



Update on insider reporting requirements and penalties

On February 1, 2008, the new definition of “Insider”¹ in the *Securities Act* (Quebec) (the *Securities Act*) came into force². It now basically includes every director or officer of an issuer, of a subsidiary of an issuer and of an insider of an issuer; a person controlling more than 10% of the voting rights attached to all outstanding voting securities of an issuer; an issuer holding its own securities; and any person prescribed by regulation or designated as an insider.

A person who becomes an insider must disclose on the *System for Electronic Disclosure by Insiders* (SEDI) the number of securities he or she controls, directly or indirectly, within 10 days of becoming an insider. Thereafter, that insider must disclose any change in the number of securities he or she controls, directly or indirectly, within 10 days of that change³ (including weekends).

The Canadian Securities Administrators (CSA) published on December 19, 2008, a Notice and Request for Comment regarding Draft *Regulation 55-104 respecting Insider Reporting Requirements and Exemptions* (Regulation 55-104) which will bring changes to the insider reporting regime.

PENALTIES IN QUEBEC

The current system in Canada with regards to late filing fees or penalties is fragmented and reporting insiders face substantially different consequences for late and non-filing of insider reports, ranging from no late fee to an uncapped liability. However, Regulation 55-104 is not proposing at this time any changes in that respect.

Penalty structure - In Quebec, insiders' failure to timely disclose their control, or change of control, on the securities of an issuer will result in an administrative monetary penalty of \$100 for each day they are late, up to a maximum of \$5,000⁴ per transaction.

The *Autorité des marchés financiers* (the AMF) has interpreted these requirements strictly. For example, if an insider sells five blocks of securities, even if the sales occur the same day, and fails to file five SEDI reports, the AMF will consider that there are five reportable transactions with a potential maximum penalty of \$25,000. With historical reported penalties of \$30,000 and more, penalties are entirely unrelated to any gain from the transaction or the value of the purchased securities. Additionally, the names of

late filing insiders and penalties are published in the AMF weekly bulletin.

Mitigating factors - When insiders direct their broker to sell securities, brokers may sell the securities in several small transactions. However there is evidence that the insider gave one single order to sell, the AMF has sometimes accepted that only one reportable transaction had really occurred.

RECENT DEVELOPMENTS IN QUEBEC

Underlying securities and procedural equity - In a decision dated September 28, 2007⁵, the *Bureau de décision et de révision en valeurs mobilières* (BDRVM) concluded that there is currently no legal requirement to file a distinct report for the increased number of underlying securities, upon the declaration of the conversion by insiders of securities exchangeable for securities of an issuer, in circumstances where a report was filed at the time of initial acquisition of the exchangeable securities by the insider.

The BDRVM also confirmed that the AMF must follow general rules of procedural equity when imposing penalties. In particular, insiders must be given a fair chance to defend themselves before any decision. For that purpose, accusations must be sufficiently clear and precise for insiders to be able to defend themselves, and should indicate the days during which the insider was late. Furthermore, legal changes may not be retroactive in their application.

Proposed regulatory changes - The proposed Regulation 55-104 will set out the main insider filing requirements and exemptions. It will also consolidate the requirements previously found in *Regulation 55-101 respecting Insider Reporting Exemptions* and *55-103 respecting Insider Reporting of Certain Derivative Transactions (Equity Monetization)* and reduce the delay for filing an insider report to 5 days, from 10, except for initial filings by a person who first becomes an insider.

Regulation 55-104 also attempts to narrow the reporting obligations of insiders with the introduction of a definition of “reporting insider”. However, at the same time the CSA proposes to widen the definition of insider found in the *Securities Act*, and through the addition of the definition of “Significant shareholder based on post-conversion beneficial ownership” which is included in the definition of “Significant Shareholder” and in the list of reporting insiders under

Regulation 55-104. Consequently, through a combination of the two definitions, an insider would not only include a person exercising control over more than 10% of the voting right attached to all outstanding voting securities of an issuer, as per article 89(3) of the *Securities Act*, but also any person who is a beneficial owner of a security convertible within 60 days into securities carrying more than 10% of the voting right attached to all outstanding voting securities of an issuer.

The CSA will also require issuers to disclose in their information circular any late filings by their insiders. Consequently, issuers will be made to disclose information related to third parties they may have no knowledge about. What will then happen if an insider fails to disclose any late filing?

In answer to the BDRVM *Dupont* decision, a specific requirement (Section 3.5) has also been introduced to file a "balancing report" with regards to convertible or exchangeable securities, in order to report the increased number of underlying securities.

Bill 29 - Prior to February 1, 2008, article 89 of the *Securities Act* defined "insiders" as the issuer itself, its subsidiaries, its senior executives and the senior executives of its subsidiaries, any person with a 10% control on the voting securities of the reporting issuer and the senior executives of such control person. Prior to December 14, 2006, "senior executive" was defined under article 5 of the *Securities Act* and included any director or person acting as a director. Therefore, a director was defined as a "senior executive" and was an "insider" by way of consequence.

On December 14, 2006, article 3 of Bill 29, *An Act to amend the Securities Act and other legislative provisions*⁶ (Bill 29) replaced the definition of "Senior Executive" with the current definition of "officer". Bill 29 also proposed to make a parallel change to the definition of "insider" under article 89 of the *Securities Act*, but the entry into force of the new definition was suspended until a decision of the government by Decree.

¹ *Securities Act* (Quebec), article 89.

² Government of Quebec Decree 25-2008, dated January 31, 2008.

³ Articles 96 and 97 of the *Securities Act* and articles 171 and 174 *Regulation Respecting Securities* (Quebec).

⁴ *Regulation Respecting Securities* (Quebec), article 271.14.

⁵ Decision no. 2006-027-001: *Luc Dupont c. Autorité des marchés financiers*.

⁶ Statutes of Quebec 2006, Chapter 50. article 143 of Bill 29 provided that most parts of that Act would come into force on December 14, 2006, except for certain articles including the new article 89, which came into force as indicated on February 1, 2008.

⁷ Ibid note 1.

Consequently, after the December 14, 2006 amendments, "insider" as per article 89 of the *Securities Act* still referred to the old definition of "senior executive" that had been replaced by the definition of "officer".

The definition of officer that came into force on December 14, 2006, includes the chair or vice-chair of the board of directors, the chief executive officer, the chief operating officer, the chief financial officer, the president, the vice-president, the secretary, the assistant secretary, the treasurer, the assistant treasurer or the general manager of an issuer, or any natural person designated as such by the issuer or acting in a similar capacity. However, directors were not included in the new definition of officer.

Even if we assume that the definition of "officer" replacing "senior executives" should have applied with regard to the definition of "insider" under article 89 of the *Securities Act*, "directors" were omitted in the list of people defined as "officer" (though directors were included in the definition of "senior executive"). It is only on February 1, 2008, that the omission was rectified with the coming into force of the new definition of "Insider" (which now includes directors).

A question therefore remains in connection with the implementation on February 1, 2008, of the new definition of insider, namely whether between December 14, 2006 and February 1, 2008, the AMF was entitled to impose late filing penalties on directors, given that directors were not included in the definition of "Insider"⁷ during such period, and to publish their name in the AMF weekly Bulletin.

This update is intended to provide general comment only and should not be relied upon as legal advice.

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