NP 12-203 Cease Trade Orders for Continuous Disclosure Defaults

NOTICE OF NATIONAL POLICY 12-203
CEASE TRADE ORDERS
FOR CONTINUOUS DISCLOSURE DEFAULTS

Introduction

The Canadian Securities Administrators (CSA regulators or we), have adopted National Policy 12-203 *Cease Trade Orders for Continuous Disclosure Defaults* (the Policy). The Policy provides guidance to reporting issuers, investors and market participants as to how we will generally respond to certain types of continuous disclosure defaults.

Background

On March 28, 2008, we published a proposed version of the Policy for comment. During the comment period, which ended on May 27, 2008, we received four comment letters. We thank the commenters for their submissions.

We have considered the comments and are publishing a summary of comments and responses as Appendix A to this notice. The summary includes the names of the commenters, a summary of their comments and our response. After considering the comments, we have made a number of minor changes to the version of the Policy that we published for comment. However, as these changes are not material, we are not republishing the Policy for a further comment period.

Substance and Purpose

The Policy

- modernizes, harmonizes and streamlines our existing practices relating to cease trade orders (CTOs) including general CTOs and management cease trade orders (MCTOs);
- provides guidance for issuers as to the circumstances in which the CSA regulators will issue a general CTO or an MCTO;
- explains factors the CSA regulators will consider when evaluating an application for an MCTO; and
- describes what other actions issuers need to undertake if we issue an MCTO.

The Policy replaces:

- CSA Staff Notice 57-301 – *Failing to File Financial Statements on Time – Management Cease Trade Orders*;

- CSA Staff Notice 57-303 – *Frequently Asked Questions Regarding Management Cease Trade Orders Issued as a Consequence of a Failure to File Financial Statements;* and

- Ontario Securities Commission Policy 57-603 – *Defaults by Reporting Issuers in Complying with Financial Statement Filing Requirements*.

These instruments have been rescinded with the adoption of the Policy.

Summary of the Policy

The Policy provides guidance as to how the CSA regulators will ordinarily respond to a specified default (as defined in part 2 of the Policy) by a reporting issuer. This response will usually be the issuer's principal regulator issuing either a general CTO or an MCTO.

The Policy describes the criteria the CSA regulators will apply when assessing whether to issue a general CTO or an MCTO and outlines what an issuer needs to include in its application for an MCTO. The Policy also describes what information an issuer must file during the period of an MCTO to support informed trading.

The Policy recommends that issuers monitor trading by management and other insiders during the period of default and reminds insiders of their trading prohibitions under securities legislation. Finally, the Policy discusses the effect of a CTO issued by a CSA regulator in one jurisdiction on trading in another jurisdiction.

Unpublished materials

In developing the Policy, we have not relied on any significant unpublished study, report, decision or other written materials.

Questions

Please refer your questions to any of:

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Appendix A
Summary of Comments
List of commenters

Commenter	Signatory	Date of Comment Letter
Market Regulation Services Inc.	Felix Mazer Policy Counsel Market Policy and General Counsel's Office	May 15, 2008
Ontario Bar Association Business Law Section Securities Law Subcommittee	Greg Goulin President Ontario Bar Association Paul J. Stoyan Chair, Business Law Section Ontario Bar Association	May 28, 2008
Research Capital	Vanessa M. Gardiner Director, Senior Vice-President and Chief Compliance Officer	April 15, 2008
Securities Transfer Association of Canada	William Speirs President	May 22, 2008

Copies of the original comment letters are available for review at the following websites:

