Material Change Guidance

On December 31, 2012 the Securities Act, 2012 ("***SA 2012***") came into operation thereby ushering in a new legislative framework governing the Securities Industry. The SA 2012 has widened the Trinidad and Tobago Securities and Exchange Commission's ("the Commission") powers of surveillance and enforcement and has also introduced substantial changes to the statutory obligations of the Commission's registrants and other market actors.

As with any major transformation, there is always a teething period in which all parties adjust to their new responsibilities. The Commission being mindful of the issues that may arise during this time has taken the liberty of issuing advisory circulars highlighting the changes to some of the more complex and contentious issues under the old legislative regime; and, their impact on its relationship with persons under its jurisdiction.

One of the more contentious issues under the Securities Industry Act, 1995 ("1995 Act") concerned reporting issuers' disclosure obligations under Section 66(3) in respect of material changes. The following discourse is therefore geared at illustrating the nature and scope of the changes relating to material change and their impact on the statutory obligations of reporting issuers under the SA 2012.

1) The Definition of Material Change

The concept of materiality is inextricably linked to the necessary disclosure requirements and its significance in securities law. Undeniably, a "*central tenet of securities law is that disclosure obligations are limited to material matters*"[1]. This begs the question as to 'what is material?' A "material change" under the 1995 Act was defined as:-

> *"where used in relation to the affairs of an issuer, means a change in the business operations, assets or ownership of the issuer* ***that would reasonably be expected to have a significant effect on the market price or value of the securities of the issuer*** *and includes a decision to implement such a change made by the directors of the issuer."*

The definition of "material change" was changed by virtue of the SA 2012, most notably deleting the words *"significant effect on the market price or value of the securities"* and thereby altering the definition to:-

> *(a) "when used in relation to an issuer other than a collective investment scheme, a change in the business, operations, assets or ownership of an issuer, the disclosure of which would be considered important to a reasonable investor in making an* ***investment decision*** *and includes a decision to implement such a change made by the directors of the issuer or other persons acting in a similar capacity; or*

[1] *Cornish v. Ontario Securities Commission*, 2013 ONSC 1310.

(b) when used in relation to an issuer that is a collective investment scheme, a change in the business, operations or affairs of the issuer, the disclosure which would be considered important by a reasonable investor in determining whether to purchase, sell or transfer or continue to hold securities of the issuer, and includes a decision to implement such a change made by the directors of the issuer or the directors of the manager of the issuer or other persons acting in a similar capacity."

Thus under the previous legislative regime, material change was defined in broad terms and was applicable to reporting issuers without reference to the nature of the investment scheme. Under the SA 2012, this definition has been modified and a distinction is now made between collective investment schemes and all other schemes not falling within that category. This therefore means that reporting issuers need to note the difference in meaning of the phrase as it is used in relation to the types of schemes that they operate.

Further in the 1995 Act the distinguishing factor of a material change was that it would have a **significant effect on the market price or value of the securities of the issuer**. This concept has been removed and the SA 2012 now employs a reasonable investor standard whereby information is considered material if it would be considered **important to a reasonable investor in making an investment decision**.

The process of gauging materiality for the purposes of disclosure as contemplated by the SA 2012 therefore, is that it must first be determined that there has been a change in the "business, operations assets or ownership of an issuer." Secondly this change must have been material. Indeed, a comprehensive look at the U.S. and Canadian jurisdictions and their respective application of materiality sheds light on our country's recent adoption of the concept into our own securities legislation.

2) Materiality/the material change standard in various jurisdictions

An analysis of the term materiality, in the context of securities law can be found in the United States (U.S.) Supreme Court case, *TSC Industries, Inc. v. Northway, Inc.,*[2] (*'Northway'*). This case establishes that information is material if there is "*a substantial likelihood that a reasonable [investor] would consider it important.*"[3] It provides further that "*it would have been viewed by the reasonable investor as having significantly altered the total mix of information made available*"[4] Furthermore, the Supreme Court in *Basic, Inc. v. Levinson,*[5] and subsequent cases, expressly adopted the "reasonable investor standard" as set out in *Northway*.

