

THE SECURITIES COMMISSION OF THE BAHAMAS
SECURITIES INDUSTRY REGULATIONS, 200[9]
EXECUTIVE SUMMARY
MAY 2009

INTRODUCTION

The International Monetary Fund ("IMF") conducted a full review of the securities regulatory regime in The Bahamas as part of an Offshore Financial Centre assessment in October 2002. An IMF follow-up technical assistance mission recommended a number of changes to improve the Securities Industry Act, 1999 ("current Act") in light of international best practices. Given the extensive nature of some of the proposed changes, it was recommended that a new Act be drafted.

The Consultant, Tanis MacLaren, was engaged by The Caribbean Regional Technical Assistance Centre ("CARTAC") to draft the new legislation for the Securities Commission of the Bahamas (the "Commission"). The proposed Securities Industry Act, 2007 ("new Act") was prepared to address the identified issues and to be consistent with international best practices, both for securities legislation and the Financial Action Task Force recommendations to combat money laundering and terrorist financing.

The new Act was prepared following a legislative framework commonly used for securities legislation. The key legal obligations appear in the Act itself, while subordinate instruments such as regulations or Commission-made rules set the detailed requirements. This structure allows securities regulators to respond quickly and effectively as circumstances change.

The Consultant was engaged by CARTAC to draft the necessary general regulations (the "draft Regulations").

The process followed was to:

- review the existing Securities Industry Regulations, 2000 (the "existing Regulations") requirements and expectations for market participants,
- address any gaps or weaknesses identified by the Commission or the Consultant,
- build in best practices, both from a regional and international perspective, and
- adapt these to the framework set out in the new Act.

The Commission published the new Act on its website on January 28, 2008 for industry-wide consultation and public review. The new Act is to remain out for public consultation throughout the period of development of the regulations as well as for the period allowed for review of the regulations.

In preparing the draft Regulations, two objectives were balanced in an attempt to establish a robust framework for day to day regulation while maintaining flexibility and not fettering the Commission's discretion to act. Where possible, the language used is designed to facilitate further additions or changes by rule or guidance. For example, in some places the draft Regulations take a principles-based approach. It sets out a high level standard to be met by the affected parties, which then can be supplemented by more detailed requirements by rule or guidance.

While it is noted that the concept of "international best practices" is subjective and there is no agreed single standard for best practices on most topics covered by securities regulation. The practices included in the draft Regulations are a fair representation of best practices across a range of countries that use the common law system, with an emphasis on North American and Caribbean practices.

GENERAL

Duplication. There was an attempt for obvious reasons, to avoid repeating in the draft Regulations requirements that are set out in the new Act. It was necessary however, in certain places, to have some repetition of provisions or requirements in order to make the relevant provisions of the draft Regulations clear.

Forms. The Forms appear in Schedule 2 to the Regulations. The general approach to forms is to list the required headings, followed by some guidance on the information that should be provided under each heading. In a few cases where standardized responses is desirable, such as the annual renewal forms for firms and the personal questionnaires for individuals, the forms are structured in 'fill in the blanks' style.

PART I – PRELIMINARY (Regulations 1 – 7)

Accredited Investor. Issuers are permitted to distribute securities to an investor who qualifies as an "accredited investor" without having to provide a prospectus. The policy rationale underlying the concept is that these investors have sufficient expertise (or are able to pay for suitable advice) not to need the protection provided by the prospectus disclosure requirements of securities legislation. The list of qualified persons set out in the draft Regulations builds on the current definition in the existing Regulations by including those entities set out in proposed amendments to the equivalent definition in the Investment Funds Act, 2003 ("IFA") and in similar provisions in Bermuda, Canada, Jamaica, Trinidad and Tobago¹ and the United States.

Fit and Proper. The requirement that registered entities and their key personnel must be fit and proper is a fundamental concept in securities legislation world-wide. The phrase covers the person's experience, financial resources, training and reputation. As it is used in several places in the draft Regulations, it was appropriate to craft one inclusive definition. The definition included here is adapted from the Hong Kong Securities and Futures Ordinance, which we believe best summarized the concepts used across the major common law jurisdictions.

Fees. The new Act gives the Commission the power to set its fees by rule and the fees provisions in the draft Regulations are drafted assuming the rule would list each action for which a fee was charged,² along with the relevant fee.³ It also contains provisions imposing late fees for filing of renewals, separate from the general power to impose late fees set out in section 135(2) of the Act. These provisions in the draft Regulations are based on the late fee requirements of section 35 of the IFA.

Application to Investment Funds Act Entities. Only certain parts of the new Act apply to investment funds and activities related to investments funds.⁴ Investment funds were carved out of the requirements in the new Act directed at governing public issuers⁵ and those requiring registration to advise on or manage investment funds, as the Commission is largely satisfied with the comparable rules contained in the IFA. As a result, many of the topics addressed in the draft Regulations have very limited application to entities governed by the IFA. Therefore, entities governed by the IFA are exempt from the Regulations unless the Regulations expressly state they apply to these entities.

PART II – THE COMMISSION (Regulation 8)

¹ Trinidad and Tobago, Securities Act, 2007.

² Actions would include filing a prospectus or renewing a registration.

³ For an example of this sort of rule, see Ontario Securities Commission Rule 13-502 Fees which can be found at http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part1/rule_20080905_13-502_unofficial-consolidated.pdf

⁴ Only those sections that deal with general matters – including the Commission's functions, scope of jurisdiction, specific investigation, inspection and enforcement powers and general rule-making, exemption and recognition authority – apply to investment funds and participants in that market.

