



Private placements

Corporate Update

15 December 2020

By: Christopher Pejovic

One common way in which companies expand and develop is by raising capital through the issuance of equity or debt securities. In Canada, absent an exemption, a distribution of securities cannot be made without preparing and qualifying a prospectus with the relevant securities regulators which describes the company and its business in a fairly significant degree of detail. The distribution of securities on an exempt basis is generally referred to as a private placement. This bulletin discusses some of the key features of private placements and summarizes some of the most commonly used prospectus exemptions.

Benefits of a private placement

The process of distributing securities by way of a private placement tends to be more cost effective and time efficient as compared to conducting a public offering by way of a prospectus filing. More specifically, by issuing securities through a private placement offering, companies are exempt from the extensive disclosure requirements involved in prospectus offerings, which can often include the preparation of audited financial statements. Moreover, in contrast to prospectus offerings, the offering materials in a private placement are not generally reviewed by the provincial securities regulators. These features help to provide companies with more flexibility to conduct their offerings and react to market conditions.

Drawbacks of a private placement

In contrast to a prospectus offering, in which securities can be issued to any person or company once a receipt for the prospectus is obtained, companies conducting private placement offerings will need to ensure that their proposed distribution fits within one of the applicable prospectus exemptions available under securities legislation. As a result, companies are somewhat restricted in terms of the investors from whom capital can be raised.

Moreover, securities distributed by way of private placement are generally subject to a restricted trading period, during which investors are unable to freely transfer or resell such securities to other investors. Put another way, during this restricted period, the securities may only be resold by investors in reliance on prospectus exemptions under securities legislation. The applicable restricted period and the limitations imposed on investors vary somewhat depending on which prospectus exemption is relied upon to distribute the securities.

Prospectus exemptions

In order to offer securities without filing a prospectus, entities must rely on one of the exemptions enumerated in securities legislation. Generally, the availability of particular prospectus exemptions will depend on the nature of the entity, the nature of the investor and the type of securities being distributed. The most commonly utilized prospectus exemptions include the following:

1. Accredited investor exemption

The accredited investor exemption is set out in section 2.3 of National Instrument 45-106 - *Prospectus Exemptions* ("NI 45-106"). This prospectus exemption allows for the distribution by an entity of any type of security to an "accredited investor" who purchases the security as principal.

This exemption does not apply if the person purchasing the securities as principal was created, or is being used, solely to purchase or hold securities in reliance on this exemption. The rationale behind this exemption is to provide entities with the ability to distribute securities to certain types of sophisticated investors that are generally considered to be able to make informed investment decisions without the standard prospectus disclosures.

The most common types of accredited investors, as defined under NI 45-106, include:

- Investment funds, pension funds, financial institutions, and registered securities dealers;
- Individuals who, either alone or with a spouse, beneficially own financial assets having an aggregate realizable value that, before taxes but net of any relatable liabilities, exceeds \$1,000,000;
- Individuals who beneficially own financial assets having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds \$5,000,000;
- Individuals whose net income before taxes exceeded \$200,000 (or with a spouse, exceeded \$300,000) in each of the two most recent calendar years and who, in either case, reasonably expects to exceed that net income level in the current calendar year;
- Individuals who, either alone or with a spouse, have net assets of at least \$5,000,000;
- Persons, other than individuals or investment funds, that have net assets of at least \$5,000,000 as shown on their most recently prepared financial statements; or
- Persons in respect of which all of the owners of interests, direct, indirect or beneficial, except the voting securities required by law to be owned by directors, are persons that are accredited investors.

Entities relying on this exemption are responsible for determining whether an investor meets the definition of accredited investor under securities legislation. In order to do so, certain representations and warranties from the purchaser are typically included in the offering document pursuant to which the securities are offered.

A distribution made pursuant to this exemption requires the filing of a Form 45-106F1 - *Report of Exempt Distribution* ("45-106F1") in the jurisdictions where the distribution took place no later than 10 days after the date upon which the distribution occurred. Further, a risk acknowledgment form ("Form 45-106F9") must be signed by individual accredited investors (unless an individual with financial assets in excess of \$5,000,000) at the same time or prior to signing the agreement to purchase the securities. The entity making the distribution must retain the signed Form 45-106F9 for a period of eight years after the distribution.

2. Private issuer exemption

The private issuer exemption is set out in section 2.4(2) of NI 45-106. This prospectus exemption allows for entities that qualify as private issuers to distribute securities to certain permitted persons which purchase the securities as principal without the need to file a prospectus.

In order to qualify as a private issuer, an entity must: (i) not be a reporting issuer or an investment fund; (ii) have restrictions on the transfer of its securities (other than non-convertible debt securities) which are contained in the entity's constating documents or security holders' agreements; (iii) not have more than 50 beneficial owners of its securities (excluding employees and former employees); and (iv) have only distributed its securities to permitted persons.