Sharbern Holding Inc. v. Vancouver Airport Centre Ltd,[6] is a 2011 Supreme Court of Canada case in which the court assessed the notion of materiality and adequate disclosure to investors, while simultaneously considering the disclosure standard under British Columbia's Real Estate Act. It is noteworthy that in determining materiality, the Supreme Court of Canada, in light of

[2] 426 U.S. 438 (1976).
[3] *Ibid*. at p. 449.
[4] *Ibid*. at p. 449.
[5] 485 U.S. 224 (1988).
[6] 2011 SCC 23.

the now repealed Real Estate Act's failure to define "material", chose to apply the standard of the "reasonable investor" as it pertains to U.S. securities law notwithstanding that the Ontario Securities Act ('OSA') criteria for materiality is that of 'market impact' test.[7] In other words, though the decision does not alter current provincial securities law in Canada it does suggest the Courts' possible movement away from being "*reasonably expected to have a significant effect on the market price or value of any of the securities*" standard as it now stands under the OSA, towards the standard of the 'reasonable investor'.[8]

Further still, as recently as March 2013, the Ontario Superior Court of Justice (Divisional Court) upheld the 2011 decision of the Ontario Securities Commission ('OSC') in *Cornish v. Ontario Securities Commission*.[9] The OSC reveals that there are two materiality standards for disclosure purposes in Canada. The first standard being the "market impact test" and the second being, the "reasonable investor" test. The former is premised on statutory definitions of materiality expected to have a significant effect on the market price or value of a security. The latter, establishes a broader materiality standard based on what a reasonable investor would consider important in making an investment decision and is used for the purpose of regulatory liability. This case therefore confirms that the reasonable investor test was the correct test to be applied and may be applied in Canada's regulatory proceedings.[10]

To this end, the U.S. and Canadian case law reveal that the bounds of materiality are no longer solely confined to financial and quantitative factors. The sole focus on the former bright-line test that was narrowly viewed and premised on the extent to which the price or value a security was affected, is now rejected in favour of looking at the surrounding qualitative factors. This therefore lowers the threshold for materiality which is determined by the size of the effect that an event has on a company.

3) Application of the reasonable investor standard

In determining who a reasonable investor is, the United Kingdom's Financial Conduct Authority ('FCA') provides:-

> "*The investor is specifically a reasonable investor and not just a reasonable person. This simply means that the objective standard to be applied is that of the reasonable investor.*
>
> *In the FCA's view, the characteristics of the reasonable investor include:*
> *(1) sound judgment based on good sense;*
> *(2) some knowledge of, and possibly experience in, the field of investment in property of the same kind as that in which the body corporate is to invest; and*
> *(3) some knowledge of the characteristic features of collective investment.*

[7] Andrew Gray and Gillian B. Dingle, "Supreme Court of Canada clarifies Assessment of Materiality" *Tory's on Corporate and Capital Markets*, 13 May, 2011.
[8] Further buttressing this theory is the application of this U.S. reasonable investor standard by the Ontario Securities Commission in *Re Biovail Corporation* (2010), 33 O,S,C,B 8914.
[9] 2013 ONSC 1310.
[10] Andrew Gray, "Ontario Court Affirms OSC's Disclosure Decision in Convetree" *Corporate and Capital Markets Bulletin*, 3 April, 2013.

Where investment in a particular body corporate is clearly targeted at investors with certain characteristics, the reasonable investor can be assumed to have those characteristics."[11]

As such, the new rules under the SA 2012 are meant to allow for disclosure of the variety of material information that would not necessarily be apparent to, or furthermore kept from, a more sophisticated type of investor. It further takes the determination of what is material outside of the realm of the reporting issuer's discretion, as it was known to be, under the 1995 Act.

4) <u>Material Change Reports and Notices</u>

Section 64 (1) of the SA 2012 introduces a new three part procedure for treating with the disclosure requirements for material changes[12]. This process is subject to a strict timeline which requires reporting issuers to:

a) File a report with the Commission, certified by a senior officer, containing details of the substance of the material change within **three days** of the date of the change.
b) Publish a notice of the material change, authorized by a senior officer, in two daily newspapers of general circulation in this country detailing the nature and substance of the change within **seven days** of the change.
c) File a copy of the published notice with the Commission within **seven days** of the material change.

This represents a marked departure from **section 66 (3) of the 1995 Act** which stipulated a two-step procedure of firstly, publishing a press release and secondly filing a copy of that release with the Commission within seven days of the date of the change. **Reporting issuers are therefore asked to note that not only have the timelines been amended, but also that there is the added requirement to file a report with the Commission in respect of the material change which was not a requirement under the 1995 Act**.

