TSXV Security Based Compensation policies: New flexibility and potential M&A risk

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On November 24, 2021, the TSX Venture Exchange (the TSXV or the Exchange) issued a bulletin outlining significant amendments to its policies regarding security based compensation (the Amendments).

What you need to know

- The Amendments expand the Exchange's previous policies, which governed incentive stock options only, to address additional types of security-based compensation, and provide greater flexibility with respect to the categories of plans that may be adopted and how issuers can structure securities based compensation arrangements generally.
- The Exchange has changed the timing for its review of a plan's adjustment provisions.
- The Amendments came into effect on November 24, 2021 through the amendment of TSXV Policy 4.4 – *Incentive Stock Options* (the Former Policy) from May 8, 2013, which has been amended and renamed TSXV Policy 4.4 – *Security Based Compensation* (the New Policy), and will govern the security-based compensation policies of all TSXV-listed issuers as of that date.

Types of Security Based Compensation

Prior to the Amendments coming into effect, the Former Policy specifically only addressed stock options. As a result of the increasing popularity of alternative types of security-based compensation, and ambiguity with respect to how the Former Policy applied to these securities, the New Policy explicitly contemplates the use of other types of security-based compensation in addition to stock options. This includes deferred share units (DSUs), performance share units (PSUs), restricted share units (RSUs), stock appreciation rights (SARs) and any other compensation or incentive mechanism involving the issuance or potential issuance of securities from treasury (collectively, New Compensation Securities).

Previous lack of guidance with respect to New Compensation Securities resulted in various terms being used to describe different types of security based compensation

inconsistently and imprecisely, with no standardized definitions being used by TSXV-listed issuers. This resulted, at times, in confusion with respect to the specific attributes of a compensation security.

The New Policy includes specific definitions for certain types of New Compensation Securities, including, DSUs, PSUs, RSUs and SARs, which must be adhered to for the purposes of the New Policy. Issuers are advised to consider these definitions, and consult with counsel, when implementing or making any changes to their security based compensation plans and policies, and when considering their compensation goals more generally.

New Compensation Securities will largely be subject to and governed by the Exchange rules that previously applied to stock options, with some noteworthy changes. New Compensation Securities cannot vest before a minimum one-year period from the date of grant or issuance. Vesting may be accelerated in limited circumstances: in the case of the death of a participant or if a participant ceases to be eligible under a plan in connection with a change of control, take-over bid, reverse take-over or similar transaction. In addition, New Compensation Securities cannot be granted or issued to persons providing investor relations services. Such persons may only be granted stock options that must vest in stages over a period of not less than 12 months such that:

i. No more than ¼ vest before three months from the grant date;
ii. No more than another ¼ vest before six months from the grant date;
iii. No more than another ¼ vest before nine months from the grant date; and
iv. The remaining ¼ vest no sooner than 12 months after the grant date.

New categories of Security Based Compensation plans

The Former Policy permitted two types of stock option plans:

i. **Rolling Stock Option Plans:** Rolling stock option plans reserve for issuance pursuant to the exercise of stock options a number of shares up to a maximum of 10 per cent of the issued shares of an issuer at the time of grant; and
ii. **Fixed Stock Option Plans:** Fixed stock option plans reserve for issuance pursuant to the exercise of stock options a specified number of shares up to a maximum of 20 per cent of the issued shares of an issuer at the date of implementation of the plan.

The New Policy allows for four categories of security based compensation plans (Plans) (from which an issuer must choose one), as follows:

i. **Rolling up to 10 per cent:** Plan(s) under which the number of shares that are issuable pursuant to all such Plan(s) in the aggregate is equal to a maximum of 10 per cent of the issued shares of an issuer as at the date of grant or issuance of any security-based compensation under any of such Plan(s);
ii. **Fixed up to 20 per cent:** Plan(s) under which the number of shares that are issuable pursuant to all such Plan(s) in the aggregate is a fixed specified number of shares up to a maximum of 20 per cent of the issued shares of an issuer as at the date of implementation of the most recent of such Plan(s);

iii. **Hybrid (Rolling up to 10 per cent and fixed up to 10 per cent):** A hybrid category comprised of: (a) a rolling stock option plan (Stock Option Plan) under which the number of shares that are issuable pursuant to the exercise of stock options is equal to up to a maximum of 10 per cent of the issued shares of an issuer as at the date of any stock option grant, and (b) fixed Plan(s) (other than Stock Option Plans) under which the number of shares that are issuable pursuant to all such Plan(s) in the aggregate is a fixed specified number of shares up to a maximum of 10 per cent of the shares of the issuer as at the date of implementation of the most recent of such Plan(s) (other than Stock Option Plans); or

iv. **Fixed Stock Option Plan up to 10 per cent:** A fixed Stock Option Plan under which the number of shares that are issuable pursuant to the exercise of stock options is a fixed specified number up to a maximum of 10 per cent of the shares of the issuer as at the date of implementation of the Stock Option Plan.

