

PROSPECTUS  
EXEMPTIONS

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Note: In this brochure, the masculine form may refer to both women and men.

## Autorité des marchés financiers

The *Autorité des marchés financiers* (AMF) is the body mandated by the government of Québec to regulate Québec's financial sector and to offer assistance to consumers of financial products and services.

Its mission is to protect the public by applying the laws and regulations governing the following areas of activity: insurance, securities, deposit institutions (other than banks) and distribution of financial products and services.

## Purpose of the brochure

The purpose of this brochure is to help you become more familiar with securities sold under a prospectus exemption.

This AMF brochure is provided for your information. It does not offer any advice on the purchase or use of specific financial products and services.

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## WHAT IS A PROSPECTUS EXEMPTION?

In Canada, businesses and governments (which we will refer to as issuers in this brochure) may raise capital by selling securities – such as common shares, units or shares of investment funds, or bonds – in one of the following two ways:

- the issuer can prepare a disclosure document, called a prospectus, containing detailed information about the securities offered as well as the issuer's activities, its management and its financial condition. Once the prospectus has been filed with, and approved by, a securities regulatory authority, the issuer can sell its securities to the public (see our brochure entitled *Prospectuses made clear*);
- the issuer may be exempted from the obligation to prepare a prospectus in order to sell securities, but only under certain conditions. We will refer to this as a prospectus exemption.

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## WHY USE AN EXEMPTION?

The prospectus is an important component of the investor protection system in Canada, but the task of preparing and having a prospectus approved by the regulatory bodies involves significant costs and time for issuers in search of capital. Consequently, securities regulations reduce the obligations relating to prospectuses under specific conditions, which we will outline below. The exemptions available to issuers provide either for the preparation of a disclosure document or they require no disclosure document whatsoever.

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## WHO USES THESE EXEMPTIONS?

Several types of issuers use prospectus exemptions. The following are some examples:

- Governments use exemptions to sell savings bonds.
- Private issuers, which we will discuss below, use prospectus exemptions to sell securities to certain persons.
- Issuers listed on a stock exchange use exemptions to raise funds from institutional investors, such as banks, pension funds and mutual funds.

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## HOW DO YOU DETERMINE WHETHER SECURITIES HAVE BEEN ISSUED UNDER AN EXEMPTION?

Consult your brokerage firm's representative, the issuer of the securities or the securities regulator in your province or territory. Every issuer that sells securities must prepare a prospectus or be entitled to use a prospectus exemption.

In addition, you may acquire securities without receiving a disclosure document, even though the issuer is not entitled to use a prospectus exemption. Indeed, securities traded on the secondary market<sup>1</sup> (where securities are traded between one investor and another) do not necessarily include a prospectus. For example, millions of shares are sold on stock exchanges (the secondary market) every day by individuals who have no connection with the issuer, other than as shareholders. These shares are often securities that were previously sold with a prospectus and are now freely traded on the market.

### CONTEXT

**Mary**  
*invests her savings...*

Mary, who was looking for a way to invest her savings, attended a very lively presentation about a limited partnership. In her excitement, she signed forms, a promissory note as well as a cheque for \$5,000. She took home a copy of the forms as well as a 30-page document containing information about the investment. She promised herself to read the document when she had the time. It was already too late.

The limited partnership in question invested in risky projects. In only a few months, several of these projects failed. The income Mary expected to draw from her investment never materialized and she was required to disburse additional sums of money to pay the interest on her loan. She then asked her dealer to sell her investment, but he told her that the securities could not be sold at that time. Her broker explained that even if she could sell them, there was no market for these securities.

Mary finally read the document describing the potential risks inherent in the investment. It explained that the limited partnership was a high-risk investment and that the fact of borrowing to invest increased the risk. Mary discovered the resale restrictions. This investment was not at all suitable for her.

Mary learned the hard way about securities sold under a prospectus exemption and the restrictions attached to such securities. She admits that she should have acquired more information.

1. It differs from the primary market, where securities are issued for the first time by an issuer to investors.

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## WHY SHOULD YOU BE FAMILIAR WITH PROSPECTUS EXEMPTIONS?

Investments made in connection with prospectus exemptions are an important part of the Canadian financial system. Each year, billions of dollars are invested under prospectus exemptions.

Unfortunately, some issuers abuse the system. They sell their securities to investors who, like Mary, are not sufficiently careful and fail to read the disclosure documents or acquire sufficient information before making a decision.

This brochure is intended to help you understand the risks inherent in these securities as well as the restrictions on their resale, and to determine whether this type of investment suits you.

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## DOES IT MATTER IF YOU DON'T RECEIVE A PROSPECTUS?

You will not benefit from information as detailed as that in a prospectus, nor will you enjoy the same rights as those provided under a prospectus. For example, you will not be entitled to cancel your transaction within two days, by contrast with investments made under a prospectus. Moreover, unless an offering memorandum has been prepared, you will not be entitled to launch proceedings under the Québec *Securities Act* based on a misrepresentation.

In certain cases you will not receive a disclosure document from the issuer, unless it has prepared an *offering memorandum*. An offering memorandum contains information on the securities to be issued as well as on the activities of the issuer, its senior executives and its financial condition. The document also sets out the potential risks of making an investment. An offering memorandum must contain a signed certificate stating that the offering memorandum does not contain a misrepresentation.

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## CONDITIONS AN ISSUER MUST FULFILL IN ORDER TO RELY ON A PROSPECTUS EXEMPTION

A prospectus is not required for the distribution of certain securities, including government securities and certificates of deposit guaranteed by deposit insurance.

Securities legislation in the Canadian provinces, including Québec, also grants other prospectus exemptions under certain conditions.<sup>2</sup> The following are examples of cases in which a prospectus exemption may be granted.