Further, **section 64 (2)(b) of the SA 2012** now allows the issuer to contact the Commission not only where the issuer believes disclosure would be unduly detrimental but also where the issuer is of the opinion that the disclosure is unwarranted. This may occur for example where the issuer is of the opinion that the information is already in the public domain.

It must be noted however, that the timeframe for informing the Commission of the change and the reasons for not wanting to disclose the change or for requesting a delay in publication has been substantially reduced from seven (7) days to three (3) days. Reporting issuers must therefore be mindful of the impact that these stringent timelines may have on their operations and take the necessary precautions to ensure that they comply with all deadlines when fulfilling their statutory obligations under **section 64 of the SA 2012**.

[11] FCA Handbook, Chap. 9 at 9.7.5.
[12] Please transcribe the information into the attached Form 10.

5) Penalty for failure to file/publish

One of the more substantial changes brought about by the SA 2012 treats with the broad expansion of the Commission's enforcement powers. Consequently, a failure to comply with the disclosure obligations in respect of material changes as described above may result in the imposition of hefty administrative fines under **section 156 of the SA 2012.** This section confers upon the Commission the power to issue orders for an administrative fine for breaches of the Act after affording the issuer the opportunity to make oral and/or written submissions. Reporting issuers must therefore note **section 156 (2) of the SA 2012** which states that where a breach of the Act occurs, solely by reason of failure to file or publish a document or instrument required under this Act within the period prescribed, the Commission may impose an administrative fine of **one thousand dollars for each day that the document or instrument remains outstanding**.

Reporting issuers are also asked to note that the nature of the fine makes it imperative to comply with the obligations under **section 64 of the SA 2012** in a timely manner, as prolonged delay could have costly repercussions.

6) Guidance on the interpretation of "Notice"

For the purpose of satisfying a disclosure obligation under **section 64**, the Commission shall consider a "notice" to be any informational material which is published in a daily newspaper and which is ***published at the request of the*** **reporting issuer in the submitted substance and form**. Such a notice shall be authorized by a senior officer of the reporting issuer and shall appear in the exact form as drafted and issued for publication by the reporting issuer.

The publication of the required notice is to be contrasted with the publication of a "media release" and/or "presentation/interview". Where a reporting issuer issues a "media release" or "presentation/interview" to reporters, journalists or other media personnel with respect to a material change which has occurred in its affairs, such advertising, though encouraged in addition to the above-mentioned notice, in and of itself shall not be considered as a sufficient discharge of a reporting issuer's obligation under **section 64 of the SA 2012**.

The rational for the emphasis being placed on a notice (usually paid for) that is published at the request of the reporting issuer in a newspaper is grounded in the fact that the substance and form associated with a "media release" or a "presentation/interview" is invariably subject to the direction and editorial control of the media house and not that of the reporting issuer. In fact the decision as to time and place of publication is that of the media house and not that of the reporting issuer.

To that extent, valuable information required to be provided to the investor may be edited or omitted as an unintended consequence of such editorial control, driven by fiscal restraint. In the interest of affording the investor the full benefit of substantive information related to the material change, reference is drawn to **section 4 of the SA 2012** which defines published in relation to the disclosure of a material change or fact as publication in two daily newspapers of general circulation in Trinidad and Tobago or made available to the public in such matter as approved by the Commission.

7) Findings and Analysis

It follows, that the revision of the materiality benchmark under the SA 2012 evidences a divergence from what has been coined the 'market impact' standard and has instead shown movement towards a standard that is concerned with information that the investor would consider important in making an investment decision as it pertains to a security. This is to be distinguished from information that could affect the market price or value of the security.

The foregoing U.S. and Canadian decisions further reveal that in giving effect to the new threshold as set by the SA 2012, materiality is to be determined objectively, from the perspective of a reasonable investor. Moreover what constitutes materiality hinges on a specific set of facts that is to be assessed in light of all the surrounding circumstances forming the 'total mix of information.' The test is not premised on whether information obtained would have changed the investment decision of a reasonable investor but rather would have assumed actual significance in a reasonable investor's deliberations.[13]

Most importantly it sets a standard that allows for greater disclosure, when compared to the former test applied under the 1995 Act, which, to a great extent left judgment in the hands of the issuer. The new approach is to reject sole reliance on the bright-line test, that is, the estimated financial impact of a change has ceased to be the primary consideration of immateriality, as all information must now be assessed by adopting a holistic approach in view of a company's activity. To be sure, the materiality of a piece of information will vary from one company to the next depending on its distinctive size, structure and business operations, among other factors.