- www.osc.gov.on.ca

Summary of comments

	Summary of comment	CSA response
A. General comments		
Adoption of a national policy relating to cease trade orders for continuous disclosure defaults	One commenter was generally supportive of the proposed adoption of a consistent national policy with respect to cease trade orders for continuous disclosure defaults. One commenter was generally in support of the policy and agreed that CTOs should be issued using mutual reliance principles. The commenter believed this will go a long way to harmonizing the treatment and administration of CTOs. This commenter also liked the concept of MCTOs which places responsibility and accountability on the management of an issuer while allowing investors to continue to trade. The other commenters did not express a view.	We thank the commenters for their support.
Concerns with the CTO database administered by the CSA	One commenter, although generally supportive of the policy, expressed concern with the ability of the investment dealer community to play its customary gatekeeper role given certain perceived deficiencies with the existing CSA database for CTOs. The commenter noted that the database lacks fields for certain information	We have not made any changes to the policy in response to this comment as the comment is primarily focused on concerns with the CSA CTO database rather than the policy. However, CSA staff will consult with the commenter and other representatives of the dealer community to consider improvements to the CSA CTO database.

	Summary of comment	CSA response
	contained in certain CTOs including the names of persons restricted by the CTO, in the case of an MCTO. The commenter further noted that dealers are generally unable to block certain trading for issuers and individuals subject to CTOs, particularly where the issuer also trades on a foreign market, such as the U.S. OTC Bulletin Board market. The commenter also raised concerns relating to the integrity of the information in the CTO database. These concerns include the following: • In the CTO database, CUSIP numbers are not provided for all issuers. • CTO database names are not normalized, consistent or accurate. • Concerns relating to the manner in which information relating to MCTOs is entered into the database. The commenter provided some suggestions as to how the entering of this information into the database could be improved.	
B. Specific comments		
Section 3.2 Why do we issue cease trade orders in response to a specified default?	One commenter requested that the Commissions consider implementing a system to allow investors who had	We have not made any changes to the policy in response to this comment.

	Summary of comment	CSA response
	purchased securities prior to the imposition of the CTO to register securities during the period the cease trade is in effect. The commenter noted that, at this time, these transactions are rejected by the transfer agents to ensure there is no possibility of their contravening the CTO. This situation comes up often when requests for transfer come in via the mail from locations outside the city in which the issuer's transfer agent is located. In these situations the seller has obtained payment and remains the "registered" holder while the purchaser is not able to register the securities in their name until the CTO is lifted. The other consideration is for investors to register securities prior to the record or effective date for an upcoming corporate event, assuming the CTO would not prevent the event or transaction from taking place. For example, a purchaser who is not able to register the securities may be left with having to claim their entitlement from the seller on an event such as a stock split. The commenter noted that some time ago securities legislation provided a mechanism whereby a transfer could be	Where a *bone fide* sale has occurred (i.e., beneficial ownership has passed from the investor to a subsequent purchaser) prior to the imposition of a CTO, but the transfer has not been registered by the time of the imposition of a CTO, we believe it is acceptable for the transfer agent to proceed to register the transfer. We would generally not consider the act of a transfer agent processing a transfer request, made in good faith and not as part of a plan or scheme to evade requirements of securities legislation, as constituting a trade prohibited by the CTO, where there was reasonable evidence (such as a sworn affidavit) to support the conclusion that the trade had in fact occurred prior to the date of imposition of the CTO. However, the securities that are the subject of the transfer request may remain subject to the CTO depending on the terms of the CTO.

	Summary of comment	CSA response
	presented with an affidavit from the transferee/broker/beneficial owner; provided it was complete and properly executed, it would allow the transfer agent to process the transfer during the CTO. The commenter attached copies of these forms to this comment letter for information purposes.	
Section 4.2 Contents of application (Expectation that the application should be filed at least two weeks in advance of the filing deadline)	One commenter expressed concern that the issuance of a general CTO in response to a specified default – unless the issuer applies in writing for an MCTO at least two weeks before a potential default – will result in an increased administrative burden for issuers and regulators and increased market disruptions from the greater incidence of general CTOs. The commenter believed that this aspect of proposed NP 12-203 would make the proposed application process under the policy substantially more onerous for issuers than under the current process described in OSC Policy 57-603 and in CSA Staff Notice 57-301. The commenter believed that, under the current regime, a general CTO would only be triggered by a continuing default, following the imposition of an MCTO.	The application process described in Part 4 of proposed NP 12-203 is generally similar to the current process described in OSC Policy 57-603 and in CSA Staff Notice 57-301. In particular, both Part 3 of OSC Policy 57-603 and CSA Staff Notice 57-301 currently provide that an eligible issuer should contact its principal regulator at least two weeks before the filing deadline and request that an MCTO be issued rather than a general CTO. They also describe the necessary supporting materials that should be included with the request, including an affidavit identifying the persons to be named in the MCTO. Accordingly, we do not believe the application process described in proposed NP 12-203 would represent a substantial