⁵ These include prospectus and continuous disclosure requirements and civil liability for misrepresentations.

Under the new Act, the Commission will set its own codes to govern, inter alia, its hearing and appeal procedures and a code of conduct for its Members and staff. These matters are therefore not addressed in the draft Regulations.

Delivery of Documents. Under the new Act, the Commission may prescribe the manner that documents are to be submitted. The provision in the draft Regulations requires physical delivery of three paper copies of each document that is required to be filed or delivered, but leaves the Commission with the discretion to recognize alternative delivery methods, such as delivery via electronic mail.

Publication of Documents. The new Act gives the Commission the authority to require the publication of the financial statements of market participants (section 67(2)), registered firms (section 79(2)) and public issuers (section 98(4)). Details regarding the form of publication will be implemented by Commission rule or order.

PART III – APPROVED AUDITOR (Regulations 9-13)

The new Act requires public issuers, persons registered under Part V (such as stock exchanges), and registered firms to have their annual financial statements audited by an approved auditor. This Part of the draft Regulations sets out the requirements, form (Form 1) and process for recognition as an approved auditor. It also delineates the duties of these auditors, including giving notice to the Commission in certain circumstances, such as if it appears the auditor will have to qualify its audit opinion. The provisions are structured to grant approval for an auditor to act for any public issuer, person registered under Part V or registered firm, rather than being restricted to a single type of entity or a specific company. The obligations of market participants regarding notice to the Commission of the appointment, termination or resignation of an approved auditor are also set out. A form for this notice is included in Schedule 2 (Form 2).

PART IV – BOOKS AND RECORDS REQUIREMENTS (Regulations 14-18)

The books and records requirements for all market participants have been brought together in this Part. The draft Regulations set out the general standard that applies to all market participants to keep the 'necessary and prudent' records. It then supplements the general standard with more specific requirements for marketplaces, clearing facilities and registered firms. These latter provisions largely are drafted as principles-based requirements, meaning rather than listing each type of record and the details that must be kept under each heading, the requirements establish the objectives that must be fulfilled by the records.

This Part also gives guidance to all market participants on how and where the records are to be kept and how accessible these records must be. Finally, it sets the records retention requirements as the longer of seven (7) years or the required period under any other law. This continues the current seven year requirement under the existing securities legislation. Shortening the retention period to five years to match that of the anti-money laundering legislation was discussed during the drafting process. While the Commission hoped to harmonize and simplify these requirements, we note that subsection 5(1) of the Limitation Act (Ch. 83) gives a plaintiff six years to sue on a claim under contract or tort. Legislative permission for market participants to destroy records sooner would therefore not be ideal.

PART V – REGISTRATION OF MARKETPLACES, CLEARING FACILITIES AND ANCILLARY FACILITIES (Regulations 19-36) AND PART VI – REGISTRATION OF FIRMS AND INDIVIDUALS (Regulations 37-64)

The language in these Parts has been conformed where the same requirements appear in both Parts. Including common provisions in one place in the Act was considered, but the drafting often became unduly complicated. Further, from the perspective of ease of use, it seemed better to group requirements by the type of entity they applied to, rather than by type of obligation.

The new Act gives the Executive Director the responsibility for making registration decisions. The relevant provisions of the new Act give the Executive Director the authority to grant, amend, refuse and impose terms and conditions on an applicant or registered entity under either of these Parts. The Executive Director's decisions are, of course, subject to appeal to the Commission. Further, except in certain specified circumstances, the decision to cancel a registration lies in the Commission's hands. A person still becomes registered with the Commission and files their various notices and forms with the Commission.

Forms. Because there was a fair degree of commonality across the initial registration requirements for companies under these Parts, the application forms were drafted to be consistent with each other. Further, a single form was developed to collect personal and 'fit and proper' information on the officers, directors and security holders of these companies (Form 4). This form and the application form for registration of an individual to act for a registered firm (Form 10) share many questions. The personal questionnaires are structured as forms to be filled in as is, including tick boxes for yes/no answers. Given that these are to be completed by individuals with varying degrees of sophistication, it seemed advisable to be more directive. It also ensures the Commission gets the same information from each individual. This approach is consistent with the practices in most developed jurisdictions and in the Cayman Islands and Bermuda. A common form for transfers and new issues of securities of regulated persons is also included in the forms (Form 7).

Evidence of Registration. The draft Regulations eliminate the practice of issuing certificates of registration. The granting of registration will be evidenced by a letter from the Executive Director. The processes surrounding the issue, replacement and cancellation of paper certificates are labour intensive and a registration certificate posted in one office provides information only to a limited number of interested parties. Much greater transparency on a person's registration status may be achieved through lists of registrants posted on the Commission's website. In an era when most regulators and market participants are working to improve efficiency of the markets by eliminating physical certificates for securities, the concept seemed outdated. It is noted that many other Caribbean countries still issue certificates of registration. They are not used in Canada, the US, the UK, Hong Kong or Australia.

Registered Marketplaces and Clearing Facilities. This division of Part V, coupled with the related form (Form 3), carries forward the registration requirements under the current legislation, supplemented with new provisions giving additional guidance on the necessary contents of rules and procedures for these entities and on their systems and controls.

