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# CROSS BORDER SECURITIES UPDATE

April 2010

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## New Canadian Insider Reporting Regime Comes Into Force April 30, 2010

The Canadian provinces and territories have adopted *National Instrument 55-104 - Insider Reporting Requirements and Exemptions* (“**NI 55-104**”), and its related companion policy. NI 55-104 consolidates the main insider reporting requirements and exemptions for insiders of reporting issuers into one policy. NI 55-104 comes into force in all Canadian jurisdictions, except Ontario, on April 30, 2010. In Ontario, equivalent provisions to NI 55-104 will be adopted in the *Securities Act* (Ontario) as of April 30, 2010.

The new insider trading regime:

1. narrows the parties required to file insider reports to a defined group of “**reporting insiders**”;

2. accelerates the filing requirement from 10 calendar days to 5 calendar days (after a six month transition period ending on October 31, 2010);
3. simplifies and makes reporting requirements for stock-based compensation arrangements more consistent;
4. facilitates insider reporting of stock-based compensation arrangements by allowing issuers to file an issuer grant report in a similar manner to the current issuer event report; and
5. includes most reporting exemptions in one location.

### Reporting Insiders

Only the following defined “**reporting insiders**” are required to file insider reports under NI 55-104:

1. the CEO, CFO or COO of the reporting issuer, or of a significant shareholder of the reporting issuer or of a major subsidiary of the reporting issuer;
2. a director of the reporting issuer, or of a significant shareholder of the reporting issuer or of a major subsidiary of the reporting issuer;
3. a person or company responsible for a principal business unit, division or function of the reporting issuer;
4. a significant shareholder (beneficial ownership of, or control or direction over, whether direct or indirect, of 10% or greater of the voting rights attached to all the reporting issuer’s outstanding voting securities);

5. a significant shareholder and the CEO, CFO, COO and every director/significant shareholder of the significant shareholder based on post-conversion beneficial ownership of the reporting issuer’s securities;
6. a management company and the CEO, CFO, COO and every director/significant shareholder of a management company that provides significant management or administrative services to the reporting issuer or a major subsidiary of the reporting issuer;
7. an individual performing functions similar to the functions performed by any of the insiders described in paragraphs (1) to (7);
8. the reporting issuer itself, if it has purchased, redeemed or otherwise acquired a security of its own issue, for so long as it continues to hold that security; or
9. any other insider that:
  - a. in the ordinary course receives or has access to information as to material facts or material changes concerning the reporting issuer before the material facts or material changes are generally disclosed; and
  - b. directly or indirectly exercises, or has the ability to exercise, significant power or influence over the business, operations, capital or development of the reporting issuer.

NI 55-104 defines a “**major subsidiary**” to include subsidiaries of a reporting issuer whose assets or revenues represent 30% or more of the reporting issuer’s assets or revenues, respectively.

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## New Canadian Insider Reporting Regime Comes Into Force April 30, 2010 (Continued)

### Shortened Filing Deadline

Under NI 55-104, reporting insiders are required to file an insider report electronically on the System for Electronic Disclosure by Insiders ("SEDI") within five (5) calendar days from the day of the event that triggers a reporting requirement.

This new filing deadline takes effect immediately on April 30, 2010 in Ontario and on October 31, 2010 in the rest of Canada.

The timeline for filing initial reports remains ten (10) days under NI 55-104.

### Reporting Stock-based Compensation

NI 55-104 defines "compensation arrangements" as all stock options, stock appreciation rights, phantom shares, restricted shares or restricted share units, deferred share units, performance units or performance shares, stock, stock dividends, warrants, convertible securities, or similar instruments. All of these instruments are now treated the same under NI 55-104.

Reporting insiders have a choice of reporting their option (or similar security) acquisitions within five (5) calendar days on or before March 31 of the next calendar year, provided the reporting issuer has previously disclosed the terms of the compensation arrangement and filed the applicable "issuer grant report" on SEDI within five days of the applicable grant of securities.