	Summary of comment	CSA response
	The commenter indicated that they do not believe that it is typically the case that an issuer "will usually be able to determine that it will not comply with a specified requirement at least two weeks before its due date". The commenter stated that, in their experience it is sometimes very difficult for an issuer to know even days in advance of a filing due date that a default will occur. Often, a failure to file on time is caused by the late identification of a problem with the issuer's financial statements or other disclosure, or by delays in the completion of the audit process, the resolution of which requires input from third parties (including the issuer's auditors and counsel). The commenter believed that the proposed NP 12-203 framework may lead issuers to file "precautionary" applications to avoid triggering a general CTO if there is any possibility of a delay in completing required filings. Such applications would result in a significant administrative burden for issuers and securities regulators.	change from current practice or result in a greater incidence of general CTOs. In addition, it is not currently the general practice of the CSA to a) issue a cease trade order only after "a continuing default" or b) issue a general CTO only following the imposition of an MCTO. Regulators may issue general CTOs immediately following a default. We have considered the comment relating to situations in which an issuer will be unable to determine whether it can comply with a specified requirement at least two weeks before its due date. We acknowledge that there will be situations where an issuer, notwithstanding the exercise of reasonable diligence, will be unable to determine whether it can comply with a specified requirement at least two weeks before its due date. Accordingly, we have amended the policy to reflect the commenter's concern. However, we believe that, in most cases, an issuer exercising reasonable diligence should be able to make this determination at least two weeks in advance of the deadline.

	Summary of comment	CSA response
	In particular, requiring issuers to have prepared a detailed remediation plan for inclusion in the MCTO application two weeks before a potential default may be problematic – given that, during this same period, management will no doubt be very busy trying to resolve outstanding issues in the hope of avoiding a default in the first place. Issuers may also face challenging disclosure issues in making such "precautionary" applications, in determining whether the making of such an application is a material fact requiring a press release. Such a release may be premature if the application is being filed out of an abundance of caution – but could result in increased trading activity and a significant effect on the market price or value of the issuer's securities in anticipation of a default that never comes to pass. In light of these concerns with the two-week advance application requirement, the commenter suggested the following changes to proposed NP 12-203:	The Canadian securities regulators will consider all relevant facts and circumstances in considering applications under the policy. If it is the case that an issuer could not, notwithstanding the exercise of reasonable diligence, make this determination at least two weeks before its due date, the issuer should include a brief explanation of the reasons for the delayed filing in its application.

	Summary of comment	CSA response
	• Issuers should be required to notify the regulators and issue a default announcement immediately upon management having a reasonable expectation that a filing deadline will not be met, but in any case no later than the due date of the filing; • Upon a specified default, an MCTO should generally be issued for a two-week period, after which it would automatically be converted into a general CTO unless the issuer files an application to maintain the MCTO; and • The application to maintain the MCTO would contain the same information currently proposed in NP 12-203 for MCTO applications. The commenter believed that providing issuers with a short grace period to prepare the MCTO application and remediation plan after a default occurs and before a general CTO is issued represents an appropriate balance between the competing objectives of maintaining liquidity and preventing trading in issuers' securities without sufficient secondary market disclosure.	