The list of permitted persons includes, but its not limited to:

- A director, officer, employee, founder or control person of the entity or its affiliates;
- A spouse, parent, grandparent, brother, sister, child or grandchild of a director, executive officer, founder or control person of the entity;
- A close personal friend or a close business associate of a director, executive officer, founder or control person of the entity;
- An existing security holder of the entity;
- An accredited investor;
- A trust or estate of which all of the beneficiaries or a majority of the trustees or executors are permitted persons; and
- A person of which a majority of the voting securities are beneficially owned by, or a majority of the directors are, permitted persons.

As this prospectus exemption does not require the filing of a 45-106F1, this is a commonly used exemption among small, closely-held entities.

3. Family, friends and business associates exemption

The family, friends and business associates exemption is set out in section 2.5 of NI 45-106. This prospectus exemption allows for the distribution by an entity of a security to certain permitted persons who purchase the security as principal.

The list of permitted persons includes, but is not limited to:

- A director, executive officer or control person of the entity or its affiliates;
- A spouse, parent, grandparent, brother, sister, child or grandchild of a director, executive officer or control person of the entity;
- A close personal friend of a director, executive officer or control person of the entity;
- A close business associate of a director, executive officer or control person of the entity;
- A founder of the entity or a spouse, parent, grandparent, brother, sister, child, grandchild, close personal friend or close business associate of a founder of the entity;
- A parent, grandparent, brother, sister, child or grandchild of a spouse of a founder of the entity;
- A person of which a majority of the voting securities are beneficially owned by, or a majority of the directors are, permitted persons; and
- A trust or estate of which all of the beneficiaries or a majority of the trustees or executors are permitted persons.

Following the distribution of securities pursuant to the family, friends and business associates exemption, the entity will be required to file a Form 45-106F1 no later than 10 days following the date of distribution. If the distribution is made to an investor resident in Saskatchewan in reliance on such investor being a close personal friend or close business associate of a director, executive officer, control person or founder of the entity, a signed risk acknowledgement in the prescribed form must be obtained from the purchaser. If the distribution is made to an investor resident in Ontario, a signed risk acknowledgement in the prescribed form must be obtained from the investor. The risk acknowledgement forms referred to above must be retained by the entity for a period of eight years following the distribution.

4. Minimum amount investment exemption

The minimum amount investment exemption is set out in section 2.10 of NI 45-106. This prospectus exemption allows for the distribution by an entity of a security to a person that is not an individual where the security has an aggregate acquisition cost of a minimum of \$150,000, paid in cash at the time of the distribution.

This exemption does not apply if the investor does not purchase as principal or was created, or is being used, solely to purchase or hold securities in reliance on this exemption.

As in the case of the accredited investor exemption and family, friends and business associates exemption, the entity will be required to file a Form 45-106F1 no later than 10 days following the date of distribution.

Distributions to foreign purchasers

A number of provincial securities regulators have enacted specific regimes for the distribution of securities to purchasers in foreign jurisdictions. For example, in March 2018, the Ontario Securities Commission enacted OSC Rule 72-503 - *Distributions Outside Canada* (the "OSC Rule") which introduced four new prospectus exemptions permitting a distribution of securities outside Canada to occur on a basis that is exempt from the prospectus requirements. The OSC Rule was designed with the goal of facilitating cross-border offerings by doing away with the prospectus requirements where offerings are aimed at investors resident outside of Canada and are made in compliance with the securities law of the foreign jurisdiction. Put another way, so long as the entity has taken reasonable steps to comply with the requirements applicable to the distribution under the securities law of the jurisdiction outside of Canada, the investor is not required to otherwise satisfy the prospectus requirements in Canada.

However, as the rules and guidance surrounding distributions into foreign jurisdictions vary by province, entities intending to distribute securities outside of Canada should pay particular attention to the rules of their jurisdiction of incorporation and organization to ensure that they are in compliance.

Conclusion

Private placements offer entities a cost-efficient and expeditious way of raising capital. The specific exemption relied on and the structure of the private placement will depend on the size of the entity, the type of securities offered, the investors interested in purchasing the securities, along with the time frame required to conduct the offering. Any entity interested in pursuing a private placement offering in Canada should contact the undersigned authors to discuss their intentions and goals in accessing capital markets and to determine how to structure the private placement to suit their capital needs.

This article provides only general information about legal issues and developments, and is not intended to provide specific legal advice. Please see our [disclaimer](#) for more details.

AUTHORS



Christopher Pejovic

Associate

Toronto | T: +1 416 365 3500

christopher.pejovic@dlapiper.com
