of the reporting issuer” is ambiguous in that it could expand the scope of insider reporting to trades in securities issued by another issuer whose trading price closely correlates to the trading price of the reporting issuer of which the person is an insider. ... Accordingly, we believe that clause (b) of the definition should be amended to replace the phrase “varies materially with the market price” with the phrase “is derived from, referenced to or based on”, similar to that contained in the definition of “derivative”.	We agree with this comment and have amended the proposed instrument accordingly.
16.	Definitions – “Underlying Interest” (Blakes)	We recommend replacing the term “underlying interest” used in section 2.2(a) with the term “underlying security, interest, benchmark or formula”, which is used in the definition of “derivative”, to ensure clarity as well as consistency across those jurisdictions that do not have a local rule defining “underlying interest”.	We agree with this comment and have amended the proposed instrument accordingly.
17.	Scope of Section 2.1 – The Reporting Trigger (Teachers)	We believe that section 2.1 should be expanded to also require reporting of the termination of, or material amendments to, reported agreements, arrangements or understandings altering the insider’s economic exposure to (or interest in) the reporting issuer (or its securities), so long as the reporting insider remains an insider.	We agree with this comment and have amended the proposed instrument accordingly.
18.	Scope of Section 2.1 – The Reporting Trigger (CIBC)	We believe that the reporting requirement should not be triggered until a legally enforceable agreement exists. ... Requiring an insider to report an “understanding of any nature or kind” may lead to the dissemination of unreliable and misleading information. By way of example, some market participants operate their business	The reporting requirement in section 2.1 is triggered when an insider enters into “an agreement, arrangement or understanding ... , the <i>effect of which</i> is to alter” the insider’s economic exposure to the reporting issuer or the insider’s economic interest in a security of the reporting

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		<p>such that the documentation for an equity monetization transaction is settled first, but not signed until an agreement is reached on the pricing and other relevant terms. ... If the participant is not able to execute its hedge at a suitable price, the transaction may never occur.</p> <p>By including the words “understanding of any nature or kind” in the Proposed Instrument, one may argue that the insider should file a report at the time that the documentation is settled or when the participant begins putting its hedge in place since at either of those times one might say that they have an “understanding of any nature or kind”...</p> <p>Accordingly, we recommend that the wording of Section 2.1(a) be amended to read “enters into a binding agreement or arrangement, the effect of which is to alter ...”.</p>	<p>issuer.</p> <p>If an informal understanding or an undocumented arrangement exists, and such understanding or arrangement has the <i>effect</i> of altering the insider’s economic interest or economic exposure, the understanding or arrangement should be disclosed.</p> <p>If the documentation has been settled but not signed, and there is no agreement on pricing or other relevant terms, we would question whether there has been any alteration to the insider’s economic interest or economic exposure.</p>
19.	Exemptions – Section 2.2(a) (CIBC)	<p>With regard to the “material component” test, the Proposed Policy states that in determining materiality similar considerations to those involved in the concepts of material fact and material change would apply. Presumably, this is intended to mean that a security of a reporting issuer would be considered to be a material component of a derivative entered into by an insider of the reporting issuer if a market participant would consider the presence (or level of presence) of the security underlying the derivative to be material. It is submitted that the reference to the concepts of material fact and material change in the Proposed Policy is not particularly helpful and more clarity should be built into the Proposed Instrument in this regard. For example, if an insider of a company whose securities comprised part of the S&P/TSE 60 index purchased a bank-issued deposit or entered into a third-party derivative linked to such index, at what point would the insider be required to report the transaction under the Proposed Instrument? If the insider entered into the transaction at a time when the securities were considered to be a “material component” of the</p>	<p>We believe that the language of section 2.2(a) is clear.</p> <p>If an insider of an issuer whose securities comprised part of the S&P/TSE 60 index entered into a third-party derivative linked to such index, the insider would only be required to report the transaction if the issuer’s securities constituted a material component of the index. In determining whether a security is a material component of the index, the insider should consider the concept of materiality used in the definitions of “material change” and “material fact” in securities legislation.</p> <p>The definition of “material change” in Ontario, for example, makes reference to a change “that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer”. If a material change in relation to an issuer would reasonably be expected to have a significant effect on the market price or value of units of an index, the issuer’s securities would be a material component of that index.</p>

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		<p>derivative, what would happen if the securities became less of a component of the index (i.e. a Nortel situation)? Presumably, any new (or unwinds of) derivatives on the index would not be reported, with the result that any earlier reports may not reflect the insider’s true economic position.</p>	<p>If an insider entered into the transaction at a time when the securities were considered to be a “material component” of the derivative, and the securities ceased to be a material component, the reporting obligation would cease. The relevant time for determining whether a security is a material component of a derivative is the time that section 2.1 is triggered.</p> <p>It should also be noted that a number of additional exemptions have been added that may also address the concerns identified in this comment, including</p> <ul style="list-style-type: none"> • an exemption for agreements entered into by an insider in the ordinary course of business of the insider (new subsection 2.2(f)) and • an exemption for credit derivatives (new subsection 2.2(g))
20.	Exemptions – Section 2.2(a) (Oslers)	<p>Subsection 2.2(a) is currently too narrow. Any understanding which indirectly involves a security or a derivative will not be exempt under this provision. Subsection 2.2(a) should be revised to apply to any agreement, arrangement or understanding which does not involve, directly or indirectly, “<i>an interest in</i>” a security of the reporting issuer or a derivative.</p>	<p>We have amended the section accordingly.</p>
21.	Exemptions – Section 2.2(b) Compensation Arrangements (Teachers)	<p>We believe that providing an exemption when compensation arrangements will be disclosed in an issuer’s annual financial statements or other filings, at some date after the arrangements come into effect, would lead to situations where the insider’s publicly reported holdings do not reflect the insider’s true economic position in the issuer for a lengthy period. An issuer’s annual statements or filings disclosing the compensation arrangements may not be available for over twelve months after the compensation arrangements have taken effect. ... We believe that this could create inappropriate delays in disclosure and an unwarranted difference between the standards of reporting required of employee insiders and other insiders.</p> <p>An exemption from disclosing an employee insider’s</p>	<p>We acknowledge that there is the potential for inconsistency in treatment between insiders who participate in compensation arrangement and insiders who do not participate in such arrangements. However, we have not amended the proposed instrument at this time in response to this comment for the following reasons.</p> <p>Generally, we believe that compensation arrangements that have a similar economic effect to conventional stock-based compensation arrangements should be transparent to the market. For example, if a compensation arrangement allows for an exercise of discretion similar to the exercise of discretion inherent in a conventional stock option plan, we believe that this exercise of discretion should be transparent to the market. We do not believe that a disclosure requirement should turn simply on whether the</p>

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		<p>derivative transactions, simply because the issuer would later be required to disclose the compensation arrangements in question, is inconsistent with the objectives of MI 55-103. Unlike paragraph 2.2(b)(ii), paragraph 2.2(b)(i) addresses circumstances in which a discrete investment decision is being made by the employee insider. The concerns cited in the Companion Policy relating to harm to investors and the integrity of the insider reporting regime could all arise: misleading public reporting of insider positions, impaired market efficiency, and the increased possibility of insiders improperly profiting from material undisclosed information. ...</p> <p>An exemption of the type contemplated in paragraph 2.2(b)(i) should only be available if the compensation arrangements in question are currently disclosed.</p>	<p>plan, for example, provides for a payout in the form of a security, or a payout in the form of a cash amount reflecting the change in value of a security. We believe that the policy rationale underlying an insider reporting system – deterring insider misuse of and profiting from material undisclosed information and signalling insider views as to the prospects of an issuer – apply equally to both forms of plan.</p> <p>However, we recognize that some market participants have historically taken the view that certain stock-based compensation arrangements are not subject to the insider reporting requirements on the grounds that, allegedly, the arrangements do not involve a “security”. (See, for example, the next comment.)</p> <p>Although we do not necessarily agree with this view, we have attempted to be sensitive to the concern that the proposed instrument may potentially extend the insider reporting regime into areas of executive compensation more properly covered by other regulatory regimes.</p> <p>Accordingly, the proposed instrument attempts to strike an appropriate balance between the benefits to the market for timely disclosure of insider activities and the burdens that may be imposed on insiders and their issuers in terms of a new filing requirement. In the case of compensation arrangements that come within the exemption in s. 2.2(b)(i) of the proposed instrument, we believe that the fact that the existence and material terms of the arrangement will ultimately be disclosed in a public filing makes the need for immediate disclosure through the insider reporting system unnecessary at this time.</p> <p>We will consider this question further as part of our ongoing review of issues relating to insider reporting, and may reconsider this response at a future time.</p>
22.	Exemptions – Section 2.2(b) Compensation Arrangements	The Multilateral Instrument, as drafted, would appear to require reporting for a very large number of compensation arrangements for which there are currently	In most cases, we do not expect there to be any significant change to the existing approach to reporting (or not reporting) of compensation arrangements.

