

# OTCQX Proposed Rule Changes

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by Stephanie Gambino

The OTC Markets Group published this week proposed amendments to the OTCQX Rules for U.S. Companies, U.S. Banks and International Companies. The rules will become effective on December 12, 2019; comments will be accepted until December 11, 2019.

To qualify for the OTCQX, International Companies must, among other qualifications, have a class of securities traded on a Qualified Foreign Exchange (includes the Toronto Stock Exchange, the TSX Venture Exchange and the Canadian Securities Exchange), be an SEC Reporting Company or be a Regulation A Reporting Company. The proposed rules contain several amendments for International Companies, which will be the focus of this update.

First, if an International Company applying to trade on the OTCQX is not listed on a Qualified Foreign Exchange, the applicant must meet the following corporate governance requirements:

1. Have a board of directors that includes at least two independent directors, meeting the qualifications in the OTCQX proposed rules;
2. Have an audit committee, a majority of the members of which are independent directors; and
3. Conduct annual shareholders' meeting and make annual financial reports available to shareholders at least 15 calendar days prior to such meeting.

A company must continue to comply with the corporate governance requirements to maintain its eligibility on the OTCQX. International Companies with securities not listed on a Qualified Foreign Exchange that are traded on the OTCQX when the proposed rules become effective will not need to comply with the corporate governance requirements until January 1, 2021.

Second, applications to the OTCQX will now include Background Check Authorization Forms. This form will authorize the OTC Markets Group to conduct background checks

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during the application process on certain persons associated with the companies applying to be on the OTCQX.

Third, with some limited exceptions, companies applying to be on the OTCQX must have an OTCQX Sponsor that has been approved by the OTC Markets Group to deliver a Letter of Introduction. Dorsey & Whitney LLP is an approved OTCQX Sponsor. Under the proposed rules, a company that trades on a Qualified Foreign Exchange or that has been an SEC Reporting Company and publicly traded for at least one year might be able to rely on a Letter of Introduction from its primary outside securities counsel under certain limited circumstances.

Fourth, Canadian companies that are on the OTCQX must retain a transfer agent that participates in the Transfer Agent Verified Shares Program. This program has been required for U.S. Companies for several months, but the proposed rules extend the requirement to Canadian companies. Many Canadian transfer agents are already part of the program, but it will be important to confirm that the company's current transfer agent has opted into this program.

Finally, the proposed rules modify the initial disclosure obligations. Under the proposed rules, a company will be required to disclose annual reports for the prior three years (or such shorter time as the company has been in existence) and any interim reports released during the prior three years. For Canadian issuers, we would recommend filing annual audited financial statements, the annual MD&A and the Annual Information Form, if applicable, in order to comply with the annual report requirement. Additionally, a company must disclose all other material disclosures made after its last annual report.

In addition to the application changes, the OTC Markets Group made one significant change to the ongoing responsibilities of a company to maintain eligibility on the OTCQX. Companies are now required to notify the OTC Markets Group if a Change of Control occurs. A Change of Control is defined as any event that results in:

(i) Any "person" (as such term is used in Sections 13(d) and 14(d) of the Exchange Act) becoming the "beneficial owner" (as defined in Rule 13d-3 of the Exchange Act), directly or indirectly, of securities of the Company representing fifty percent (50%) or more of the total voting power represented by the Company's then outstanding voting securities;

(ii) The consummation of the sale or disposition by the Company of all or substantially all of the Company's assets;

(iii) A change in the composition of the Company's board of directors occurring within a two (2) year period, as a result of which fewer than a majority of the directors are directors immediately prior to such change; or

(iv) The consummation of a merger or consolidation of the Company with any other corporation, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the

surviving entity or its parent) at least fifty percent (50%) of the total voting power represented by the voting securities of the Company or such surviving entity or its parent outstanding immediately after such merger or consolidation.

If a Change of Control occurs, the Company is required, within 20 calendar days of the change, to notify the OTC Markets Group by submitting a Change of Control Notification as well as a new OTCQX Application and application fee. Failure to notify the OTC Markets Group may result in suspension or removal from the OTCQX. If the proposed rules are adopted, OTCQX companies will need to pay particular attention to calculating whether any change in the composition of the board of directors, combined with other changes over the preceding 24 months, constitutes a Change of Control under part (iii) of the test.