### Exemption for distribution to accredited investors

The law enables an issuer to use a prospectus exemption if it issues its securities to *accredited investors*.

To qualify, an investor must clearly have above-average income or substantial assets.<sup>2</sup>

Certain institutions are considered to be accredited investors, including securities dealers and advisers, banks, trust companies, insurance companies and credit unions, among others.

### Exemption for offering memorandum

In most provinces, an issuer can use a prospectus exemption if it delivers an offering memorandum in the prescribed form. In such a case, the investor must sign a *risk acknowledgment* form in which the investor recognizes that he is investing entirely at his own risk and that he is aware that resale restrictions may apply to the securities.

In certain provinces, including Québec, the maximum subscription amount is \$10,000, unless the investor is an *eligible investor*. To be an eligible investor, an individual must satisfy at least one of the prescribed conditions. These conditions include the following:

- alone or with a spouse, own net assets exceeding \$400,000;
- have net income before taxes exceeding \$75,000 during the year and during the two previous years;
- with his spouse, have income exceeding \$125,000 during the year and during the two previous years;
- be advised by a registered dealer or adviser.

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2. For more details, please refer to Regulation 45-106 respecting Prospectus and Registration Exemptions on the AMF website.

#### CONTEXT

**Mary**  
*did not read...*

If Mary had read the offering memorandum given to her before making her investment, she could have been aware of these particular features, such as the resale restrictions.

## Exemption relating to a minimum investment amount

An issuer can obtain an exemption if its securities have an acquisition cost to the investor of not less than \$150,000 paid in cash.

## Exemption for a private issuer

An issuer is referred to as a “private” issuer when it meets the following criteria:

- It is not an issuer subject to continuous disclosure obligations;
- It is not an investment fund;
- It does not have more than 50 investors, excluding employees and former employees of the issuer;
- Most of its securities are subject to resale restrictions. Consequently, you may be unable to sell them for a certain period. Even if you were able to resell your securities, there might be no market for those securities, such that you would not be able to find any purchasers.

In general, it can offer its securities only to the following classes of investors:

- A director, officer, employee, founder or control person of the issuer;
- a spouse or other family member (grandparent, brother, sister or child) of a director, executive officer or control person;
- a close personal friend or close business associate of the persons mentioned in the preceding item;
- an accredited investor;
- a spouse or a family member of the selling shareholder or the selling shareholder’s spouse.

Other prospectus exemptions are available, but they usually apply to specialized business transactions that do not relate to the majority of investors.

**Remember:**

- certain securities exempted from the prospectus requirement can usually only be sold to a limited number of persons.
- the securities could be subject to resale restrictions. Consequently, you could be unable to sell them for a certain period or indefinitely.

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## WHAT QUESTIONS SHOULD YOU ASK BEFORE INVESTING IN PROSPECTUS-EXEMPTED SECURITIES?

The key is to determine whether the investment suits you. The advice of a competent financial adviser may be of great assistance. However, you can start by asking yourself the following basic questions.

### *Do you qualify as an investor?*

If you are not an accredited or eligible investor or you are not a director, officer or employee of the issuer or any of its affiliates, the issuer may not legally be entitled to sell you its securities without a prospectus. Before investing, consult your dealer's representative or the AMF to ensure that the investment is legal.

### *Why is this investment being offered to you?*

Certain issuers offer generous commissions for recruiting investors for prospectus-exempted securities. Ensure that you are not being pressured to purchase and that the investment is in your interest and not solely in the interest of the person selling the securities.

### *What information is available about this investment?*

Depending on the exemption used, the issuer may be required to provide prospective investors with an offering memorandum. If the issuer is not subject to continuous disclosure obligations or if it has not prepared an offering memorandum in order to raise capital, you may not receive any disclosure documents from the issuer.

### *What legal recourses will you have if the information provided is incorrect?*

When you invest under a prospectus exemption, you may not necessarily have access to all the recourses to which you would be entitled for a distribution made with a prospectus. For example, you will not be entitled to launch proceedings for damages against the directors or underwriter of the issuer. You may nevertheless be entitled to sue the issuer or its representatives if you were urged to invest on the basis of misrepresentations. If you are uncertain of your rights, seek the advice of a registered dealer or adviser.

*What about future disclosure?*

Ask the issuer or your financial adviser about the type of information the issuer is legally required to provide you in the future.

*Will there be any resale restrictions?*

Almost all securities issued under a prospectus exemption are subject to resale restrictions. Find out about the hold period (remember that it could be indefinite) and about the other conditions you will have to fulfill before being entitled to sell the securities.

*Is there or will there be a market for the securities?*

There might never be a market for the issuer's securities. Beware of issuers claiming that their securities will soon be listed on a stock exchange. Such statements are illegal and often do not materialize.

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## BE INFORMED BEFORE INVESTING...

It is important to know about the issuer, its activities and its senior executives, as well as about the type of securities you are purchasing and the manner in which they are being offered. Most securities issued without a prospectus are suitable only for certain types of investors. If you are thinking about purchasing securities from an issuer under a prospectus exemption, remember that you will generally receive less information, that your recourses may be more limited and that the investment may be very risky. The possibility of reselling your securities could also be significantly limited.

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## QUESTIONS?

If you want to know more about prospectus exemptions or investments in general, ask your representative.

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You can also visit the website of the *Autorité  
des marchés financiers* at [www.lautorite.qc.ca](http://www.lautorite.qc.ca)

## Brochures to help you with your investments

Update your financial position

Choose the investments  
that suit you

Short investment glossary

Choosing a securities firm  
and representative

Mutual Funds

Watch out for securities fraud

Prospectuses made clear

Prospectus exemptions