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	(Blakes)	<p>no insider reporting requirements. This represents a very significant change in approach and policy. For example, stock appreciation rights, restricted share units and deferred share units (a type of restricted share unit) would all appear to be caught by the insider reporting requirements imposed by the proposed Instrument. Such arrangements which provide for the possibility of a payout in shares or other securities, whether acquired in the market or issued from treasury, are arguably caught by the current insider reporting rules and certainly, to our knowledge, this is the view taken by most issuers. However, where these arrangements provide only for a cash payment by the issuer, the commonly accepted view is that they are not subject to current insider reporting requirements as they are not securities. ...</p> <p>We note that the exception in section 2.2(b)(i)(A) will be of limited benefit as annual audited financial statements do not typically contain disclosure of individual compensation arrangements. ...</p> <p>Similarly, while the current requirements require a narrative description of the executive compensation arrangements for directors, which would typically apply to deferred share unit plans, such disclosure does not require individualized disclosure for each director of the number of deferred share units granted to him or her and thus it appears each director would be required to individually disclose these under the proposed insider reporting requirements, while such units granted to named executives would not be subject to the proposed reporting requirements.</p>	<p>We note that the commenter’s concern may be based on an interpretation of the proposed exemption in section 2.2(b)(i)(A) of the proposed Instrument that is narrower than our intention. It is not intended that “disclosure of individual compensation arrangements” in a public filing be a precondition to reliance on the exemption. If an issuer establishes a plan for its directors, and an insider participates in the plan because the insider is a director, the insider is not subject to a disclosure requirement if the plan and its general terms (e.g., the fact that the plan is available to all directors) are disclosed in a public filing.</p> <p>We have amended the proposed instrument to clarify this point.</p> <p>As explained in the proposed companion policy, a compensation arrangement will only be caught by the proposed instrument if:</p> <ul style="list-style-type: none"> • the insider is not otherwise required to file an insider report in respect of such arrangement under any provision of Canadian securities legislation; • the arrangement involves, directly or indirectly, a security of the reporting issuer or a derivative which involves a security of the reporting issuer; • the arrangement is not disclosed in any public document (such as audited annual financial statements or any other regulatory filing); and • the insider is able to alter his or her economic interest in securities of the reporting issuer, or his or her economic exposure to the reporting issuer, through “discrete investment decisions”. <p>We believe that, in these circumstances, there is a compelling case for public disclosure of such an arrangement through the insider reporting system.</p>
23.	Exemptions – Section 2.2(b)	We note the exemption provided in section 2.2(b)(ii)	We understand that some compensation arrangements

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	Compensation Arrangements (Blakes – Continued)	requiring “the satisfaction of a pre-established condition or criterion” rarely applies in the case of the grant of most stock appreciation rights, restricted stock unit or deferred stock unit plans. Hence, this exception would not apply to many such arrangements.	provide for a payout (in cash or otherwise) only upon the occurrence of certain specified events, such as retirement or other termination of office or employment. In view of the fact that the occurrence of such an event generally will not reflect an investment decision by the participant, the policy rationale for insider reporting do not apply to such an event.
24.	Exemptions – Section 2.2(b) Compensation Arrangements (Blakes – Continued)	Based on [the previous comments of the commenter] and the statement by the CSA in the Companion Policy that “compensation arrangements are not the primary focus of the Multilateral Instrument”, the simplest approach would be to exempt from the Instrument compensation arrangements on the basis that, for named executive officers, these would be specifically disclosed in any event under executive compensation disclosure requirements and for directors, their arrangements are disclosed on a narrative basis.	<p>We do not agree with the suggestion that all compensation arrangements should automatically be exempted from the proposed instrument.</p> <p>The fact that a compensation arrangement may be subject to a separate disclosure requirement under an executive compensation disclosure regime does not necessarily mean that such an arrangement should not be disclosed under an insider reporting regime. Under the current insider reporting regime, for example, the grant and exercise of stock options are clearly reportable events, notwithstanding the fact that such events may also be subject to executive compensation disclosure requirements.</p> <p>If a compensation arrangement allows for an exercise of discretion similar to the exercise of discretion inherent in a conventional stock option plan, we believe that this exercise of discretion should be transparent to the market.</p> <p>We do not believe that a disclosure requirement should turn simply on whether the plan, for example, provides for a payout in the form of a security, or a payout in the form of a cash amount reflecting the change in value of a security. We believe that the policy rationale underlying an insider reporting system – deterring insider misuse of and profiting from material undisclosed information and signalling insider views as to the prospects of an issuer – apply equally to both forms of plan.</p>
25.	Exemptions – Section 2.2(b)	[T]he exemption only permits the insider to rely upon it if	We recognize that the availability of this exemption will

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	Compensation Arrangements (Oslers)	<p>the <i>reporting issuer</i> has disclosed sufficient information about the compensation arrangement. Therefore, the insider is not in control of whether the exemption is available to it.</p> <p>Furthermore, as the exemption in subsection 2.2(b)(i) states that the disclosure must be of the compensation arrangement “between the insider and the reporting issuer”, it would appear, on its face, that the disclosure cannot simply be of the general terms of a compensation plan applicable to any number of insiders, but must be and specific information in respect of that particular insider’s compensation arrangement. ... The exemption should therefore be recast to ensure that, at most, general disclosure concerning a plan is sufficient.</p>	<p>depend upon whether the <i>reporting issuer</i> has disclosed, or is required at law to disclose, sufficient information about the compensation arrangement. Accordingly, an insider will need to determine, prior to reliance upon this exemption, i) whether the general terms of the compensation arrangement have previously been disclosed in a public filing; or ii) whether, in the case of a new compensation arrangement, the reporting issuer is required to disclose, or otherwise intends to disclose, the general terms of the compensation arrangement in a public filing. In the case of a new compensation arrangement, we would expect an insider to obtain written confirmation from the reporting issuer that the issuer will make the necessary disclosure prior to reliance upon the exemption.</p> <p>The disclosure contemplated by this exemption is general disclosure about the material terms of the compensation arrangement applicable to all participants in the compensation arrangement. It is not intended that there be individualized disclosure about a specific insider’s individual circumstances (e.g., the fact that an insider may receive a certain number of units under the compensation arrangement). To clarify this point, we have replaced the phrase “between the insider and the reporting issuer” with the phrase “established by the reporting issuer”.</p>
26.	Exemptions – Section 2.2(b) Compensation Arrangements (Oslers)	<p>Subsection 2.2(b)(ii) requires that the terms of the compensation arrangement be set out in a written document and the alteration to the economic exposure or economic interest of the insider results from satisfaction of pre-established criterion or condition set out in <i>the</i> written document.</p> <p>In our experience, many compensation plan documents set out the general terms of the plan but the specifics of the grant of the compensation is done by way of a board resolution. Technically, this would not comply with the wording of 2.2(b)(ii). We suggest that the words “in the written document” be replaced with “in writing”.</p>	We have amended the instrument to address this concern.
27.	Exemptions – Section 2.2(e) (Full	[I]t is not clear to us why the exemption is only	We disagree with this comment. Where a pledge is made