Categories (i) and (ii) reflect the two previously existing types of Plans, but have been expanded to permit the granting or issuance of New Compensation Securities in addition to stock options. Category (iii) is a new hybrid category, designed to provide additional flexibility to issuers in meeting their compensation needs. Category (iv) is effectively a subset of category (ii) in that it permits a fixed number up to 10 per cent only, and is further limited to stock options only.

Shareholder approvals

Subject to limited exceptions, issuers must annually obtain shareholder approval of any rolling Plan, and must obtain shareholder approval of any fixed Plan at the time it is implemented and when the number of shares issuable under the Plan is amended (including any time issuers intend to increase the fixed limit). Category (iv) above is the only category of Plan that issuers may implement without shareholder approval, subject to certain restrictions, including that such Plans cannot have a net exercise provision (as discussed below) and the number of shares issuable under the Plan cannot be increased more than once in a 24 month period. Any shareholder approval required in connection with the implementation or amendment of a Plan must be at a meeting of shareholders, and not by written consent.

In response to the Exchange's observation that many issuers fail to obtain required annual shareholder approval for rolling Plans, the New Policy no longer allows issuers to grant any security-based compensation under a Plan that has not received the required annual approval.

Cashless exercise or net exercise

Under the Former Policy, the exercise price of stock options was required to be paid in cash. The New Policy permits stock options to be exercised using "cashless exercise" or "net exercise", which were previously only available to TSX-listed issuers and not permitted to be included in TSXV-listed issuers' Stock Option Plans. Where possible, the Exchange has used terminology in the New Policy that aligns with TSX policies to align the TSXV's security based compensation policies with those of the TSX, which is designed to facilitate TSXV-listed issuers' graduation to the TSX.

Cashless exercise often involves an arrangement with a brokerage firm pursuant to which the brokerage firm will lend an optionee money to purchase the shares underlying the stock options. The brokerage firm then sells a sufficient number of shares at the prevailing market price to cover the exercise price of the stock options in order to repay the loan made to the optionee. From there, the optionee either receives the balance of shares after such sale or cash proceeds from the balance of the shares.

Under ***a net exercise***, an optionee exercises their options without making any cash payment to the issuer. Instead, optionees receive the number of underlying shares equal to the quotient obtained by dividing:

a. The product of the number of stock options being exercised multiplied by the difference between the volume weighted trading price of the shares and the exercise price of the stock options by; or
b. The volume weighted trading price of the underlying shares.

The availability of a net exercise option will facilitate the exercise of “in the money” options by participants without having to put in place any arrangements for financing the exercise of such options, and will result in less dilution to issuers. Of note, if any stock options are exercised using a net exercise, the number of stock options available to an issuer under a particular Plan will decrease by the number of options exercised, not the number of shares issued. Although net exercise will result in less dilution, issuers should consider their balance sheet requirements and compensation policies when deciding whether to include cashless exercise or net exercise provisions.

Disclosure requirements

The Exchange has clarified the disclosure requirements for security based compensation, so that it is easier for issuers to determine when a news release is required to announce the implementation or amendment of a Plan, or the granting or issuance of security based compensation.

Every (i) Plan that is adopted, (ii) agreement to grant or issue security based compensation to a director, officer or investor relations service provider, and (iii) amendment to either (i) or (ii) must be disclosed to the public by way of a news release on the day the Plan is implemented or amended, or the security based compensation is granted, issued or amended, as applicable. Guidance on what news releases should include is provided in the New Policy. Issuers may wish to consider timing of multiple grants in order to aggregate and streamline the requisite news release disclosure. When security based compensation is granted outside of a Plan, there are additional disclosure requirements.

