No prospectus, no problem: the Listed Issuer Financing Exemption allows for free trading securities without a prospectus

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The upcoming amendments to National Instrument 45-106 - *Prospectus Exemptions* (NI 45-106) will provide reporting issuers listed on a Canadian stock exchange with a means to raise equity capital by virtue of a new prospectus exemption known as the Listed Issuer Financing Exemption (the Exemption).

The amendments to NI 45-106 are expected to come into effect on November 21, 2022.

What you need to know

- The Exemption is noteworthy, as it will permit the issuance of freely tradeable securities to any type of investor, including the public, without a prospectus. Instead, issuers may rely on their continuous disclosure record and a short offering document, which will not be reviewed or receipted by a securities regulatory authority.
- The time lag and associated execution risk of clearing comments with the applicable securities regulatory authorities in connection with a short form prospectus offering is eliminated for offerings made in reliance on the Exemption.
- Exempt market dealers may lead public offerings under the Exemption, which, until now, was something only IIROC registrants could do.
- Only listed equity securities and equity units can be issued using the Exemption.
- The Exemption is designed for small offerings (*i.e.,* less than $10 million) to serve as a less expensive and more efficient method of raising capital for small-cap issuers, although it remains to be seen whether larger more seasoned issuers will avail themselves of the Exemption as part of their capital raising initiatives.

Exemption requirements

To complete a distribution using the Exemption, an issuer must meet certain requirements and take certain steps, including the following:

- Issuers must prepare and file a short offering document, which in conjunction with the issuer's public disclosure, must disclose all materials facts related to the securities being distributed.
- Issuers must disseminate and file a news release announcing the offering and providing notice that the offering document is available on the System For Electronic Document Analysis And Retrieval (SEDAR) and on the issuer's website. While there is no requirement to deliver a physical copy of the offering document, it must be prepared and filed prior to making any solicitations, which we expect will limit the practicality of bought deal and overnight marketed offerings relying on the Exemption. The distribution must close no later than 45 days after the date the news release announcing the offering is disseminated.
- Issuers must be a reporting issuer in a jurisdiction of Canada for at least 12 months.
- Issuers must be listed on a Canadian stock exchange and must have filed all timely and period disclosure documents under Canadian securities legislation.
- Issuers cannot be investment funds or, within the preceding 12 months, capital pool companies, special purpose acquisition companies or growth acquisition companies (*i.e.,* an issuer whose principal asset is cash).
- Issuers must prepare and file a report of exempt distribution within 10 days of the closing of the distribution including a schedule detailing individual purchaser information.

Exemption limitations

In addition to the qualification requirements for the Exemption, there are also certain limitations imposed under the Exemption, including:

- Issuers will be limited to raising $5 million or 10 per cent of the issuer's market capitalization (whichever is greater) to a maximum total dollar amount of $10 million during any 12-month period in reliance on the Exemption. Distributions that did not rely on the Exemption are excluded for the purpose of this limit.
- Issuers will be not be able to rely on the Exemption to issue securities that would result in the issuance of more than 50 per cent of the issuer's outstanding listed equity securities during any 12-month period. Once again, this limitation is confined to distributions made in reliance on the Exemption and would not capture previous private placements or prospectus offerings.
- Similar to existing standards observed by securities regulators in connection with prospectus offerings, issuers must also reasonably expect to have sufficient funds to meet their business objectives and liquidity requirements for a period of 12 months following the closing of the distribution. We expect this limitation will present a significant hurdle for issuers operating in capital-intensive industries, such as mining exploration and technology, and biotech/pharma development, where access to financing short-term operations is imperative.
- Only listed equity securities and units including warrants can be issued using the Exemption. This means, the Exemption cannot be used to distribute certain common securities, such as subscription receipts, special warrants or convertible debentures, but may be used in connection with various types of flow-through offerings, which we expect will be very appealing to small-cap mining issuers with exploration projects.

- The use of proceeds from securities issued in reliance on the Exemption must not be allocated to significant acquisitions, restructuring transactions, or any other transaction that requires approval from any security holder.

Exemption benefits and drawbacks

In addition to the limitations discussed above and the impact these limitations may have on a distribution made in reliance on the Exemption, other considerations for issuers and dealers include potential cost savings, the potential discount advantage, the liability associated with the offering document used in connection with the Exemption, the involvement of a registrant and cross-border considerations.

Cost savings

In Canada, the prospectus offering regime often presents an impediment to capital raising because of its associated costs and time requirements. Clearing comments from the applicable securities regulatory authorities in connection with short form prospectus offerings also introduces significant delays to closing as well as execution risk should the principal regulator refuse to receipt the offering.

That said, while the Exemption may lead to lower costs, there remain a number of uncertainties in that regard. For example, unlike a prospectus, no personal information forms or expert consents would be required and a venture issuer would not be required to have a current annual information form to rely on the Exemption. However, the cost to prepare the offering document may not be dissimilar to preparing a prospectus supplement under an existing base shelf and we expect that the due diligence procedures currently employed by dealers in connection with prospectus offerings may change very little in connection with offerings under the Exemption.

Furthermore, while it is likely an issuer’s auditor will be less involved than demanded by a prospectus offering, it remains unclear what type of comfort dealers may request or require in connection with an offering under the Exemption.

Discount to market price

Unlike private placements to accredited investors, issuers will have access to the broader public market and be able to issue freely tradeable securities, which may result in distributions with less significant discounts. In that respect, the Canadian Securities Administrators notes that exchanges may consider similar factors when applying discounts to market price as they currently apply in a prospectus offering, although this remains an open point for the stock exchanges to address.

Statutory liability

In the event of a misrepresentation, the Exemption will impose primary offering liability against the issuer, and in most jurisdictions, the officers that sign the offering document and the issuer’s directors. Like a prospectus or offering memorandum, this would provide a statutory cause of action to investors that purchase securities from the issuer in the event of a misrepresentation (in addition to the secondary market liability that is imposed by virtue of the offering document being a “core” document).

Involvement of a registrant

An issuer can rely on the Exemption without the participation of a registered dealer, although an issuer may engage an IIROC registered investment dealer or exempt market dealer to assist with a distribution under the Exemption. We expect the involvement of a dealer may be required in some instances to market the deal and to assist with a concurrent offering in the United States through a U.S.-registered broker-dealer.

Cross-border considerations

When utilizing the Exemption, issuers and dealers will need to be mindful of securities laws of any other jurisdictions where solicitations to purchase or sales of securities are made.

As noted above, an offering in the United States may require the participation of a U.S.-registered broker-dealer but issuers will need to consider each distribution on a case-by-case basis. At least initially, we expect cross-border offerings made in connection with the Exemption to resemble those in a private placement with such distributions to be limited to the investors permitted by applicable U.S. securities laws.

Takeaways

The Exemption is designed to be a progressive capital-raising tool that will enable small-cap issuers to bridge the gap to access retail investors and issue freely trading securities without having to file a prospectus.

The Exemption has the potential to reduce the current burden on small issuers to raise capital in the public market and given the disproportionate number of small-cap issuers in Canada, ultimately has the potential to change the landscape for raising capital in Canada. However, given certain of the limitations and drawbacks discussed above, time will tell if the Exemption gains widespread adoption as the preferred offering structure for small-cap issuers looking to issue freely trading securities.

For further information on utilizing the Exemption, please feel free to contact any of the key contacts listed below.

By

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