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	<p>recourse debt) (CIBC)</p>	<p>applicable to full recourse debt. The Proposed Policy attempts to provide a rationale for this limitation by explaining the concern that a pledge in support of a limited recourse debt may effectively allow the insider to “put” the securities to the lender in satisfaction of the debt. Presumably, the rationale for this is a concern that in entering into a limited recourse loan, an insider would be transferring economic risk to the lender and that should be disclosed. However, it is just as likely that the insider may repay the debt with the result that any prior disclosure of the pledge will have been misleading. Requiring disclosure of a pledge in respect of non-recourse debt ignores that reality of the marketplace and it is submitted that a reasonable investor would not presume that such a pledge represents a change in an insider’s economic interest in a security any more than a pledge in respect of a full recourse debt obligation.</p> <p>Moreover, limiting the exemption in this way effectively amends the definition of “trade” in the securities legislation which would not include a pledge (except by a control block holder) as a trade if the collateral was provided for a debt obligation made in good faith. Accordingly, if the exemption is not available for pledges in respect of limited recourse debt obligations, the CSA is presumably adopting the position that for insider reporting purposes a limited recourse loan by an insider is not considered a debt made in good faith.</p>	<p>in connection with a limited recourse loan, the limitation on recourse to the pledged securities represents a transfer of economic risk in relation to the pledged securities from the insider to the lender. We believe that this transfer of risk should be transparent to the market.</p> <p>We recognize that, in many cases, the insider may ultimately repay the debt and reacquire the pledged securities (since, e.g., the securities may have appreciated in value) or deliver identical securities in exchange for the pledged securities. This does not alter the fact that the initial pledge on a limited recourse basis effectively transferred market risk from the insider to the lender.</p> <p>If there is no disclosure of the initial pledge, the market may believe that the insider remains fully at risk in respect of all of the insider’s publicly reported holdings. If the insider then purchases securities in the market in order to settle the insider’s obligations under the limited recourse loan, absence of disclosure about this loan may render this purchase misleading.</p> <p>We do not agree that creating an exemption for full recourse debt effectively amends the definition of “trade”.</p> <p>We do not agree with the statement that “for insider reporting purposes a limited recourse loan by an insider is not considered a debt made in good faith”. As noted in the Companion Policy, we recognize that investors, including insiders, may enter into monetization transactions for a variety of legitimate reasons.</p>
28.	<p>Exemptions – Credit Derivatives and Similar Arrangements (CIBC)</p>	<p>Further, given the nature of an ongoing lending relationship, one could imagine many situations where a lender might have “understandings or arrangements” with a reporting issuer borrower which could alter the lender’s “economic exposure” to such borrower. For example, each time the borrower makes a scheduled payment on the loan, the financial institution’s economic exposure to the borrower will have changed and, it could be argued, that the arrangement does not fit within the exemption in</p>	<p>We believe that the example cited by the commenter, a scheduled repayment by a borrower to a lender that is an insider of the borrower, will not trigger a reporting requirement under the Instrument for several reasons.</p> <p>First, if a borrower makes a scheduled payment on a loan, this will not constitute “entering into, materially amending or terminating” an agreement, arrangement or understanding described in section 2.1.</p>

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		<p>Section 2.2(a) of the Proposed Instrument because the payment may directly or indirectly involve a security (i.e. bond, debenture or other evidence of indebtedness) of the borrower. Again, it is submitted that requiring such disclosure will not further the stated policy objectives of the Proposed Instrument and suitable exemptions should be considered.</p>	<p>Secondly, we believe that in most cases either the agreement, arrangement or understanding will be subject to an insider reporting requirement under the existing insider reporting requirements or the insider will be entitled to rely on the exemption contained in section 2.2(a). We note that the commenter suggests that the exemption in section 2.2(a) of the Proposed Instrument may not be available because the commercial borrowing arrangement may “involve a security (i.e. bond, debenture or other evidence of indebtedness)”. If the commercial borrowing arrangement involves a security, we would expect the lender to be subject to an insider reporting requirement under the existing insider reporting rules. If the commercial borrowing arrangement does not involve a security, we would expect that the insider would be entitled to rely on the exemption in section 2.2(a).</p> <p>Nevertheless, for additional certainty, we have added the following exemptions:</p> <ul style="list-style-type: none"> • an exemption for agreements entered into by an insider in the ordinary course of business of the insider (new subsection 2.2(f) and • an exemption for credit derivatives (new subsection 2.2(g).
29.	<p>Exemptions – Other</p> <p>(CIBC)</p>	<p>[A] reporting issuer may be considered an insider of itself in circumstances where the reporting issuer has purchased, redeemed or otherwise acquired any of its securities for so long as it holds any of its securities. If, for example, a reporting issuer is in the process of redeeming some of its securities or is engaged in a normal course issuer bid, there may be a time period during which it is an insider of itself. During this time period, it is conceivable that the reporting issuer could be involved in various transactions which could be construed as altering the reporting issuer’s economic exposure to</p>	<p>If a financial institution is an insider of itself, and acquires securities through realization on collateral because of borrower default, the acquisition would likely be reportable under current rules, unless an exemption were otherwise available. We do not believe the proposed instrument alters this requirement.</p>

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		<p>itself or its economic interest in its securities. For example, there may be situations when the reporting issuer is holding its own securities as collateral for a loan to one of its employees. ... In the event the financial institution is in the midst of a normal course issuer bid, holds its own securities as collateral for a loan and realizes on such collateral because of a borrower default, should the financial institution file an insider report with respect to the securities it realized upon? What about securities previously held as collateral? It is submitted that such disclosure serves no useful purpose and the CSA should consider amending the Proposed Instrument to narrow the focus of the reporting requirements.</p>	
30.	<p>Exemptions – Other (CIBC)</p>	<p>By virtue of the definition of “securities” found in relevant securities legislation, certain insurance contracts and deposits issued by banks, credit unions or loan and trust companies are excluded from the application of such legislation. However, one effect of the Proposed Instrument will be to cause such instruments to be subject to the new insider reporting regime. ... As with the retroactive effect of the Proposed Instrument noted above, it is submitted that careful consideration should be made before making such a substantial change to one of the primary assumptions underlying Canadian securities law.</p>	<p>We understand that certain hedging strategies involve insurance contracts. We do not believe that hedging strategies by insiders that involve insurance contracts should be treated differently from hedging strategies by insiders that do not involve insurance contracts.</p>
31.	<p>Exemptions – Section 2.2(e) Full Recourse Debt (Romano)</p>	<p>Does an “economic interest in a security” include a <i>bona fide</i> loan secured by a pledge of securities? Does it matter whether the loan is legally non-recourse, structurally non-recourse (but legally full recourse), or full recourse legally and structurally? If so, then section 2.2 should include an appropriate exemption (see s.8.2 of NI 62-103) for financial institutions who grant loans in the ordinary course of their businesses, since they will not likely have the ability to monitor such transactions on a country-wide or world-wide basis, whether or not the financial institution is an insider of a reporting issuer. S.2.2(e) exempts full recourse pledges <u>by</u> the borrower, but apparently not the receipt of a <u>pledge</u> by a financial institution granting a loan. See also paragraph 8 of s.2.8</p>	<p>The exemption in section 2.2(e) of the proposed instrument is available “so long as there is no limitation on the recourse available against the insider for any amount payable under such debt”.</p> <p>A loan secured by a pledge of securities may contain a term limiting recourse against the borrower to the pledged securities (a legal limitation on recourse). Similarly, a loan secured by a pledge of securities may be structured as a limited recourse loan if the loan is made to a limited liability entity (such as a holding corporation) owned or controlled by the insider (a structural limitation on recourse). If there is a limitation on recourse as against the insider either legally or structurally, the exemption would</p>

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		of NI 55-103 CP.	not be available. We have added an exemption for an agreement, arrangement or understanding entered into by an insider in the ordinary course of the business of the insider. See subsection 2.2(f) of the proposed instrument.
32.	Exemptions – Other (Teachers)	If an insider is unaware that its economic exposure to the reporting issuer (or interest in its securities) has altered in particular circumstances, there should not be a requirement for the insider to file a report under MI 55-103, so long as the insider remains unaware of the alteration.	We agree with this comment and have amended the proposed instrument. See new subsection 2.2(h).
33.	Exemptions – Investment Funds (Borden Ladner Gervais)	<p>While we are in general agreement with the principles based approach to insider reporting put forward in the Proposed Rule, we are concerned that the tests set out in section 2.1 would require insiders of a reporting issuer to report trades of investment funds (including mutual funds, non-redeemable investment funds and other pooled funds) ...</p> <p>We would submit that generally insiders trading in securities of an investment fund, which holds securities of the insider’s reporting issuers, should not be subject to insider reporting requirements. Presumably this is consistent with the intent of subsection 2.2(a) of the Proposed Rule and an exemption to this effect should be included. ...</p> <p>Only a limited number of investment funds are likely to fall within the definition of “derivative” included in the Proposed Rule, i.e., Exchange Traded Funds, and thereby be included within the exemption. ...</p> <p>[I]f the materiality threshold were to be included in the exemption for passively managed investment funds, the definitions of an “index mutual fund” and “index participation unit” in National Instrument 81-102 – <i>Mutual Fund Distributions</i> could be incorporated into the Proposed Rule and the following might be appropriate:</p>	We generally agree with the concerns identified by the commenter, and have added an exemption similar to that suggested by the commenter.