We recommend that reporting insiders continue to file an insider report within the five (5) calendar days as the deferred

approach requires careful checking that the reporting issuer has made all necessary disclosures required to use the deferred approach.

### Exemptions from Filing Insider Reports

NI 55-104 exempts reporting insiders from the insider reporting requirements if their direct or indirect beneficial ownership of, control or direction over securities of a reporting issuer changes as a result of an "issuer event", such as a stock dividend, stock split, consolidation, amalgamation, reorganization, merger or other similar event that affects all holdings of a class of securities of an issuer in the same manner.

Under NI 55-104 the insider reporting requirement also does not apply to:

1. an insider of an issuer that is a mutual fund;
2. the insider of an issuer if the insider is not a *reporting insider* of that issuer;
3. in certain circumstances, a director or officer of a *significant shareholder*, or a director or officer of a subsidiary of a *significant shareholder*, in respect of securities of an *investment issuer* or a *related financial instrument* involving a security of the *investment issuer*;
4. a *reporting insider* of a reporting issuer who:
  - a. does not have any beneficial ownership of, or control or direction over, whether direct or indirect, a security of the issuer; and
  - b. does not have any interest in, or right or obligation associated with, a *related financial instrument* involving a security of the issuer.
  - c. has not entered into any agreement, arrangement or undertaking as described in part 4 of NI 55-104;

- d. is not a significant shareholder based on post-conversion beneficial ownership;
5. a reporting insider, if the reporting insider is a subsidiary or affiliate of another reporting insider and such reporting insider has filed an insider report disclosing the required information; in certain circumstances, a reporting insider for a security of an issuer beneficially owned or controlled, directly or indirectly, by an estate.

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## BC Adopts New Rules/Step Concerning Private Placements – Finders and Agents

On March 27, 2010, the BC Securities Commission ("BCSC") added another layer of regulation and paper companies must comply with when offering their securities utilizing certain private placement exemptions from the prospectus and registration requirements found in *National Instrument - 45-106 Prospectus and Registration Exemptions* ("NI 45-106").

*BC Instrument 32-513 - Registration exemption for trades in connection with certain prospectus-exempt distributions* ("BCI 32-513"), and its companion policy, provide an exemption from the requirement that a company or individual be registered as a dealer when involved in the sale of securities pursuant to the following exemptions under NI 45-106:

- accredited investor (s. 2.3);
- family, friends, and business associates (s. 2.5);
- offering memorandum (s. 2.9); and
- minimum investment amount (s. 2.10)

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## BC Adopts New Rules/Step Concerning Private Placements – Finders and Agents (Continued)

In order to rely on this dealer registration exemption the following requirements must be met:

1. the person must not be registered under any provincial or territorial securities legislation;  
  
the person must not be registered under the securities legislation of a foreign jurisdiction;
2. prior to the trade, the person must not have advised, recommended or otherwise represented to the purchaser that the security being traded was suitable for the purchaser, with regard to the purchaser's
  - a. investment needs and objectives,
  - b. financial circumstances, or
  - c. risk tolerance;
3. at or before the time at which the purchaser enters into an agreement to purchase the security, the person obtains from the purchaser a signed Risk Acknowledgement Form in the prescribed form;
4. the person does not hold or have access to the purchaser's assets; and
5. the person has or within 10 days of the sale electronically files with the BCSC a current information report in the prescribed form.

The required forms are in addition to the Risk Acknowledgement and the Exempt Distribution Report required under NI 45-106.

The Risk Acknowledgement form required under BCI 32-106 ensures that the purchaser is aware the

individual or company introducing them to the securities is not registered, has not determined suitability, is not acting for the purchaser and that essentially the purchaser is acting on their own in making a risky investment.

The current information report required to be filed with the BCSC electronically provides just basic identification and contact information of the person or company involved in the sale.