The requirement in the existing Regulations that a securities exchange have \$250,000 of paid up capital has been replaced with general duties to have sufficient resources to carry out its proposed functions and to observe standards of solvency and levels of capital as required. Paid up capital is not a particularly useful measure of either financial resources or solvency from a regulatory point of view as it reflects historical investments, not resources available for investment in new systems or cash to use in the business. Of greater regulatory concern is that the marketplace or clearing facility makes sufficient investments in the appropriate infrastructure to carry on its activities in an efficient and prudent manner and has sufficient working capital to continue to carry on business.

There is no clear international standard on whether a stock exchange or clearing facility should be subject to a regulatory capital requirement or if it is, on the form that that requirement should take. Attached to these Explanatory Notes are three examples of capital requirements imposed on securities exchanges. In all of these cases, the specific terms were imposed on a particular exchange by way of a unique recognition order. Moreover, it appears that other than the existing Bahamian requirement, no exchange in the Caribbean region is subject to a capital requirement imposed by securities legislation or regulators.

Registrars and Transfer Agents (RTAs). RTAs are required to be registered. The services they provide have been designated as "services provided by an ancillary facility" as that term is set out in the

new Act and draft Regulations. Note that as drafted, an RTA is subject to being registered if it acts as an RTA for any issuer, not just ones that are public issuers under the Act.

Division 2 of Part V, coupled with Form 5, sets out the requirements for registration as an RTA. These bring forward some of the requirements from the existing Regulations, supplemented to parallel the requirements for marketplaces and clearing facilities regarding the need for sufficient capacity and resources to carry out the RTA's functions in compliance with relevant laws.

The requirements in the existing Regulations limiting who may be a security holder of a securities exchange, clearing facility and RTA to those carrying on specified businesses have been eliminated in the draft Regulations and replaced with a general requirement that security holders of these entities be fit and proper.

Registered Firms. An applicant for registration must be incorporated under the Companies Act or the International Business Companies Act, 2000. The securities activities that international business companies may carry on are not limited. An applicant must specify which of the securities businesses listed in Part 2 of the First Schedule to the new Act it plans to carry on and will be registered accordingly. The draft Regulations presently do not set different requirements based on which activities are to be undertaken. However, it is expected that new capital and insurance requirements will be implemented in due course by rule that will reflect the different risk exposures created by the various activities. This is consistent with what is done in other jurisdictions (such as Bermuda, the UK and the Cayman Islands) that register by function. All firms must have sufficient capital and prudent internal controls; however, the regulatory expectations of what would fulfill those requirements may be very different depending on the type of activities that are undertaken. Insurance requirements (as in Canada or Jersey) that vary by the amount of assets under management or capital requirements that are tied to the nature of the assets held or business conducted (as in the Cayman Islands, UK, Bermuda and Jersey) result in differential requirements.

Benchmarking of regional requirements for insurance at registered firms was conducted. The Cayman Islands and Bermuda specifically require "appropriate insurance coverage", but do not set minimum coverage amounts by legislation or regulation. The Barbados securities legislation requires registered firms to have policies of insurance "on terms prescribed by the Commission" providing indemnity against liability for acts of employees. It should be noted that Canada, the US, UK and Jersey have specific requirements, but they differ substantially in the details. The insurance provision included in the draft Regulations tracks that of the Cayman Islands.

Registered Individuals. There are five categories of individual registration: Chief Executive Officer, Compliance Officer, and Dealing, Discretionary Management or Advising representatives. The representative categories track the main categories of securities business. A representative may only register to carry on a securities activity that the firm for which he or she works is registered to undertake. For example, if a firm is registered to deal only as a principal, then its dealing representatives cannot be registered to undertake agency transactions or be discretionary management representatives.

A general standard for education and experience has been introduced. The rest of the proficiency requirements are a simplification of those presently in place. A specific provision permitting the registration of individuals who lack the required standard of experience has been added. These trainees could be registered subject to the condition that their securities activities be supervised and authorized by a designated registered person at the firm.

Reporting Requirements. The requirements to give the Commission notice of changes are consistent across applicants, registered firms and those registered under Part V of the Act. The specific circumstances when notice must be given have been substantially enhanced from those in the existing Regulations, in line with the requirements in Canada, the US, the Cayman Islands and Bermuda. The North American jurisdictions specify various forms to be used to deliver these notices to the securities

regulator, the Caribbean jurisdictions do not. The Commission took a middle ground and provided a general format to be used to give notice (Form 6). Simpler notice requirements apply for individual registrants (based on the existing requirements). Individuals are required to report these changes to the Commission and to their sponsoring registered firm.

In general, the financial statement requirements are common across Part V persons and registered firms,⁶ with respect to content, frequency and filing deadlines. Annual audited financial statements must be provided to the Commission within 90 days of the company's year end and interim statements are required within 30 days of each quarter end. In addition, registered firms are required to deliver Form 14 – based on Form H under the existing Regulations – with their financial statements. Form 14 includes a report on compliance with the reconciliation and client asset requirements under the Regulations.