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		<p>“a trade in a security of an investment fund, provided that if the fund is an index mutual fund or issues index participation units, securities of the reporting issuer do not form a material component of such investment fund’s economic, financial or pecuniary value.”</p>	
34.	<p>Exemptions – Actively Managed Funds (Borden Ladner Gervais)</p>	<p>As discussed above, it is our submission that the Proposed Rule should not require insiders to report trades in securities of actively managed investment funds. Similarly, where an insider trades in securities of an issuer that holds, as part of its investment portfolio, securities of the insider’s reporting issuer, then provided the insider is not a controlling shareholder of the issuer and does not have or share control of the investment portfolio, such trades should not be subject to the insider reporting requirements for the same reasons given above.</p> <p>If the materiality threshold for passively managed investment funds were to included in the exemption, the following might be appropriate:</p> <p>“a trade in a security of an issuer, which holds directly or indirectly securities of the reporting issuer, provided:</p> <ul style="list-style-type: none"> (i) the insider is not a controlling securityholder of the issuer; and (ii) the insider does not have or share investment control over the securities of the reporting issuer; and (iii) if the issuer is an index mutual fund or issues index participation units, securities of the reporting issuer do not form a material component of 	<p>We generally agree with the concerns identified by the commenter, and have added an exemption similar to that suggested by the commenter.</p>

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		such issuer’s economic, financial or pecuniary value.”	
35.	<p>Exemptions – s. 2.2(a) Concept of Materiality</p> <p>Borden Ladner Gervais</p>	<p>[T]he inclusion of a materiality threshold does raise some concern for insiders and their advisors since the information needed to ascertain whether or not such threshold has been met is frequently unavailable on a timely basis. This is not necessarily the case with derivative transactions, which should generally be more transparent since the underlying security, formula or benchmark is fixed, but if such a test were applied to actively managed investment funds or other securities, securities of the insider’s reporting issuer might comprise a small percentage of the fund’s portfolio one day and a much larger percentage on another. ...</p> <p>Notwithstanding the interests of securities regulators in moving towards a more principles based approach to securities regulation, some guidance with respect to the percentage of securities in a securities portfolio, benchmark index, etc. which the regulators would consider to satisfy the materiality threshold would be appreciated. ... If a similar threshold [to the control block threshold] were used for materiality, the following language might be inserted in Part 2 of the Companion Policy at item 6 after the last sentence:</p> <p style="padding-left: 40px;">“Generally, if securities of the reporting issuer comprise more than 20% of the economic, financial or pecuniary value of an issuer, such securities should be considered a material component of the issuer’s economic, financial or pecuniary value. In the case of an agreement, arrangement or understanding that involves a derivative, if securities of the reporting issuer comprise more than 20% of the</p>	<p>We have not adopted this comment. We believe that market participants are familiar with and able to apply the concept of materiality in the context of the concepts of material fact and material change.</p>

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		<p>economic, financial or pecuniary value of the underlying interest, benchmark or formula, such securities should be considered a material component of the underlying interest.”</p>	

Appendix "B"

[Blackline February 2003 draft to final draft of Instrument and Policy]

MULTILATERAL INSTRUMENT 55-103

INSIDER REPORTING FOR CERTAIN DERIVATIVE TRANSACTIONS (EQUITY MONETIZATION)

PART 1 DEFINITIONS

1.1 Definitions – In this Instrument

“compensation arrangement”¹ includes, but is not limited to, any plan, contract, authorization or arrangement, whether or not set forth in any formal document and whether or not applicable to only one individual, under which cash, securities, options, SARs, phantom stock, warrants, convertible securities, restricted shares or restricted share units, performance units and performance shares, or similar instruments may be received or purchased;

“~~derivative~~”² means control person” means

- (a) a person holding a sufficient number of the voting rights attached to all outstanding voting securities of an issuer to affect materially the control of the issuer,
- (b) one or a combination of persons acting in concert by virtue of an agreement, arrangement, commitment or understanding and holding a sufficient number of the voting rights attached to all outstanding voting securities of an issuer to affect materially the control of the issuer, or
- (c) a person or combination of persons holding more than 20% of the voting rights attached to all outstanding voting securities of an issuer, unless there is evidence that the holding does not affect materially the control of the issuer;

“credit derivative” means a derivative in respect of which the underlying security, interest, benchmark or formula is, or is related to or derived from, in whole or in part, a debt or other financial obligation of a reporting issuer;

“derivative” means an instrument, agreement or security, the market price, value or payment obligations of which are derived from, referenced to or based on an underlying security, interest, benchmark or formula;

“economic exposure”³ in relation to a reporting issuer means the extent to which the economic, or financial ~~or pecuniary~~ interests of a person or company are aligned with the trading price of securities of the reporting issuer or the economic, or financial ~~or pecuniary~~ interests of the reporting issuer;

“economic interest in a security” means ~~the extent to which a person or company is entitled to receive, bears or is subject to~~

- (a) ~~(a) — an economic, financial or pecuniary~~⁴ a right to receive or the opportunity to participate in a reward, benefit or return from a particular the security, or
- (b) ~~(b) — an economic, financial or pecuniary~~ exposure to a loss or a risk of loss in respect of a particular security, and includes, without limitation, the extent to which such person or company has or shares the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in such security or a transaction which directly or indirectly involves such to the security;

“effective date” means the date specified in Part 5 of this Instrument;

“exemptive relief” has the ~~same meaning as is~~ ascribed to that term in National Policy 12-201 *Mutual Reliance Review System for Exemptive Relief Applications*;

“insider report” means a report in the form prescribed for insider reports under securities legislation;

“NI 55-101” means National Instrument 55-101 *Exemption from Certain Insider Reporting Requirements*;

“reporting issuer” does not include a mutual fund that is a reporting issuer;

“security of a reporting issuer” ~~shall be~~ is deemed to include⁵

- (a) a put, call, option or other right or obligation to purchase or sell securities of the reporting issuer; and
- (b) a security, the value or market price of which varies materially with the are derived from, referenced to or based on the value, market price or payment obligations of a security of the reporting issuer; ~~and~~

“stock appreciation right” (“SAR”)⁶ means a right, granted by an issuer or any of its subsidiaries as compensation for services rendered or otherwise in connection with office or employment, to receive a payment of cash or an issue or transfer of securities based wholly or in part on changes in the trading price of publicly traded securities.

PART 2 REPORTING FOR CERTAIN DERIVATIVE TRANSACTIONS

2.1 Reporting Requirement – If an insider of a reporting issuer

- (a) enters into, materially amends or terminates an agreement, arrangement or understanding of any nature or kind, the effect of which is to alter ~~either,~~ directly or both of indirectly,
 - i) the insider's economic ~~exposure to~~ interest in a security of the reporting issuer, or
 - ii) the insider's economic ~~interest in a security of~~ exposure to the reporting issuer; and
- (b) the insider is not otherwise required to file an insider report in respect of such ~~agreement, arrangement or understanding~~ event under any provision of Canadian securities legislation, then

the insider shall file a report in accordance with Section 3.1 of this Instrument.