## FINRA Proposes New Rules and Fees for Actions Taken by OTCBB and PinkSheet Issuers

Financial Industry Regulatory Authority, Inc. (“**FINRA**”) currently operates the OTC Bulletin Board (“**OTCBB**”) and the OTC Reporting Facility (“**ORF**”), which together provides a trading facility and mechanism for FINRA members to trade and report, for both regulatory and dissemination purposes, transactions in OTC equity securities.

Although FINRA does in theory process and review issuers' Company Related Actions in the OTC market, its role is limited. FINRA does not have any true oversight function of OTC market issuers. It only has jurisdiction over FINRA members. As a result, FINRA and the United States Securities and Exchange Commission (“**SEC**”) have both expressed concerns that certain parties may be attempting to use the facilities of FINRA, including its ministerial functions, to announce corporate-related actions, to further fraudulent activities in the OTC market.

On December 17, 2009, FINRA proposed that it be allowed to adopt *Rule 6490 - Processing of Company-Related Actions* (“**Rule 6490**”) to clarify its regulatory authority and discretionary power when processing documents related to announcements for company-related

actions by issuers whose securities trade in the OTC markets (“**OTC Issuers**”). Rule 6490 would codify the authority of FINRA's Department of Operations to conduct in-depth reviews of company-related actions and allow the staff discretion not to process such actions that are incomplete or when certain indicators of potential fraud exist. FINRA would also be granted authority to charge a fee for these services.

“Company Related Actions” are defined in Rule 6490 as the issuance of dividends or other distributions in cash or kind, stock splits or reverse stock splits, or rights or other subscriptions offerings, the issuance or change to a trading symbol or company name, mergers, acquisition, dissolutions or other company control transactions, and any bankruptcy or liquidations by an OTC Issuer.

Rule 6490 would set out procedures for the submission, review, and determination of Company-Related Actions. Rule 6490 would permit FINRA to prescribe the forms, supporting documentation and procedures necessary to conduct more in-depth reviews of OTC Issuer Company-Related Actions.

Rule 6490 would grant FINRA the discretionary authority to not process the documentation submitted in connection with a Company Related Action in order to protect investors, the public interest and to maintain fair and orderly markets. Specifically, FINRA would have the right to exercise this discretionary authority in the following circumstances:

1. Incomplete documentation;
2. OTC Issuer not current in reporting obligations;
3. Parties related to the OTC Issuer are subject to investigation or action by a regulatory body;

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## FINRA Proposes New Rules and Fees for Actions Taken by OTCBB and PinkSheet Issuers (Continued)

4. Government authority has provided information to FINRA indicating person involved are potentially involved in fraudulent activities; and
5. Significant uncertainty regarding the OTC Issuer's securities.

The OTC Issuer or the requesting party may appeal the decision of FINRA to not process the documentation. This right of appeal must be exercised in writing within seven (7) days of receiving written notice from FINRA of its decision.

Rule 6490 will give FINRA the right to request further information from OTC Issuers and from third parties such as Depository Transfer Corporation or the OTC Issuer's transfer agent.

FINRA is proposing to charge the following non-refundable fees for the review and processing of documentation related to OTC Issuer's Company-Related Actions:

1. Timely Notification: \$200;
2. Late Notification, 5 days prior to action: \$1,000;
3. Late Notification, 1 day prior to action: \$2,000;
4. Notification After Effective Date: \$5,000;
5. Voluntary Symbol Request Change: \$500; and
6. Appeal Fee: \$4,000.

The SEC has closed its Request for Comments concerning Rule 6490. Only two comment letters were received as the request for comments went out at Christmas and the notice was set out was difficult for OTC Issuers and others to even discover on the SEC website.