Registered firms are also required to file an annual auditor's report on compliance with internal controls and other requirements (set out in s.76(2)(b) of the new Act and regulation 51) with the annual audited financial statements. The self-regulatory organizations in Canada and the US impose a requirement that the auditor report annually on a registered firm's internal controls. Among Caribbean countries, the Cayman Islands requires an annual auditor's report on a licensed firm's internal controls and Bermuda requires an annual report from the auditor on a firm's compliance with the rules governing client assets. However, there does not appear to be an equivalent requirement in any other Caribbean jurisdiction. In Jersey, registered firms are required to prepare an annual declaration regarding their compliance with financial services and anti-money laundering legislation requirements and the maintenance of proper accounting records. This declaration must be given to the firm's auditors who then must include a comment to the regulator as part of the annual audit of the firm on whether anything came to light during the course of the audit that might call into question the accuracy of the declaration.⁷

Renewal Process. Again, the requirements for renewals have been made consistent across the various categories of registered companies. The Annual Information Update Form that is used for renewals of registered firms appears in the draft Regulations as Form 11. A similar form was created for renewals by persons registered under Part V (Form 8). No separate renewal forms have been drafted for individual registrants.⁸

PART VII – CONDUCT OF BUSINESS (Regulations 65-93)

Most of the conduct of business rules from the existing Act and Regulations have been carried forward to the draft Regulation, except those provisions that are now addressed in the new Act. The provisions in the draft Regulations have been updated and expanded to cover the full range of conduct of business requirements expected by international standards.

Reporting to Clients. Contract notes must be sent to clients within one business day after a trade is executed. Quarterly statements of account are also required to be sent to clients showing cash balances and details of the securities held for or owned by the client. There was some discussion whether the client should be able to waive delivery of these statements. Regular statements of account not only keep clients informed about their affairs, they allow clients to flag incorrect or unauthorized trading in their accounts. From this perspective, waivers of these reports can produce a significant gap in the prudent internal control procedures at a firm. It is noted however that the equivalent rules in Jamaica expressly

⁶ Virtually every jurisdiction requires licensed/registered firms to deliver annual audited financial statements; only the time periods for delivery vary – from 60 days after year end in the US to 4 months in Bermuda and Jersey. The most common time frame is 90 days (Canada, Jamaica, Trinidad and Tobago and the UK). Most also require at least quarterly unaudited statements within 15 days (Cayman Islands and US) to 30 days (Canada) after the quarter end. Some impose monthly requirements and many require delivery of additional information on capital and other matters with the financials.

⁷ Jersey, Financial Services (Trust Company and Investment Business – Accounts, Audits and Reports) Order 2007.

⁸ The new Securities (General) By-law in Trinidad and Tobago requires individuals to renew their registration annually and provides a form to be used for this purpose.

permit the client to waive the delivery of these reports. In many developed countries, client statements must be sent monthly, cannot be waived and are required to contain many more details – including details of each trade carried out for the client during the period covered.

No method of delivery is specified, to allow flexibility for firms to make use of electronic methods, either by sending these documents by e-mail or by making the documents available via a website. Any such electronic method adopted should, of course, be subject to appropriate security to ensure the clients' information is protected. Also, clients should be able to opt for paper delivery, if they wish, without cost.

Trading of Listed Securities. The requirement found in section 19 of the current Act requiring trading of listed securities on the Bahamas International Securities Exchange ("BISX") has been rewritten. Trading within The Bahamas of securities listed on a registered securities exchange must take place on that exchange unless the trade is specifically exempt. Exemptions are available for trades by executors and receivers or others acting under court appointment or trades between non-arm's length parties. The permitted categories of trades and parties to the trades have been drawn from securities legislation in other jurisdictions. Trades of any kind by executors, receivers etc are usually exempt from any registration requirements under securities legislation. In fact, these persons are exempt from registration under Part 4 of the First Schedule to the new Act.

Transfer of Listed Securities. Subsection 79(1) of the current Act refers to two forms that are to be used to transfer listed securities. Presently only one form is in use and that was specified in BISX Rule 5. The mandatory use of a paper form of transfer for securities held in electronic form, as appears to be required under the BISX rules, is very unusual. In most jurisdictions, when physical stock certificates become the exception or are eliminated completely, the paper transfer forms disappear too. As a result, this requirement was not carried through in the draft Regulations.

Reconciliations and Client Assets. International standards require that registered firms have prudent risk management and internal controls in place and that client assets be safeguarded from both inappropriate use by the firm and from seizure by creditors of a failed firm. Division 2 introduces specific requirements regarding reconciliation of a registered firm's accounts and with respect to holding client cash and other assets. While these are much more detailed than what is in the existing Regulations, they are consistent with requirements in Jamaica and for firms in Canada that are not members of a self-regulatory organization. They are considerably simpler than the equivalent requirements in the Cayman Islands, Bermuda and Jersey. The provisions require registered firms to confirm their compliance with the requirements of the Division on a quarterly basis. This report has been built into Form 14 in the draft Regulations.

Advertising Standards. The advertising rules from the existing Regulations have been replaced by much simpler provisions consistent with those set out in the IFA. The draft Regulations preserve the existing IFA process for pre-approval of advertising materials, but makes this process the exception, rather than the rule. Advertisements would only be subject to prior review and approval if the Commission specifically orders this to take place – either for a particular person or for all persons. In terms of international practices, it is very uncommon to see all advertising materials subject to prior review and approval by a securities regulator.

PART VIII – DISTRIBUTION AND PROSPECTUS REQUIREMENTS (Regulations 94-119)

The provisions in the new Act relating to the prospectus regime introduced two new concepts: that the prospectus requirement is triggered by there being a 'distribution' as defined by the Act and for a preliminary prospectus to be prepared and delivered to the Commission.