2.2 Exemptions – Section 2.1 does not apply to

- (a) an agreement, arrangement or understanding which does not involve, directly or indirectly, ~~a security of the reporting issuer or a derivative in respect of which the underlying interest is or includes as a material component a security of the reporting issuer;~~
an interest in
 - (i) a security of the reporting issuer, or
 - (ii) a derivative in respect of which the underlying security, interest, benchmark or formula is or includes as a material component a security of the reporting issuer;
- (b) an agreement, arrangement or understanding in the nature of a compensation arrangement ~~between the insider and~~ established by the reporting issuer or an affiliate of the reporting issuer if
 - (i) the existence and material terms of the compensation arrangement are, or are required to be, described in
 - (A) the annual audited financial statements of the reporting issuer;
 - (B) an annual filing of the reporting issuer relating to executive compensation, or any other filing required to be made under any provision of Canadian securities legislation; or

- (C) any public filing required to be made under the rules or policies of a stock exchange or market on which securities of the reporting issuer are listed or trade; or
- (ii) the terms of the compensation arrangement are set out in ~~a written document~~writing, and the alteration to economic exposure or economic interest referred to in section 2.1 occurs as a result of the satisfaction of a pre-established condition or criterion ~~described in the written document~~ and does not involve a discrete investment decision by the insider;⁷
- (c) a person or company exempt from the insider reporting requirements ~~under a provision of NI 55-101, by virtue of an exemption contained in Canadian securities legislation~~, to the same extent and on the same conditions as are applicable to such exemption;
- (d) 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;~~or~~
- (e) a transfer, pledge or encumbrance of securities by ~~a person or company an insider~~ 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~~insider for any amount payable under such debt.;
- (f) to the receipt by an insider of a transfer, pledge or encumbrance of securities of an issuer if the securities are transferred, pledged or encumbered as collateral for a debt under a written agreement and in the ordinary course of business of the insider;
- (g) to an insider, other than an insider that is an individual, that enters into, materially amends or terminates an agreement, arrangement or understanding which is in the nature of a credit derivative;
- (h) a person or company who did not know and, in the exercise of reasonable diligence, could not have known of the alteration to economic exposure or economic interest described in section 2.1;
- (i) the acquisition or disposition of a security, or an interest in a security, of an investment fund, provided that securities of the reporting issuer do not form a material component of the investment fund's market value; or

(j) the acquisition or disposition of a security, or an interest in a security, of an issuer which holds directly or indirectly securities of the reporting issuer, if:

(i) the insider is not a control person of the issuer; and

(ii) the insider does not have or share investment control over the securities of the reporting issuer.

2.3 **Existing agreements which continue in force** – If an insider of a reporting issuer, prior to the effective date of this Instrument, entered into an agreement, arrangement or understanding in respect of which

(a) the insider would have been required to file an insider report under this Instrument if the agreement, arrangement or understanding had been entered into on or after the effective date, and

(b) the agreement, arrangement or understanding remains in effect on or after the effective date of this Instrument,

then the insider shall file a report in accordance with Section 3.2 of this Instrument.

2.4 **Same** – If an insider of a reporting issuer, prior to the date the insider most recently became an insider of the reporting issuer, entered into an agreement, arrangement or understanding in respect of which

(a) the insider would have been required to file an insider report under this Instrument if the agreement, arrangement or understanding had been entered into on or after the date the insider most recently became an insider, and

(b) the agreement, arrangement or understanding remains in effect on or after the date the insider most recently became an insider,

then the insider shall file a report in accordance with Section 3.3 of this Instrument.

PART 3 FORM AND TIMING OF REPORT

3.1 A person or company who is required under Section 2.1 of this Instrument to file a report shall, within 10 days from the day on which the person or company enters⁸ into, materially amends or terminates, as the case may be, the agreement, arrangement or understanding described in Section 2.1 of this Instrument, or such

shorter period as may be prescribed, file a report in the form prescribed for insider reports under securities legislation disclosing the existence and material terms of the agreement, arrangement or understanding.

3.2 A person or company who is required under Section 2.3 of this Instrument to file a report shall, within 10 days, or such shorter period as may be prescribed, from the effective date of this Instrument, file a report in the form prescribed for insider reports under securities legislation disclosing the existence and material terms of the agreement, arrangement or understanding.

3.3 A person or company who is required under Section 2.4 of this Instrument to file a report shall, within 10 days, or such shorter period as may be prescribed, from the date the person or company most recently became an insider, file a report in the form prescribed for insider reports under securities legislation disclosing the existence and material terms of the agreement, arrangement or understanding.

PART 4 EXEMPTION

4.1 The regulator or the securities regulatory authority may grant an exemption from this Instrument, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

4.2 Despite section 4.1, in Ontario only the regulator may grant such an exemption.

PART 5 EFFECTIVE DATE

5.1 Effective Date - This Instrument comes into force on ~~February 28, 2004.~~

¹ ~~The term “compensation arrangement” in the Instrument is similar to the definition of “plan” in Ont. Reg. 1015, Form 40 *Statement of Executive Compensation* (“OSC Form 40”). The concluding language from the definition of “plan” (reproduced in italics below) has been deleted as it is unnecessary in the present context and would have unduly narrowed the scope of the compensation arrangement exemption:~~

~~“plan” includes, but is not limited to, any plan, contract, authorization or arrangement, whether or not set forth in any formal document and whether or not applicable to only one individual, under which cash, securities, options, SARs, phantom stock, warrants, convertible securities, restricted shares or restricted share units, performance units and performance shares, or similar instruments may be received or purchased, but does not include the Canada Pension Plan or similar government plans or any group life, health, hospitalization, medical reimbursement or relocation plan that does not discriminate in scope, terms or operation in favour of executive officers or directors of the issuer and is available generally to all salaried employees;~~

² ~~The definition of “derivative” in the Instrument is similar to the definition of “derivative” in subsection 1.1(3) of OSC Rule 14-501 *Definitions*:~~

~~“derivative” means an instrument, agreement or security, the market price, value or payment obligations of which is derived from, referenced to or based on an underlying interest, other than a contract as defined for the purposes of the *Commodity Futures Act*~~

The above definition has been simplified to allow the definition to serve as a stand-alone definition in a Multilateral Instrument.

³ — The concept of “economic exposure” also appears in section 6.2 of National Policy 46-201 *Escrow for Initial Public Offerings*.

6.2 Restrictions on dealing with escrow securities

Escrow restricts the ability of holders to deal with their escrow securities while they are in escrow. The standard form of escrow agreement sets out these restrictions. Except to the extent that the escrow agreement expressly permits, a principal cannot sell, transfer, assign, mortgage, *enter into a derivative transaction concerning*, or otherwise deal in any way with the holder’s escrow securities or any related share certificates or other evidence of the escrow securities. A private company, controlled by one or more principals of the issuer, that holds escrow securities of the issuer, *may not participate in a transaction that results in a change of its control or a change in the economic exposure* of the principals to the risks of holding escrow securities.

[Emphasis added.]

⁴ — We have added a reference to “pecuniary interest” to the definition of “economic interest in a security” in the Instrument for the reason that the insider reporting requirements under U.S. securities legislation use this term. One of the objectives underlying the adoption of the Instrument is to introduce greater consistency in the reporting requirements under U.S. securities law and Canadian securities laws in relation to monetization arrangements. Under U.S. securities law requirements, insiders are generally required to report any transaction resulting in a change in “beneficial ownership” of equity securities of the issuer. For reporting purposes, a person is deemed to be the “beneficial owner” of securities if the person has a “pecuniary interest” in the securities. The term “pecuniary interest” in any class of equity securities is defined to mean “the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the subject securities”. See generally SEC Rule 16a-1(a)(2). Consequently, the reference to an “economic, financial or pecuniary reward, benefit or return” in the definition of “economic interest” in the Instrument is intended to clarify that insider transactions which are reportable under U.S. securities law requirements will also generally be covered by Canadian securities law requirements, unless covered by one of the exemptions.

⁵ — The definition of “security of a reporting issuer” in the Instrument is substantially similar to the definition of that term in s. 76(6) of the *Securities Act* (Ontario).

⁶ — The definition of “stock appreciation right” is identical to the definition of that term in OSC Form 40.

⁷ — Subparagraph 2.2(b)(ii) provides an exemption for a compensation arrangement which is not publicly disclosed, and which has the effect of altering the insider’s economic exposure to the reporting issuer, or the insider’s economic interest in securities of the reporting issuer, if

- the compensation arrangement is described in a written document,
- the alteration occurs as a result of the satisfaction of a pre-established condition or criterion described in the document (such as the insider’s retirement from office or ceasing to be a director), and
- the alteration does not involve a “discrete investment decision” by the insider.