	Summary of comment	CSA response
Part 6 – Effect of a CTO issued by a regulator in one jurisdiction on trading in another jurisdiction (Interaction with the RS Universal Market Integrity Rules (UMIR))	One commenter RS explained its role as a regulation services provider, including its role in administering and enforcing trading rules for the marketplaces it regulates. The commenter noted that, under its trading rules, if a Commission issues a general CTO, no order for the purchase or sale of a security may be executed on a marketplace or over-the-counter market governed by its trading rules. However, the trading rules do not recognize the concept of an MCTO and RS would not impose a regulatory halt in connection with an MCTO. RS further noted that, under its rules, any order entered on a marketplace must contain a marker that identifies the order as being entered on behalf of an insider. However, RS does not have the capacity to further distil trading by insiders named in an MCTO as opposed to insiders generally. RS expressed concern that the current text of Part 6 may provide a misleading description of the effect of a CTO with respect to the ability to trade in a security that is listed or quoted on a marketplace	We thank the commenter for the comment and believe this provides a useful summary of the operation of the commenter's trading rules and the interaction of these rules with the CTO regime described in NP 12-203. We have revised Part 6 of proposed NP 12-203 in consultation with RS to clarify certain aspects of the policy that the commenter believed were unclear. CSA staff will continue to consult with RS to address any ongoing concerns.

	Summary of comment	CSA response
	governed by its trading rules. RS suggested that language be added to make it clear that certain market participants may be subject to restrictions imposed by self-regulatory organizations including any exchange of which they are a member or a QTRS of which they are a user. RS further explained its process for imposing a regulatory halt as a result of the imposition of a general CTO. If a Commission issues a CTO with respect to an issuer whose securities are traded on a marketplace, RS imposes a regulatory halt on trading of those securities on all marketplaces for which RS serves as the regulation services provider. Such action is taken whether or not that commission that issued the CTO is the PR of the issuer. Once a regulatory halt has been imposed, no person subject to UMIR may trade those securities on a marketplace, over-the-counter or on a foreign organized regulated market. Notwithstanding that the PR or another securities commission rescinds its CTO, the regulatory halt imposed by RS on all marketplaces for which RS serves as the regulation services provider will continue until all CTOs have been rescinded. RS noted that Part 6 of the Policy	

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	essentially provides a "yellow light" warning when conducting a trade off-marketplace or on a foreign organized regulated market in a security that is subject to a CTO. RS wished to emphasize that, in fact, its trading rules preclude such trading in many circumstances and was concerned that the cautionary nature of this Part of the Policy may be interpreted as providing an "over-ride" of the prohibitions imposed by its trading rules.	
Sample Form of Consent Appendix C	One commenter noted that item #9 in the proposed sample form of consent would prohibit individuals from trading in or acquiring an issuer's securities until two full business days after the required filings are made or until further order of the principal regulator. The commenter presumed that the objective of this provision was to provide sufficient time for capital markets participants to review and react to new material information that may be disclosed in filings made to remedy a default before trading by insiders is permitted. The commenter felt that, while that	In certain jurisdictions, the current form of MCTO generally prohibits all trading in and all acquisitions of securities of the issuer until two business days following the receipt of all filings the issuer is required to make under applicable securities legislation. The reference to "two business days" in item 9 of the sample form of consent is intended to be consistent with this form. We generally agree with the commenter's description of the objective of this provision and the appropriate analysis for determining when material information may be considered to have been "generally disclosed". As part of an implementation strategy,

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	objective had merit, the provision was overly restrictive and inconsistent with the principles set out in National Policy 51-201 *Disclosure Standards* ("NP 51-201"). NP 51-201 encourages issuers to adopt a case-by-case approach to determining when material information may be considered to have been "generally disclosed". In the case of an MCTO being lifted, any new material information will be publicly filed on SEDAR and capital markets participants would have been made aware of its upcoming release through the issuer's bi-weekly updates. In these circumstances, where information is being broadly disseminated to a ready and waiting market, and given today's speed of information transmission through electronic means, a two business day holding period was unnecessary, as well as being unfairly restrictive for persons with no involvement in a particular default nor knowledge of material undisclosed information.	CSA staff intend to review the forms of CTO and MCTO that are currently in use to determine whether they can be further harmonized. To the extent the current form of order is modified, we will accept corresponding modifications to the form of consent. We will also consider requests for a modification of this language on a case-by-case basis where the issuer is able to demonstrate that it is reasonable to consider information has been generally disclosed within a shorter time frame.