Prospectus Contents & Review Process. The form to be followed by an issuer in preparing a preliminary or final prospectus is set out as Form 16 and is accompanied by detailed lists of additional documents that must be filed with the Commission and/or made available for public examination. These

requirements use the existing prospectus form as a base and supplement them in line with the requirements in Canada for long form prospectuses. The Canadian requirements have also been used in the new Securities (Prospectus) By-laws, 2007 in Trinidad and Tobago and in the Securities (Registration and Prospectus Disclosure) Regulations, 2006 in Jamaica.

The requirements for opinions and consents of experts, certificates to be signed by various parties and the reasons that the Commission may refuse a receipt are included in this Part. The draft also sets out requirements regarding marketing and advertising securities before the final prospectus and the process to be followed if an amendment to a prospectus is required.

Under the new Act, purchasers have the right to rescind the sale or take action for damages if the prospectus contains a misrepresentation. After a review of various other jurisdictions' requirements in this area, one new right has been introduced in the draft. Regulation 103 tracks equivalent provisions in Canada, Trinidad and Jamaica in giving the purchaser the right to withdraw from the purchase within two days of receiving the final prospectus or amended prospectus, as the case may be. While the right to withdraw is not often exercised in practice, the right is given to purchasers in recognition of the fact that they may have subscribed for the securities based on a draft/preliminary prospectus and that they should not be irrevocably bound to purchase the securities without having had an opportunity to review the final document. The draft Regulations also introduce a requirement to flag these rights to purchasers in the prospectus.

Prospectus Exemptions. The exemptions in the existing Regulations for limited offerings have not been continued here. The two current limited offering exemptions have been replaced with a single accredited investor exemption. International practices have been followed and sales to this type of investors are permitted to take place without a prospectus and without a minimum purchase requirement. The current maximum purchase amounts set out in the current limited offering exemptions have also been eliminated.

The accredited investor offering and rights offering prospectus exemptions have been drafted to be conditional on the delivery of an offering memorandum and financial statements to the investors. In addition, the rights offering exemption is drafted so that it is not available if the rights offering would result in the issue of more than 25% more securities of that class. This dilution limit appears in the equivalent Canadian exemption. However several other jurisdictions, including Trinidad and Hong Kong, do not appear to have any dilution limit.

It was suggested that it would be appropriate if the prospectus exemptions – particularly those for accredited investor offerings and rights offerings – could be harmonized with those in use in other countries in the region. That proved difficult, as there was little commonality across the various regimes. However, if a regional consensus was reached on the contents of a particular exemption, such as a general private placement exemption, a rule could be created to implement that exemption in The Bahamas.

Under the new Act, a sale by a control block holder⁹ would always be a “distribution”. A control block holder wishing to sell any of the securities held in the issuer would be required either to arrange for a prospectus to be prepared or resell the securities under a prospectus exemption. The new Act provides an exemption for normal course sales through the facilities of a securities exchange. The draft Regulations prescribe the notice requirements and other conditions that must be met to make use of this exemption.

An approved foreign issuer (as defined) may make use of a prospectus exemption to allow these issuers to distribute their securities in The Bahamas using the disclosure documents that they prepared for their home jurisdiction, rather than having to prepare and qualify a prospectus under the new Act (see section 94). The criteria to be an approved foreign issuer are set out in regulation 115 of the draft. Consistent with mutual recognition provisions elsewhere, only issuers considered to be of sufficient size (measured

⁹ The new Act defines a "control block holder" as a person that (a) holds more than 30% of the voting rights attached to an issuer's outstanding voting securities; or (b) is able to affect materially the control of the issuer, whether alone or by acting in concert with others;

by market capitalization) and seasoning (number of years as a public issuer) qualify to use the exemption. The qualifications set out in regulation 115 essentially track those in an equivalent exemption in the new securities legislation in Trinidad and Tobago¹⁰ and those used in several other jurisdictions to qualify issuers to use short form or shelf prospectus regimes.¹¹ The information that an approved foreign issuer must provide to the Commission and send to investors in The Bahamas to use the exemption is set out in Schedule 3 of the draft Regulations.

Resale Restrictions and Hold Periods. Resales of securities acquired under certain prospectus exemptions are often subject to limitations to prevent end-running the prospectus requirements. The most common limitation is that these securities must be held by the purchaser for a period of time before they are freely saleable. Any resale of the securities before the end of the hold period is a distribution and requires a prospectus or must be done under an exemption. Hold periods vary across the jurisdictions and may well vary from exemption to exemption within a jurisdiction. Generally, they range from 6 to 18 months. There was no commonality across the Caribbean. Six months was chosen as it matched that under the new Trinidad and Tobago legislation and was the most common time period under the prospectus exemption rules in Canada. A subsequent buyer who purchases the securities from the initial purchaser during the first six months after the securities were issued under an exemption is not subject to a new six month hold period. The subsequent purchaser must only hold the securities for the remaining time to the end of the original six month period. Thereafter, the securities become freely tradable. Similarly, conversion of a convertible security acquired under a prospectus exemption does not restart the hold period.

PART IX – CONTINUING DISCLOSURE REQUIREMENTS OF PUBLIC ISSUERS (REGULATIONS 120-132)

The regime introduced in the new Act incorporates the continuous disclosure requirements for listed companies from the BIX rules and applies these requirements to all public companies. General standards for disclosure, fair treatment of security holders and the fiduciary duties of officers and directors of public issuers are also mandated as recommended in the IMF Report. These standards are followed by detailed requirements on disclosure of material changes, provision of annual and interim financial statements, annual reports and on proxy solicitation. The draft also introduces a requirement that public issuers send financial statements and annual reports to their security holders, as this is best practices under both securities and corporate legislation elsewhere.