Part 5 of NI 55-101 provides a similar exemption from the insider reporting requirements for securities which are acquired under an “automatic securities purchase plan”. Section 4.2 of the Companion Policy to NI 55-101, Companion Policy 55-101-CP *Exemption from Certain Insider Reporting Requirements*, similarly refers to the concept of a “discrete investment decision”.

⁸ — ~~Under Canadian securities legislation, an insider is ordinarily required to file an insider report within 10 days from the day on which there is a change in the insider's direct or indirect beneficial ownership or control over securities of the reporting issuer. See, for example, s. 107(2) of the *Securities Act* (Ontario). The 10 day period referred to in section 3.1 of the Instrument commences on the date the insider enters into the arrangement which satisfies the test in s. 2.1, since the arrangement may not involve a change in beneficial ownership or control over securities of the reporting issuer.~~

**COMPANION POLICY 55-103CP
TO MULTILATERAL INSTRUMENT 55-103**

**INSIDER REPORTING FOR
CERTAIN DERIVATIVE TRANSACTIONS
(EQUITY MONETIZATION)**

The members of the Canadian Securities Administrators (the CSA) that have adopted Multilateral Instrument 55-103 *Insider Reporting for Certain Derivative Transactions (Equity Monetization)* (the Multilateral Instrument) have adopted this Policy to clarify their views on several matters relating to the Instrument including:

- the regulatory objectives underlying the Multilateral Instrument and the reasons why we feel the Multilateral Instrument is necessary;
- the general approach taken by the Multilateral Instrument to certain derivative-based transactions by insiders; and
- other information that we believe will be helpful to insiders and other market participants in understanding the operation of the Multilateral Instrument.

Part 1 Purpose

1. What is the purpose of the Multilateral Instrument?

We have developed the Multilateral Instrument to respond to concerns that the existing insider reporting requirements in Canadian securities legislation may not cover certain derivative-based transactions, including equity monetization transactions (described below), which satisfy one or more of the fundamental policy rationale for insider reporting. We believe that timely public disclosure of such transactions is necessary in order to maintain and enhance the integrity of, and public confidence in, the insider reporting regime in Canada.

The Multilateral Instrument seeks to maintain and enhance the integrity of, and public confidence in, the insider reporting regime in Canada by:

- ensuring that insider derivative-based transactions which have a similar effect in economic terms to insider trading activities are fully transparent to the market;
- ensuring that, where an insider enters into a transaction which satisfies one or more of the policy rationale for insider reporting, the insider is required to file an insider report, even though the transaction may, for technical reasons, fall outside of the existing rules governing insider reporting; and

- reducing uncertainty as to which arrangements and transactions are subject to an insider reporting requirement and which are not.

These objectives are discussed in greater detail below.

2. What are the current insider reporting rules?

Canadian securities legislation requires “insiders” of a reporting issuer (i.e., a public company) to file insider reports disclosing their ownership of and trading in securities of their reporting issuer (the insider reporting requirements).

The insider reporting requirements serve a number of functions, including deterring illegal insider trading and increasing market efficiency by providing investors with information concerning the trading activities of insiders of the issuer, and, by inference, the insiders’ views of their issuer’s prospects.

We have adopted the Multilateral Instrument in response to the concern that the existing insider reporting requirements may not in all cases cover certain derivative-based transactions, including equity monetization transactions.

3. What are equity monetization transactions?

In recent years, a variety of sophisticated derivative-based financial products have become available which permit investors to dispose, in economic terms, of an equity position in a public company without attracting certain tax and non-tax consequences associated with a conventional disposition (e.g., a sale) of such position.

These products, which are sometimes referred to as “equity monetization” products, allow an investor to receive a cash amount similar to proceeds of disposition, and transfer part or all of the economic risk and/or return associated with 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.)

4. What are the concerns with equity monetization transactions?

Where an *insider* of a reporting issuer enters into a monetization transaction, and does not disclose the existence or material terms of that transaction, there is potential for harm to investors and the integrity of the insider reporting regime because:

- an insider in possession of material undisclosed information, although prohibited from trading in securities of the issuer, may be able improperly to profit from such information by entering into derivative-based transactions which mimic trades in securities of the reporting issuer;

- market efficiency will be impaired since the market is deprived of important information relating to the market activities of the insider; and
- since the insider's publicly reported holdings no longer reflect the insider's true economic position in the issuer, requirements relating to the public reporting of such holdings (e.g., an insider report or proxy circular) may in fact materially mislead investors.

Although we believe that many such transactions fall within the existing rules governing insider reporting, we accept that, in certain cases, it may be unclear whether the existing insider reporting rules apply. Accordingly, we have developed the Multilateral Instrument to respond to this ambiguity.

The Multilateral Instrument reflects a principles-based approach to monetization transactions and ties the obligation to report to the fundamental policy rationale underlying the insider reporting regime. Consequently, if an insider enters into a transaction which satisfies one or more of the policy rationale for insider reporting, but for technical reasons it may ~~legitimately~~ be argued that the insider falls outside of the existing insider reporting requirements, the insider will be required to file an insider report under the Multilateral Instrument unless the insider is otherwise covered by one of the exemptions. In this way, the market can make its own determination as to the significance, if any, of the transaction in question.

5. Does the Multilateral Instrument prohibit insiders from entering into monetization transactions?

No. The Multilateral Instrument imposes a reporting requirement only. It does not prohibit insiders from entering into a monetization transaction. An insider may, however, be prohibited on other grounds from entering into a monetization transaction. For example, Canadian securities legislation generally prohibits insiders (and certain others) from trading in securities of a reporting issuer while in possession of material undisclosed information about that issuer (the insider trading prohibition). It should be noted that, in many cases, the scope of the insider trading prohibition is broader than the scope of the existing insider reporting obligation.

An insider may also be prohibited from entering into a monetization arrangement by the terms of an escrow agreement. The standard form of agreement prescribed by National Policy 46-201 *Escrow for Initial Public Offerings*, for example, contains restrictions on parties to the agreement entering into monetization arrangements.

6. Why do investors enter into monetization transactions?

Investors, including insiders, may have legitimate reasons for entering into monetization transactions. These reasons may include:

- *Tax planning* – where there has been significant appreciation in the value of securities held by an investor, a conventional disposition of such securities may trigger a significant tax liability; a monetization transaction may permit the investor to receive a cash amount similar to proceeds of disposition while deferring this tax liability.

- *Liquidity* – an investor may have a short-term need for cash and wish to borrow against his or her securities. A monetization arrangement may permit the investor to borrow an amount equal to a substantially higher proportion of the current market price of his or her securities (e.g., 90%) than he or she could with a simple pledge of the securities.
- *Retained ownership* – an investor may wish to monetize a portion of his or her position but retain the full voting rights and/or entitlement to dividends associated with that position.
- *Risk management/portfolio diversification* – an investor is able to “lock in” the present value of his or her position, and avoid the risk of a future decline in the value of the holding, by means of a monetization transaction. The investor may use the funds released as a result of the transaction to diversify his or her portfolio, thereby avoiding the risk of having all of his or her assets “in one basket”.

7. *Does the requirement to report undermine any of these reasons for entering into a monetization transaction?*

No. A requirement to report the existence and material terms of a monetization transaction is not inconsistent with any of these objectives and does not prevent the insider from achieving any of these objectives.

8. *Does the Multilateral Instrument apply only to monetization transactions?*

No. The Multilateral Instrument applies to any agreement, arrangement or understanding which satisfies the conditions in ~~either section 2.1 or section 2.1, 2.3 or 2.4~~ of the Instrument.

Part 2 – Application of the Multilateral Instrument

1. *When does the Multilateral Instrument apply?*

If you are an “insider” of a reporting issuer, and you enter into, materially amend or terminate an agreement, arrangement or understanding of any kind which

- changes your “economic exposure” to your reporting issuer, ~~or~~
- ~~changes your “economic interest in a security” of your reporting issuer, and or~~
- changes your “economic exposure” to your reporting issuer, and

you are not required under any other provision of Canadian securities law to file an insider report about this agreement, arrangement or understanding, you must file an insider report under the Multilateral Instrument, unless you are covered by one of the exemptions.