U.S. and Canadian case law support the finding that these jurisdictions have taken a progressive step towards addressing the issues of disclosure through the introduction of the reasonable investor. The benefit of having overseas models is that we are able to learn from the experiences of others since the general principles in this area of law are universal. Decidedly, the objective of the legislative reform is to provide greater protection to investors whilst instilling confidence and trust in our own securities industry. As with most change, it brings with it a myriad of questions and with it a demand for a check-list and strict adherence as to who the reasonable investor is, and in turn the information important to the investment decision making process. As evidenced from the plethora of case law and academic writing, there is no precise formula attached to a finding of materiality. While at first blush the new standard appears all encompassing, what is evident is that the disclosure based regime was redefined with the intent that it strike "*the proper balance between the need to ensure adequate disclosure and the need to avoid the adverse consequences of setting too low a threshold*"[14]

Providing this delicate balance is the Trinidad and Tobago Securities and Exchange Commission. The Commission has full authority of ensuring that the provisions of the SA 2012 are complied with and in doing so has released a non exhaustive list of the types of disclosure requirements that are expected of reporting issuers. This non exhaustive list is mirrored in the Canadian National Policy 51-201 Disclosure Standards. The aim of this guideline is to provide an established framework as to the kind of information that is considered material with the

[13] *Sharbern Holding Inc. V. Vancouver Airport Centre Ltd.,* 2011 SCC 23.
[14] *TSC Industries, Inc, v. Northway, Inc,.* p. 449 at n 10.

caveat that there is no general rule. To stipulate otherwise would be to go against the purview of the SA 2012.

Reporting issuers are furthermore urged to adhere to the requirements of **section 64** and to contact staff of the Commission at materialchanges@ttsec.org.tt for further clarification where there may be doubt in determining the materiality of a change in the operating affairs of a reporting issuer or in circumstances where the reporting issuer believes that **section 64(2) of the SA 2012** applies. Attachment "A" includes examples of what would be considered a material change under the Act, while the Form 10 Material Change Report for disclosure requirements under the SA 2012 can be found on the Commission's website.

“A”

Non-Exhaustive list of Material Information

The Commission considers that the following list contains examples of the types of events or information that are material for the purposes of the Act. This list is non exhaustive and the Commission will keep registrants apprised of additions/deletions to the list.

Changes in Corporate Structure

• changes in share ownership that may affect control of the company

• major reorganizations, amalgamations, or mergers

• take-over bids, issuer bids, or insider bids

Changes in Capital Structure

• planned repurchases or redemptions of securities

• planned splits of common shares or offerings of warrants or rights to buy shares

• any share consolidation or share exchange

• changes in a company's dividend policies

• the possible initiation of a proxy fight

• material modifications to rights of security holders

Changes in Financial Results

• a significant increase or decrease in near-term earnings prospects

• unexpected changes in the financial results for any periods

• substantial changes in the value or composition of the company's assets resulting from major asset write-offs or write-downs

• any material change in the company's accounting policy

Changes in Business and Operations

• a significant development that affects the company's resources, technology, products or markets

• a significant change in capital investment plans or corporate objectives

• major labour disputes or disputes with major contractors or suppliers

• significant new contracts, products, patents, or services or significant losses of contracts or business

• significant discoveries by resource companies

• changes to the board of directors or any other senior officer as defined in Section 4 (1) of the Act

• the commencement of, or developments in, material legal proceedings or regulatory matters

• waivers of corporate ethics and conduct rules for officers, directors, and other key employees

• any notice that reliance on a prior audit is no longer permissible

• de-listing of the company's securities or their movement from one quotation system or exchange to another

Acquisitions and Disposals

• significant acquisitions or disposals of assets, property or joint venture interests

• acquisitions of other companies, including a take-over bid for, or merger with, another company

Changes in Credit Arrangements

• the borrowing or lending of a significant amount of money

• mortgaging or encumbering of the company's assets

• defaults under debt obligations, agreements to restructure debt, or planned enforcement procedures by a bank or any other creditors

• changes in rating agency decisions

• significant new credit arrangements