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Securities Regulators Reduce Friction for Capital Raising with Incremental Changes to Prospectus Rules

Authors: David Wilson, Robert S. Murphy, Steven J. Cutler and Samir Chadha

Overview

Canadian securities regulators recently implemented three blanket orders introducing exemptions intended to reduce friction for capital raising. Key among these improvements is an exemption that eliminates the requirement for a third year of annual financial statements in an initial public offering (IPO) prospectus.

The exemptions also

- limit the circumstances in which "promoters" must sign a separate certificate to a prospectus;
- rectify a misalignment between the marketing rules and market practice for communicating changes to deal size or price range in an IPO;
- implement a new exemption allowing an issuer to raise a limited amount of capital without a prospectus for 12 months following its IPO; and
- increase the annual limit on investment in an issuer pursuant to the statutory offering memorandum exemption when the investment constitutes a reinvestment in the issuer.

Coordinated Blanket Orders

Exemptions from Certain Prospectus and Disclosure Requirements

Two Years of Financial Statements

Coordinated Blanket Order 41-930 grants an exemption from the requirement to provide a third year of annual financial statements in a long-form prospectus. This exemption will affect offerings as well as information circulars, bid circulars and material change reports that reference the long-form prospectus requirement.

The exemption is a good start. We encourage regulators to scrutinize other elements of the prospectus form requirements to reduce unnecessary burden by, for example,

- permitting the use of U.S. generally accepted accounting principles, and U.S.-form compliant MD&A and CD&A, in a cross-border IPO;
- narrowing the scope of what constitutes the "issuer" for financial statement purposes to eliminate the necessity to prepare financial statements of non-material businesses acquired by the issuer.

Technical Fix to Marketing Rules

This exemption implements a technical fix to the marketing rules to permit issuers to change the size and pricing of an offering through a standard term sheet or marketing materials without needing to file a corresponding amendment to the preliminary prospectus. However, to use this exemption, the issuer must issue and file a news release containing the changed sizing and pricing information before the

standard term sheet or marketing materials are provided to potential investors. Issuers and dealers will have more flexibility while marketing an offering to respond to investor demand.

In addition, we encourage regulators to complete an overhaul of the Canadian rules governing marketing and pre-marketing of public offerings to facilitate, rather than impede, successful public offerings. Instances remain where these rules are overly prescriptive and conflict with commercial reality. Ways in which these rules could be reformed without compromising investor protection include the following:

- adopting a robust "testing the waters" regime that permits issuers and underwriters to approach institutional investors in all prospectus offerings, not just certain IPOs;
- modifying the requirement that all information contained in marketing materials be included in or derived from the relevant prospectus. This is too constraining and the exceptions provided are too limited, especially where the content is deemed to be included in the prospectus in any event. It also conflicts with the more flexible U.S. standard, which adds unnecessary complexity to marketing cross-border offerings.

Treatment of Promoters

This order also addresses a Canadian pain point regarding the concept of a "promoter." The promoter certificate requirement imposes statutory civil liability on founders of an issuer that has a very limited (or no) pre-IPO operating history. In recent years, in our experience, there has been a regulatory trend to treat all founders as promoters, whether or not the issuer has had a significant track record in its own right – for example, by having raised money from sophisticated institutional investors or borrowed money from large, reputable financial institutions. And following an IPO, there is no clear sunset as to when a founder ceases to be a promoter.

This order addresses both of these issues by exempting promoters from the requirement to sign a separate certificate to the prospectus under certain conditions:

- **Certificate exemption.** Promoters are exempt if they sign a certificate required by securities legislation in a different capacity, such as a director, CEO or CFO, where they will otherwise be subject to statutory civil liability for a prospectus misrepresentation.
- **Sunset.** Promoters are exempt if the issuer has been a reporting issuer for at least 24 months, the promoter is not a director, officer, or control person of the issuer, and the prospectus does not qualify the distribution of asset-backed securities.

Although we would have preferred a time-based sunset without additional conditions, we believe that these exemptions provide helpful clarity as to when the regulators will apply the promoter certification requirement.

Prospectus Exemption for New Reporting Issuers

Coordinated Blanket Order 45-930 allows issuers that have completed an underwritten IPO with flexibility to raise additional capital post-IPO without a prospectus. More specifically, the exemption is available to new reporting issuers within 12 months after a receipt is issued for a final long-form IPO prospectus for an underwritten offering. In lieu of a prospectus, the issuer must issue a news release and file a simple offering document. Among other conditions, the capital raise must be of the same class of securities as those offered in the IPO and at a price per security no less than the IPO price. The exemption is limited to the lesser of C$100 million and 20% of the market value of the issuer's listed equity securities on the date it issues the news release announcing the first offering in reliance on the exemption.

We will be interested to see how frequently this exemption is used. Issuers are typically subject to a contractual lockup in favour of the IPO underwriters, which prevents them from completing follow-on offerings for six months post-IPO. This limits the availability of this exemption to the last six months of the year following the IPO. And if during that time, the shares are trading above the IPO price, and a favourable market window appears, the issuer may nevertheless pursue a follow-on underwritten offering under the short-form prospectus regime – using a classic Canadian-style bought deal.

Exemption from the Investment Limit Under the Offering Memorandum Prospectus Exemption to Exclude Reinvestment Amounts

Coordinated Blanket Order 45-933 effectively increases the annual limit to C$200,000 per year, from C$100,000 per year, on investment by an individual, non-accredited investor in an issuer pursuant to the statutory offering memorandum exemption set out in National Instrument 45-106 Prospectus Exemptions. However, the amount of any investment over the initial $100,000 per year must constitute a reinvestment in the issuer, not in excess of the proceeds from the disposition of securities in that same issuer during the preceding 12 months. Given the limited use of this exemption in Ontario, we do not expect the order to have a meaningful effect on capital raising in Ontario.

Our Take

We commend the regulators for taking the initiative to introduce these exemptions. We encourage them to continue implementing further changes to modernize Canada's capital markets, increase efficiency, reduce regulatory burden, and harmonize with U.S. public offering rules where appropriate.

Key Contacts: Steven J. Cutler, David Wilson and Olivier Désilets

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