2. What does “economic exposure” mean?

The term “economic exposure” in relation to a reporting issuer is defined in the Multilateral Instrument to mean the extent to which the economic, or financial ~~or pecuniary~~ interests of a person or company are aligned with the market price of securities of the reporting issuer or the economic, or financial ~~or pecuniary~~ interests of the reporting issuer.

The concept of “economic exposure” also appears in section 6.2 of National Policy 46-201 *Escrow for Initial Public Offerings*:

6.2 Restrictions on dealing with escrow securities

Escrow restricts the ability of holders to deal with their escrow securities while they are in escrow. The standard form of escrow agreement sets out these restrictions. Except to the extent that the escrow agreement expressly permits, a principal cannot sell, transfer, assign, mortgage, *enter into a derivative transaction concerning*, or otherwise deal in any way with the holder’s escrow securities or any related share certificates or other evidence of the escrow securities. A private company, controlled by one or more principals of the issuer, that holds escrow securities of the issuer, *may not participate in a transaction that results in a change of its control or a change in the economic exposure* of the principals to the risks of holding escrow securities.

[Emphasis added.]

The term “economic exposure” in relation to a reporting issuer generally refers to the link between a person’s ~~wealth~~ economic or prospects financial interests and the ~~wealth or prospects~~ economic or financial interests of the reporting issuer in which the person is an insider. The term is intended to have broad application and is best illustrated by way of example.

An insider with a substantial proportion of his or her personal wealth invested in securities of his or her reporting issuer will be highly exposed to changes in the fortunes of the reporting issuer. Conversely, an insider who holds no securities of a reporting issuer (and does not participate in a compensation arrangement involving securities of the reporting issuer such as a stock option plan) will generally have significantly less exposure to the reporting issuer. The insider’s exposure will generally be limited to the insider’s salary and other compensation arrangements which do not involve securities of the reporting issuer.

All other things being equal, if an insider changes his or her ownership interest in a reporting issuer (either directly, through a purchase or sale of securities of the reporting issuer, or indirectly, through a derivative transaction involving securities of the reporting issuer), the insider will generally be changing his or her economic exposure to the reporting issuer. Similarly, if an insider enters into a hedging transaction which has the effect of reducing the sensitivity of the insider to changes in the reporting issuer’s share price or performance, the insider will generally be changing his or her economic exposure to the reporting issuer.

3. What does “economic interest” in a security mean?

The term “economic interest in a security” is defined in the Multilateral Instrument to mean ~~the extent to which a person or company is entitled to receive, bears or is subject to~~

- ~~(a) — an economic, financial or pecuniary right to receive or the opportunity to participate in a reward, benefit or return from a particular~~ the security, or
- ~~(b) — an economic, financial or pecuniary exposure to a loss or a risk of loss in respect of a particular~~ to the security,

~~and includes, without limitation, the extent to which such person or company has or shares the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in such security or a transaction which directly or indirectly involves such security.~~

The term is intended to have broad application and is intended to refer to the economic attributes ordinarily associated with beneficial ownership of a security, such as the following:

- the potential for gain in the nature of interest, dividends or other forms of distributions of income on the security;
- the potential for gain in the nature of a capital gain realized on a disposition of the security, to the extent that the proceeds of disposition exceed the beneficial owner's tax cost (that is, gains associated with an appreciation in the security's value); and
- the potential for loss in the nature of a capital loss on a disposition of the security, to the extent that the proceeds of disposition are less than the beneficial owner's tax cost (that is, losses associated with a fall in the security's value).

The beneficial owner could, for example, eliminate the risk associated with a fall in the value of the securities, while retaining legal and beneficial ownership of the securities, by entering into a derivative transaction such as an equity swap. If the beneficial owner is an insider, and the securities are securities of the insider's reporting issuer, such a transaction would likely trigger the test in section 2.1 of the Instrument. (Such a transaction might also be covered by the existing insider reporting rules, depending on the particular facts and circumstances of the transaction.)

4. Why is it necessary to refer to both "economic exposure" in relation to a reporting issuer and "economic interest" in a security of the reporting issuer? How are they different?

In many cases, an arrangement which satisfies the "economic exposure" test in subparagraph 2.1(a)(~~iii~~) will also satisfy the "economic interest" test in subparagraph 2.1(a)(~~iii~~). However, the tests are not identical. For example, there will be arrangements which satisfy the ~~first~~ latter test, but not the ~~second~~ former test, but which would nevertheless impinge upon the policy rationale for insider reporting.

For example, if an insider holds no securities of his or her reporting issuer, and enters into a short position (a "naked short"), or a synthetic arrangement that replicates a short position, in the expectation that the share price will fall, the test in s. 2.1(a)(~~iii~~) ~~would likely~~ may not apply, since the insider would not be altering his or her economic interest in any securities of the reporting issuer. A similar result would occur if the number of securities sold short exceeded the number

of securities held. Such arrangements would appear to satisfy the policy rationale for insider reporting, and should be transparent to the market.

Secondly, the “economic interest” test may not catch certain derivative-based compensation arrangements that we believe should be subject to a disclosure requirement. If a compensation arrangement allows for an exercise of discretion similar to the exercise of discretion contemplated by a conventional stock option plan, we believe that this exercise of discretion should be transparent to the market. If the arrangement provides for a payout in the form of cash reflecting the change in value of a security, rather than a payout in the form of a security, there may be a question as to whether the arrangement involves a “security”. In this case, there may be a question whether such an arrangement would be caught by the “economic interest” test.

~~An additional reason for retaining the test in s. 2.1(a)(i) of the Instrument is that it directly ties the requirement for insider reporting to one of the fundamental policy rationale underlying the insider reporting requirement. One of the purposes of an insider reporting system is to enhance market efficiency: insider reports provide investors with timely information concerning the trading activities of insiders of the issuer, and, by inference, the insiders’ views of their issuer’s prospects. For the same reason, we believe that insiders should be required to disclose arrangements which directly or indirectly mimic trades. Such arrangements similarly may give rise to an inference as to the insiders’ views of the issuer’s prospects.~~

Thirdly, the economic exposure test requires consideration of related financial positions. If an insider, for example, holds a long position and an offsetting short position, the acquisition of the short position arguably does not directly affect the insider’s economic interest in the long position. Arguably the insider retains his or her economic interest in the long position (viewed in isolation). It is only through consideration of the related offsetting positions together that the insider may be said to have changed his or her economic position. The insider has neutralized his or her economic exposure to the issuer.

Although it may be argued that the “economic interest in a security” test may be subsumed within the “economic exposure” test, we believe there are advantages to retaining this test as a separate test. The economic interest test references the means by which an insider may alter his or her economic exposure to the reporting issuer. We believe that, in some cases, this test may be easier to understand, and consequently easier to apply, than the economic exposure test, since this test references the direct economic consequences of a monetization transaction.

Accordingly, if an insider enters into an arrangement which has the effect, for example, of divesting the insider of the risk that certain securities owned by the insider may fall in value, and none of the exemptions in the Instrument otherwise applies, s. 2.1(a)(~~iii~~) makes it clear that there is a reporting obligation. It is not necessary to then consider the issue of whether this arrangement has the effect of altering the insider’s economic exposure.

An additional reason for retaining the economic interest test is that this test generally approximates the approach taken by the U.S. insider reporting requirements. Under the U.S. insider reporting requirements, insiders are generally required to report any transaction resulting in a change in “beneficial ownership” of equity securities of the issuer. For reporting purposes, a person is deemed to be the “beneficial owner” of securities if the person has a “pecuniary interest” in the securities. The term “pecuniary interest” in any class of equity securities is

defined to mean “the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the subject securities”. See generally SEC Rule 16a-1(a)(2). One of the objectives underlying the adoption of the ~~instrument~~Instrument is to introduce greater consistency in the reporting requirements under U.S. securities law and Canadian securities laws in relation to monetization arrangements. Consequently, the reference to an “~~economic, financial or pecuniary reward, benefit or return~~” in the definition of “economic interest in a security” in the Instrument is intended to parallel the “pecuniary interest” test in the U.S., and to clarify that monetization transactions which are reportable under U.S. insider reporting requirements will also generally be covered by Canadian insider reporting law requirements, unless covered by one of the exemptions.