Financial Statements, etc. This Part of the draft Regulations gives details regarding the contents of the annual and interim financial statements that must be prepared and filed by public issuers.¹² Annual audited financial statements are to be filed within 90 days after the issuer's year end and unaudited quarterly statements are due within 45 days of the end of the quarter. The requirements also provide that interim statements are to be reviewed by either the board of directors of the public issuer or its audit committee before submission to the Commission.

A form to be followed for Annual Reports is prescribed (Form 18). It is noted that the only common international standard in this particular area dates back to the earliest days of corporate law and says that security holders should be given regular information about the performance of the company, in particular annual financial statements of the issuer. Of late years, this requirement has been supplemented in many

¹⁰ Trinidad and Tobago, Securities Act, 2007.

¹¹ See the descriptions in footnotes 12 and 13.

¹² All of Canada, Jamaica, the Eastern Caribbean, Trinidad and Tobago, the UK and the US require public issuers to file audited annual financial statements and quarterly interim statements. The required time frames for filing the statements vary across these countries, as does the level of detail required in the interim statements. Of these jurisdictions, only the Eastern Caribbean regime does not mandate MD&A for both interim and annual statements.

jurisdictions by a requirement that management also provide a narrative explanation of how the issuer performed during the reporting period, its financial condition and its future prospects – the Management Discussion and Analysis ("MD&A").

This Part introduces the requirement for public issuers to provide annual MD&A and prescribes its required contents (in Form 19). The MD&A must accompany the annual financial statements but is not audited. The required contents of the MD&A mirror the requirements imposed in Canada and Jamaica and are consistent with those introduced in Trinidad and Tobago by their new securities legislation. It should be noted that most jurisdictions (including Canada, Jamaica and Trinidad and Tobago) that impose the MD&A requirement mandate provision of this information for both the interim and annual financial statements.

The Annual Report is seldom mandated by securities or corporate law. It primarily serves as an investor relations document. It is far more common to see requirements in securities regulation that public issuers file an annual information form ("AIF") that contains prospectus level disclosure about the issuer and its business. This requirement is often imposed in tandem with a movement to allow issuers to use shelf¹³ or short form prospectuses¹⁴ and thus be able to issue securities more quickly.¹⁵

Material Change Reporting. A simple form to be used by a public issuer to report material changes has been included (Form 20). While the requirement for public issuers to make prompt disclosure of material changes is international best practices, only a few jurisdictions provide any sort of guidance on the form that that disclosure is to take. Canada and the new Trinidad and Tobago legislation use a form much the same as that proposed here. The US Securities and Exchange Commission has several forms that apply, depending on the type of issuer involved. The UK Financial Services Authority Handbook simply requires listed companies to provide full details to a recognized newswire/disclosure service. None of the British Virgin Islands, Barbados, Jamaica, Cayman Islands or Bermuda specifies a particular form.

Proxy Process. The new Act gives the Commission the authority to prescribe additional proxy-related documents, such as the information that management or dissidents should be sending to anyone whose proxy is being solicited. The draft Regulations set out forms for both management and dissident proxy statements (Form 21 and 22, respectively) that supplement the existing requirements to provide more directed guidance on the information that should be disclosed – particularly with respect to who is soliciting the proxy and possible conflicts of interest. This is consistent with international standards¹⁶ that say security holders should be given sufficient information to make informed decisions regarding the matters to be put before them at a security holder meeting. The draft Regulations also preserve the existing process for pre-approval of proxy materials, but consistent with the language in the new Act,

¹³ The shelf prospectus is an offering document prepared and filed in respect of an aggregate dollar amount of securities, which are then put on a metaphorical shelf for up to 25 months until the issuer decides to take some or all of the qualified securities "off the shelf" to distribute them. At the time of the actual sale, the issuer prepares a shelf prospectus supplement, that is often relatively brief, containing deal-specific information, including about the securities being sold, that was not available at the time the base shelf prospectus itself was prepared and receipted. This new information is then incorporated by reference in the base shelf prospectus for purposes of the offering. Shelf prospectuses allow eligible issuers to qualify large amounts of securities at once for subsequent issuance. The shelf prospectus procedure can be faster than both the long form and regular short form prospectus processes because shelf prospectus supplements are not normally subject to any review by regulators at the time of issuance.

¹⁴ The short form prospectus incorporates by reference the issuer's Annual Information Form (the "AIF"), management proxy statements, financial statements and material change reports. The theory is that the short form prospectus, together with the documents incorporated by reference, provides equivalent disclosure to that contained in a long form prospectus.

¹⁵ For examples, see Canadian Securities Administrators National Instrument 51-102 *Continuous Disclosure* for a form of AIF http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part5/rule_20081231_51-102_unofficial-consolidated.pdf and National Instrument 44-101 *Short Form Prospectus Distributions* http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part4/rule_20080905_44-101_unofficial-consolidated.pdf

¹⁶ See for example the OECD 2004 Corporate Governance Principles.

makes this process the exception, rather than the rule. Proxy materials would only be subject to prior review and approval if the Commission specifically orders this to take place – either for a particular issuer or for all issuers. In terms of international practices, proxy materials are not often subject to routine prior review and approval by a securities regulator.