The biggest issue with Rule 6490 is that it does not create privity between OTC Issuers and FINRA. FINRA still has no real clout over OTC Issuers. In theory Rule 6490 is a good idea to level the playing field and legitimize OTC Issuers. Let's see if the SEC and FINRA will be able to fine tune the rule a bit further to make it effective prior to adoption.

## SEC Recognizes CNSX as a Designated Offshore Securities Market

On February 24, 2010, the SEC recognized the Canadian National Stock Exchange ("CNSX") and its trading platform Pure Trading as a "**designated offshore securities market**" within the meaning of Rule 902(b) of Regulation S under the United States *Securities Act of 1933*, as amended ("**1933 Act**").

Regulation S was adopted by the SEC to clarify when the SEC registration requirements do and do not apply to offerings and sales of securities outside the United States ("US"). Regulation S provides two non-exclusive safe harbours:

1. one for offers and sales by issuers, distributors and affiliates (Rule 903); and
2. one for offshore resales by persons other than issuers, distributors and affiliates (Rule 904).

Persons who resell stock under Regulation S must satisfy two conditions: (1) offers and sales must be made in an offshore transaction; and (2) there must be no "directed selling efforts" in the US.

Directed selling efforts are promotional and solicitation activities that condition the US market for the securities being sold overseas

Offshore transactions take place when the offer is made to a person physically outside the country, and either the buyer is outside the US when the buy order originates or the transaction is executed through the facilities of a "**designated offshore securities market**".

The CNSX and Pure Trading now join the TSX and TSX Venture Exchange as designated offshore securities markets. This means that US restricted securities may now be resold on any of these exchanges in Canada without first following special sale procedures to ensure the securities are not being purchased by a buyer in the US or a US person.

Regulation S does not provide a safe harbor for resales back into the US of securities sold overseas under the regulation. The securities remain subject to resale restrictions. In other words, persons cannot knowingly sell to a buyer in the US or a US person even if the sale is made on a designated offshore securities market.

## SEC Approves the Alternative Uptick Rule

On February 24, 2010, the SEC adopted amendments to rule 201 of Regulation SHO ("**Alternative Uptick Rule**") under the *Securities Exchange Act of 1934*, as amended ("**Exchange Act**").

The Alternative Uptick Rule restricts short sales in equity securities that experience a price decline of more than 10% on any trading day from the prior trading day's closing price ("**Circuit Breaker**"). Once the Circuit Breaker is triggered, the affected securities can be sold short only at a price uptick,

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## SEC Approves the Alternative Uptick Rule (Continued)

i.e. when the price is above the current national best bid ("NBB"). This restriction will remain in place for the remainder of the trading day on which the Circuit Breaker is triggered and the following trading day.

The new rule will generally apply to all equity securities that are listed on a national securities exchange, including those traded on an exchange as well as those traded in the over-the-counter market.

The Alternative Uptick Rule is designed to prevent abusive short sales that may be used to drive down the price of a security or exacerbate a market decline in a security.

There are some limited exceptions to the Alternative Uptick Rule. Short sales are allowed regardless of the Circuit Breaker being triggered, in the following circumstances:

1. a broker-dealer determines that the price of the trade at the time of submission was above the NBB and it has in place policies and procedures to monitor its short-sale activities pursuant to this exception;
2. the person selling short is deemed to own the securities but delivery of the securities will be delayed;
3. trades in certain odd-lot transactions;
4. certain domestic and foreign arbitrage transactions;
5. over-allotment or layoff sales;
6. riskless principal transactions; and
7. volume weighted average price transactions.

The Alternative Uptick Rule will become effective 60 days after the date of publication of the release in the Federal Register.

SEC Uptick Press Release:

<http://www.sec.gov/news/press/2010/2010-26.htm>

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*The information in this newsletter is of a general nature only about recent developments of interest to our clients. You are encouraged to contact legal counsel before acting on any information provided.*



Author Alixe Cormick has assisted small and micro cap companies through each stage of their growth from inception to graduation to junior and more senior trading forums.

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