Security Based Compensation outside of a Plan

Generally, all security based compensation should be granted or issued under a Plan. The New Policy provides that issuers may issue security based compensation outside of a Plan in the following limited circumstances:

i. **Securities for Services Requirements**: The New Policy permits securities to be issued for services subject to satisfying certain requirements set out in the New

Policy and TSXV Policy 4.3 – *Shares for Debt* (**Policy 4.3**), and in each case subject to the prior approval of the TSXV. The New Policy requires that such issuances be comprised solely of listed shares if the recipient is a non-arm's length party, the securities are not issued until after the services have been provided, the deemed value of the securities is determined after the date the services are provided and is not less than the discounted market price at such time, and such securities are not issued for services for investor relations activities, promotional or market making activities.

ii. **Compensation Owed to Non-Arm's Length Parties**: Under Policy 4.3, an agreement by an issuer to settle outstanding debt for securities is subject to a number of requirements imposed by the Exchange. The Exchange may deny acceptance of any shares for debt transaction if the debt relates to management fees of more than $2,500 per month. Under the New Policy, the limit has been increased to $5,000 per month per person and $10,000 per month in aggregate per issuer and requires such issuances be comprised solely of listed shares.

iii. **One Time Payments as Inducement or Severance**: Subject to prior approval of the Exchange, the New Policy enables issuers to issue listed shares as an inducement or as severance without shareholder approval provided the maximum number of shares is limited to:
    a. 1 per cent of the issued shares for any particular issuance;
    b. 1 per cent of the issued shares to any one person in any 12-month period; and
    c. 2 per cent of the issued shares to all persons in aggregate in any 12-month period.

iv. **Loans:** Where an issuer wishes to lend funds to a person for the purpose of acquiring securities of the issuer, such loan must be specifically approved by the disinterested shareholders before being advanced. In addition, certain documentation, including the documentation evidencing the loan, the news release disclosing the loan and a draft information circular for the shareholder meeting at which the loan is to be approved or form of written consent, must be filed with the Exchange.

The TSXV will consider an application from an issuer to grant or issue security based compensation outside of a Plan in other situations provided that the issuer obtains disinterested shareholder approval at a shareholder meeting or by written consent.

Review of adjustment provisions

As a general rule, issuers must receive Exchange acceptance of all Plans at the time of implementation and, in the case of a rolling Plan, yearly thereafter. To obtain Exchange acceptance of a Plan, issuers must file the Plan with the Exchange for the Exchange's review and comment, among other things. An important new caveat to the Exchange's review of any Plan so submitted is that the Exchange will no longer review adjustment provisions of Plans (other than those relating to normal course security consolidations or splits) at the time Plans are adopted. Instead, the Exchange will only review such provisions at the time an adjustment is triggered (for example, in the case of a change of control). As a result, any adjustment to security based compensation granted or issued under a Plan will be subject to the prior acceptance of the Exchange, including adjustments related to an amalgamation, merger, arrangement, reorganization, spin-off, dividend or recapitalization.

Where a merger, acquisition or other change of control transaction triggers a review of a Plan by the Exchange, the transaction timeline should build in time for Exchange review and approval. Whether this introduces new risk that should be addressed in definitive agreements should also be considered.

Form 4G

The former Form 4G has been expanded to address New Compensation Securities and to include “snapshot” summaries of outstanding Plans and outstanding security based compensation. The new Form 4G is a simplified reporting form and will no longer be used by issuers to apply to the Exchange for its acceptance of a proposed amendment to security based compensation. Instead, a letter application will be required for such acceptance of a proposed amendment.

The new Form 4G now also includes the former Form 4F as its Schedule "A". The Form 4F certification and undertaking required from an issuer granting an incentive stock option has been repealed, as the new Form 4G incorporates the substantive contents of Form 4F.

Transitional provisions

The New Policy permits Plans filed with the Exchange prior to November 24, 2021 (a Legacy Security Based Compensation Plan) to remain in force in accordance with their existing terms. However, any outstanding Plan that does not comply with the New Policy will need to be amended to comply with the New Policy the next time it is placed before shareholders for approval. Furthermore, any security-based compensation granted, issued or amended after November 23, 2021, other than Legacy Security Based Compensation must comply with the New Policy.

Conclusion

In light of the Amendments, TSXV-listed issuers should review their existing Plans and security based compensation policies to consider what amendments may be required to their Plans going forward and in connection with the upcoming proxy season. In addition, issuers will need to be alert to Exchange approval requirements, with respect to relevant adjustment provisions, in the event of a merger, acquisition or change of control transaction. The Amendments provide issuers with the opportunity to review their current security based compensation policies and consider available alternatives that will enable them to incentivize directors, management, employees and external consultants while preserving cash.

If you have any questions regarding the Amendments or require assistance updating your Plan, members of BLG’s Capital Markets Group would be pleased to assist you. Please reach out to any of the authors or key contacts below.

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