PART X – MISCONDUCT (Regulations 133-135)

Policies and Procedures to Prevent Insider Trading. The provisions governing trading on undisclosed information (usually referred to as insider trading prohibitions) were clarified in the new Act. The draft Regulations reinforce the obligations of market participants regarding the management of material undisclosed information by requiring the establishment of policies and procedures to prevent inappropriate use of that information. These are often referred to as Chinese Wall policies.

Prohibited Representation Exceptions. Section 118 of the new Act prohibits making certain representations regarding securities unless prescribed conditions are met. The draft Regulations permit representations regarding –

- repurchases of securities if the representation is made to an accredited investors and set out in an enforceable agreement; and
- listing of securities on a marketplace if either the marketplace consents to the representation or has granted at least conditional listing of those securities.

These exceptions are consistent with those in place in Canada.

PART XI – REPORTING BY SECURITYHOLDERS OF PUBLIC ISSUERS (Regulations 136-137)

Insider Reporting. It is standard international practice to require insiders to report their ownership of, and transactions in, securities of the issuers of which they are insiders. Under the new Act, all positions and trades in any securities of the issuer by insiders must be reported, as must any positions or trades in securities where the value is derived from or varies materially with the value or market price of a security of an issuer. If any of this information changes, a requirement to file a new report is triggered.

Best practices require initial notices of insider status must be filed relatively quickly after becoming an insider (10 days or less) and notices of change must be filed within similar periods. The trend internationally is to shorten the time periods for reporting and the provisions in the new Act were drafted to give the Commission the flexibility to do this by regulation or rule. The time frame for filing in the Draft Regulations is five days.

A detailed form and instructions for reporting under these provisions is set out (Form 23). This material is consistent with that used in Canada and proposed to be used in Trinidad and Tobago under their new securities legislation.

Security Holder Registers. The details of what must be set out in security holder registers kept by public issuers has been conformed to tie the information required to be kept to that required to be disclosed by insiders of the issuer.

PART XII – CIVIL LIABILITY FOR MISREPRESENTATIONS (Regulation 138)

Part XVI of the new Act sets out the rights of action of an investor where there has been a misrepresentation in a prospectus. Where the prospectus contains a misrepresentation, the investor should be able to seek the recovery of his losses against the issuer and anyone who was responsible for the statements in prospectus, including the underwriter, the directors and officers of the issuer, any promoter of the issue and any expert who provided an opinion. Common law makes these parties liable for negligent misstatements but a plaintiff must bear the burden of proving he relied on the misstatement. Civil liability provisions in securities legislation simplify that process by deeming reliance and codifying who is responsible and for which errors.

The only provision in this part of the Act that requires something to be prescribed by regulation is section 143(1)(d), which determines which promoters are caught by these civil liability provisions. The equivalent requirements in both Canada and in the new Trinidad and Tobago securities legislation impose liability on anyone who has been a promoter of the company within the two years before the date of the prospectus. The same period is prescribed in the draft Regulations.

PART XIII – GENERAL PROVISIONS (Regulations 139-142)

Rulemaking Process. The new Act contemplated that the procedures that must be followed to make Commission rules effective would be set out in the Regulations. The draft Regulations provide that rules and amendments to rules will require the approval of the Minister. Once the Minister's approval is given, a rule or amendment will be effective on the later of the date it is published in the Gazette or the date set out in the instrument.

It should be noted that there is no international consensus on the process necessary to make rules effective, or the nature of the involvement of the government in that process, beyond that the rulemaking process be objective and transparent to the public, as should any governmental involvement in the approval process.

Recognition of Foreign Securities Exchanges and Foreign Jurisdictions. The authority to recognize these entities for various purposes is continued in the new Act. The list of recognized exchanges and jurisdictions set out in Schedule 4 carry forward those securities exchanges and jurisdictions recognized under the current Act.

PART XIV – TRANSITION PROVISIONS (Regulation 143-146)

The transition provisions generally provide at least one year's grace period for public issuers and registered persons to move to the new requirements under the new Act and Regulations. For registered firms, individuals etc, all authorizations are deemed to continue for 12 months after the day the new Act comes into force (the "effective date") and thereafter are terminated. The Commission, by rule, will provide guidance on the transition process to be followed by registered persons to ensure their registrations continue. The new annual filing deadlines for audited financial statements and the requirements for MD&A apply for public issuers' financial years that start on or after the effective date. The shorter interim filing deadlines apply thereafter. The new proxy requirements apply to meetings that take place six months or more after the effective date. The Commission has the discretion to extend these transition periods.