5. *What are the exemptions to the insider reporting requirement contained in the Multilateral Instrument?*

The Multilateral Instrument contains a number of exemptions for insider transactions which satisfy one of the tests in section 2.1 of the Multilateral Instrument. These include:

- arrangements which do not involve, directly or indirectly, a security of the reporting issuer or a derivative in respect of which the underlying interest is or includes as a material component a security of the reporting issuer;
- 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 referred to in section 2.1 occurs as a result of the satisfaction of a pre-established condition or criterion 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 under ~~a provision of NI 55-101, an exemption contained in Canadian securities legislation (such as, for example, National Instrument 55-101 *Exemption from Certain Insider Reporting Requirements* (NI 55-101) or National Instrument 62-103 *The Early Warning System and Related Take-Over Bid and Insider Reporting Issues*),~~ 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;
- the receipt by an insider of a transfer, pledge or encumbrance of securities of an issuer if the securities are transferred, pledged or encumbered as collateral for a debt under a written agreement and in the ordinary course of business of the insider;
- to an insider, other than an insider that is an individual, that enters into, materially amends or terminates an agreement, arrangement or understanding which is in the nature of a credit derivative;
- a person or company who does not know and could not reasonably know of the alteration to economic exposure or economic interest referred to in section 2.1; and
- the acquisition or disposition of a security of certain investment funds.

6. *What does the reference to “material component” in paragraph 2.2(a) of the Multilateral Instrument mean?*

This is intended to ensure that if an insider entered into a derivative arrangement which satisfied one of the alteration tests in section 2.1, and in respect of which the underlying interest was a basket of securities or an index which included securities of the reporting issuer, such arrangement would trigger a reporting requirement only if the derivative involved securities of the reporting issuer “as a material component”. In determining materiality, similar considerations to those involved in the concepts of material fact and material change would apply.

7. *Why is there an exemption for compensation arrangements?*

Many compensation arrangements are specifically adopted for the purpose of creating incentives for the directors, officers and employees who participate in such arrangements to improve their performance. Such arrangements are specifically intended to align the economic, or financial ~~or pecuniary~~ interests of the recipient with the economic, or financial ~~or pecuniary~~ interests of the employer. In many cases, such arrangements would likely satisfy the economic exposure test contained in section 2.1 of the Instrument.

Many compensation arrangements, such as stock option plans, phantom stock plans, deferred share unit plans and stock appreciation right plans, involve, directly or indirectly, a security of the reporting issuer or a derivative which involves a security of the reporting issuer. Consequently, the exemption in subsection 2.2(a) would likely not be available for such plans.

We have added a broad exemption in subsection 2.2(b) to address compensation arrangements, as compensation arrangements are not the primary focus of the Multilateral Instrument. In most

cases, we do not expect there to be any change to the existing approach to reporting (or not reporting) such compensation arrangements.

A compensation arrangement will only be caught by the Multilateral Instrument if:

- the insider “is not otherwise required to file an insider report in respect of such ... arrangement ... under any provision of Canadian securities legislation”; (see s. 2.1(b))
- the arrangement “... involve[s], directly or indirectly, a security of the reporting issuer or a derivative in respect of which the underlying interest is or includes as a material component a security of the reporting issuer”; (see 2.2(a))
- the arrangement is not disclosed in any public document (such as audited annual financial statements or any other regulatory filing); and (see 2.2(b)(i))
- the insider is able to alter his or her economic interest in securities of the reporting issuer, or his or her economic exposure to the reporting issuer, through discrete investment decisions. (see 2.2(b)(ii))

We believe that most compensation arrangements will be excluded on several grounds. To the extent a compensation arrangement is not excluded on any of these grounds, we believe that there is a compelling case for public disclosure of such arrangement.

Subparagraph 2.2(b)(i) provides an exemption for a compensation arrangement which is required to be disclosed, or is disclosed, in a public document such as audited annual financial statements or another form of regulatory filing. For example, an issuer may establish a deferred share unit (DSU) plan with a view to enhancing the alignment of the interests of its directors with those of its shareholders. Assuming that the DSU plan is not otherwise covered by the insider reporting requirements under Canadian securities legislation, an insider who participated in the plan would likely be required to file insider reports as a result of the insider’s participation in the plan since the plan would likely satisfy the economic exposure test contained in section 2.1 of the Instrument. However, if the DSU plan is disclosed in a public document such as a Management Proxy Circular, an insider who participated in the DSU plan would not be required to file insider reports relating to the insider’s participation in the plan, since the insider would be entitled to rely on the exemption in subparagraph 2.2(b)(i).

Subparagraph 2.2(b)(ii) provides an exemption for a compensation arrangement which is not publicly disclosed, and which has the effect of altering the insider’s economic exposure to the reporting issuer, or the insider’s economic interest in securities of the reporting issuer, if

- the compensation arrangement is ~~described in a written document,~~
in writing,
- the alteration occurs as a result of the satisfaction of a pre-established condition or criterion ~~described in the document~~ (such as the insider’s retirement from office or ceasing to be a

director), and

- the alteration does not involve a “discrete investment decision” by the insider.

Part 5 of NI 55-101 provides a similar exemption from the insider reporting requirements for securities which are acquired under an “automatic securities purchase plan”. Section 4.2 of the Companion Policy to NI 55-101, Companion Policy 55-101 CP *Exemption from Certain Insider Reporting Requirements*, similarly refers to the concept of a “discrete investment decision”.

8. *Why is the exemption for a pledge of securities as collateral for a good faith debt limited to a debt in which there is no limitation on recourse?*

We believe that it is important to restrict the debt exemption to debts in which there is no limitation on recourse for the reason that a limitation on recourse may effectively allow the borrower to “put” the securities to the lender in satisfaction of the debt. The limitation on recourse may effectively represent a transfer of the risk that the securities may fall in value from the insider to the lender. We believe that, in these circumstances, the transaction should be transparent to the market.

A loan secured by a pledge of securities may contain a term limiting recourse against the borrower to the pledged securities (a legal limitation on recourse). Similarly, a loan secured by a pledge of securities may be structured as a limited recourse loan if the loan is made to a limited liability entity (such as a holding corporation) owned or controlled by the insider (a structural limitation on recourse). If there is a limitation on recourse as against the insider either legally or structurally, the exemption would not be available.

Part 3 – Other Information

1. *How do I complete an insider report for an arrangement covered by the Multilateral Instrument?*

An insider will file the same form of insider report as he or she would in the case of an ordinary purchase or sale of securities of the reporting issuer in question.

A CSA staff notice containing examples of various types of monetization arrangements, together with examples of completed forms for such arrangements, will be published on or before the date the Multilateral Instrument takes effect.

2. *Why does the Multilateral Instrument require disclosure of certain arrangements which were entered into prior to the effective date of the Instrument?*

The Multilateral Instrument contemplates that, in certain circumstances, it will be necessary for insiders to disclose the existence of *pre-existing* monetization arrangements.

If an insider of a reporting issuer, prior to the effective date of the Multilateral Instrument, 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 the agreement, arrangement or understanding had been entered into on or after the effective date, *and*
- the agreement, arrangement or understanding remains in effect on or after the effective date of the Instrument,

then the insider will be required to file a report under the Multilateral Instrument.

We believe it is necessary for the Multilateral Instrument also to address pre-existing arrangements *which continue in force after the effective date* since, if such arrangements are not disclosed, the insider reporting regime will continue to convey materially misleading information about certain insiders' true economic positions in their issuers.

For example, if an insider, *before* the Multilateral Instrument comes into force, enters into a monetization arrangement which has the effect of divesting the insider of substantially all of the economic risk and return associated with the insider's securities in the reporting issuer, and the insider then files an insider report *after* the Multilateral Instrument comes into force that indicates that the insider continues to have a substantial ownership position in the issuer, we believe the pre-existing arrangement will render the insider report (and all future insider reports) materially misleading. The insider report will not convey an accurate picture of the insider's true economic positions in his or her issuer.

For these reasons, we believe that it is necessary for insiders to disclose the existence of pre-existing monetization arrangements which have a continuing impact on publicly reported holdings.