Appendix 1
Marketplace Capital Requirements

Canada

Ontario Securities Commission Recognition order re: Toronto Stock Exchange

"12. FINANCIAL VIABILITY

- (a) *TSX shall maintain sufficient financial resources for the proper performance of its functions.*
- (b) *TSX shall calculate monthly the following financial ratios:*
- (i) *a current ratio, being the ratio of current assets (excluding the portion of future tax asset related to deferred revenue-initial and additional listing fees) to current liabilities (excluding deferred revenue-initial and additional listing fees),*
- (ii) *a debt to cash flow ratio, being the ratio of total debt used to finance TSX's operations (including any line of credit drawdowns, term loans, debentures and capital lease obligations, but excluding liabilities such as accounts payable, deferred revenue, income taxes payable and employee benefit liabilities) to adjusted EBITDA for the most recent twelve months, where adjusted EBITDA is earnings before interest, taxes, depreciation and amortization, adjusted to include initial and additional listing fees received and to exclude initial and additional listing fees reported as revenue, and*
- (iii) *a financial leverage ratio, being the ratio of adjusted total assets to adjusted shareholders' equity, where adjusted total assets is calculated as total assets on the TSX balance sheet less the portion of future tax asset reported on the TSX balance sheet that is related to deferred revenue-initial and additional listing fees as reported on the TSX balance sheet (Adjusted Future Tax Asset) and adjusted shareholders' equity is calculated as shareholders' equity as reported on the TSX balance sheet plus deferred revenue-initial and additional listing fees as reported on the TSX balance sheet less Adjusted Future Tax Asset,*
- in each case as calculated on a consolidated basis and consistently with the consolidated financial statements of TSX.*
- (c) *TSX shall report quarterly (concurrently with the financial statements filed pursuant to paragraph 17) to Commission staff the monthly calculations of its current ratio, debt to cash flow ratio and financial leverage ratio for the previous quarter.*
- (d) *If TSX fails to maintain or anticipates it will fail to maintain in the next twelve months:*
- (i) *its current ratio at greater than or equal to 1.1/1,*
- (ii) *its debt to cash flow ratio at less than or equal to 4.0/1, or*
- (iii) *its financial leverage ratio at less than or equal to 4.0/1,*
- it shall immediately notify Commission staff.*
- (e) *If TSX fails to maintain its current ratio, debt to cash flow ratio, or financial leverage ratio at the levels outlined in paragraph 12(d) above for a period of more than three months:*
- (i) *its Chief Executive Officer will immediately deliver a letter advising Commission staff of the reasons for the continued ratio deficiencies and the steps being taken to rectify the situation, and*
- (ii) *TSX will not, without the prior approval of the Director, make any capital expenditures in excess of its approved budget, or make any loans, bonuses, dividends or other distributions of*

assets to any director, officer, related company or shareholder until the deficiencies have been eliminated for at least six months or a shorter period of time as agreed to by Commission staff.

- (f) *TSX shall not enter into any agreement or transaction either (i) outside the ordinary course of business or (ii) with TSX Group or any subsidiary or associate of TSX Group if it expects that, after giving effect to the agreement or transaction, TSX is likely to fail to maintain the current ratio, the debt to cash flow ratio or the financial leverage ratio at the levels outlined in paragraph 12(d) above."*

British Columbia Securities Commission Recognition Order re: egX Canada Inc. (an electronic market devoted to real estate related securities)

"Financial viability and reporting

6. *egX must have sufficient financial resources to perform its functions and meet its responsibilities.*
7. *egX must:*
 - (a) *report quarterly to the Commission what capital is available and why that capital is sufficient to ensure egX can perform its functions and meet its responsibilities for the next six months;*
 - (b) *report immediately to the Commission when it does not have sufficient capital for the next six months, setting out the reasons for the deficiency and the steps egX will take to rectify the deficiency; and*
 - (c) *file unaudited quarterly financial statements within 60 days of each quarter's end prepared according to generally accepted accounting principles."*

United Kingdom

Financial Services and Markets Act, 2000 (Recognition Requirement for Investment Exchanges and Clearing Houses) Regulations 2001.

- (1) The UK Recognised Investment Exchange (RIE) or and Recognised Clearing House (RCH) must have financial resources sufficient for the proper performance of its relevant functions as a UK RIE or UK RCH.
- (2) In considering whether this requirement is satisfied, the FSA may (without prejudice to the generality of [the regulation]) take into account all the circumstance, including the UK RIE/UK RCH's connection with any person, and any activity carried on by the UK RIE/UK RCH, whether or not it is an exempt activity.

Handbook (Specialised Sourcebook) Supervision of Recognised Investment Exchanges and Recognised Clearing Houses – REC 2.2.3

In determining whether a UK recognised body has financial resources sufficient for the proper performance of its relevant functions, the FSA may have regard to:

- (1) the operational and other risks to which the UK recognised body is exposed;
- (2) if the UK recognised body acts as a central counterparty or otherwise guarantees the performance of transactions in specified investments, the counterparty and market risks to which it is exposed in that capacity;
- (3) the amount and composition of the UK recognised body's capital;
- (4) the amount and composition of the UK recognised body's liquid financial assets;

(5) the amount and composition of the UK recognised body's other financial resources (such as insurance policies and guarantees, where appropriate);

(6) the financial benefits, liabilities, risks and exposures arising from the UK recognised body's connection with any person, including but not limited to, its connection with:

(a) any undertaking in the same group as the UK recognised body;

(b) any other person with a significant shareholding or stake in the UK recognised body;

(c) any other person with whom the UK recognised body has made a significant investment whether in the form of equity, debt, or by means of any guarantee or other form of commitment;

(d) any person with whom it has a significant contractual relationship.

(7) in relation to a UK RIE, the nature and extent of the transactions concluded on the UK RIE.

...

For operational risks:

The FSA considers that a UK recognised body which (after allowing for the financial resources necessary to cover counterparty and market risks) has at any time:

(1) liquid financial assets amounting to at least six months' operating costs; and

(2) net capital of at least this amount;

will, at that time, have sufficient financial resources to meet the recognition requirement unless there are special circumstances indicating otherwise.

In this standard approach, the FSA assumes liquid financial assets are needed to cover the costs that would be incurred during an orderly run down of the UK recognised body's business as such, while continuing to satisfy all the recognition requirements and complying with any other obligations under the Act (including the obligations to pay periodic fees to the FSA under REC 7).