

London Calling?: The Experience of the Alternative Investment Market and the Competitiveness of Canadian Stock Exchanges

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Stock exchanges are an important determinant of the competitiveness of Canadian capital markets. Regulators have recognized this fact when they have approved the consolidation of Canadian stock exchanges in 1999. The specialization of stock exchanges purported to enable them to cater more effectively to issuers and investors, and thereby to face the competition from foreign-based exchanges. Indeed, the competition has increased as foreign stock exchanges increasingly seek to attract listing from Canadian firms. In this respect, Canadian issuers' interest in listing on the Alternative Investment Market (AIM) of the London Stock Exchange (LSE) is a testament of this growing competition. Created in 1995 to allow companies to access public capital with a reduced regulatory burden, AIM has been extremely successful in attracting investors and issuers, including more recently a number of Canadian public companies.

The attractiveness of AIM is intriguing for policymakers interested in the competitiveness of Canadian securities markets. Despite the interest generated by AIM, few studies have been devoted to this specialized stock exchange, either from an economic or regulatory perspective. And none of the existing studies has sought to analyze the relevance of the AIM model for Canadian stock exchanges, and, more broadly, the competitiveness of Canadian capital markets. From this perspective, the following analysis seeks to fill this research gap by providing a better understanding of AIM.

Specifically, the objectives of this article are two-fold. First, this article examines the extent to which AIM has been successful with Canadian issuers. Second, it discusses whether the AIM model is informative for the regulatory approach followed by Canadian stock exchanges.

Les bourses de valeurs exercent une forte influence sur la compétitivité des marchés des

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capitaux canadiens. Les régulateurs ont reconnu cette réalité en 1999 lorsqu'ils ont autorisé la restructuration des places boursières canadiennes. La spécialisation des bourses visaient à leur permettre de mieux servir les émetteurs et les investisseurs afin de faire face à la concurrence des marchés étrangers. De fait, la concurrence s'est accrue alors que des bourses étrangères cherchent à attirer à leurs cotes des émetteurs canadiens. À cet égard, l'intérêt des émetteurs canadiens envers le Alternative Investment Market (AIM) atteste de cette concurrence croissante. Créée en 1995 afin de faciliter l'accès aux marchés publics pour les sociétés en réduisant le fardeau réglementaire, AIM a connu beaucoup de succès, attirant des émetteurs et des investisseurs, dont un nombre significatif d'émetteurs canadiens récemment.

L'attrance des émetteurs canadiens envers AIM est intrigante pour les responsables des politiques publiques préoccupés par la compétitivité des marchés des valeurs mobilières canadiens. Malgré l'engouement pour AIM, peu d'études en économie ou en droit ont été consacrées à cette bourse spécialisée. En outre, aucune étude n'a examiné l'intérêt du modèle de AIM pour les bourses de valeurs canadiennes et plus généralement la compétitivité des marchés canadiens. Dans cette perspective, la présente étude vise à combler cette lacune dans la littérature en améliorant les connaissances relatives à AIM.

Plus particulièrement, l'étude comporte deux objectifs. Premièrement, elle examine l'étendue du succès de AIM auprès des émetteurs canadiens. Deuxièmement, elle analyse la pertinence du modèle de AIM pour la réglementation des marchés boursiers canadiens.

INTRODUCTION

Stock exchanges are key market infrastructure entities.¹ Thus, the existence of well-functioning stock exchanges is an important determinant of the competitiveness of Canadian capital markets. Canadian regulators recognized this fact when they approved the consolidation of stock exchanges in 1999. The specialization of stock exchanges purported to enable them to cater more effectively to issuers and investors, and thereby face competition from foreign-based exchanges. Indeed, during the same period, the competition increased as foreign stock exchanges increasingly sought to attract listing from Canadian firms.

In this respect, Canadian issuers' interest in listing on the Alternative Investment Market (AIM) of the London Stock Exchange (LSE)

¹ International Organization of Securities Commissions, *Regulatory Issues Arising from Exchange Evolution*, Consultation Report of the Technical Committee (2006), online: <<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD225.pdf>>; A.M. Fleckner, "Stock Exchanges at the Crossroads" (2006) 74 *Fordham L. Rev.* 2541; J. Macey & H. Kanda, "The Stock Exchange as a Firm: The Emergence of Close Substitutes for the New York and Tokyo Stock Exchanges" (1990) 75 *Cornell L. Rev.* 1007; and J.R. Macey & M. O'Hara, "The Economics of Stock Exchange Listing Fees and Listing Requirements" (2002) 11 *J. Fin. Intermediation* 297.

is a testament of this growing competition.² AIM was created in 1995 to allow companies to access public capital with a reduced regulatory burden in comparison to, for example, the LSE Main Market.³ It appears that AIM has been extremely successful in attracting investors and issuers, including more recently a number of Canadian public companies.

The attractiveness of AIM is intriguing for policymakers interested in the competitiveness of Canadian securities markets. Theoretically, managers should list their firms' securities on the exchange that maximizes firm value.⁴ Differently stated, they should select the stock exchange that keeps the firm's cost of capital at its lowest level. Thus, the recent trend and relative success of AIM raises the issue as to whether AIM is doing something "right," and whether Canadian exchanges should be looking to AIM in order to remain competitive. If they are unable to discharge their core functions effectively, Canadian exchanges risk losing market share as they will be less attractive to companies. Companies will seek listing on more effective exchanges that will enable them to reduce their cost of capital. The departure of a significant number of companies could have some adverse impact for the reputation, operations, and, ultimately, the viability of Canadian exchanges.

Despite the interest generated by AIM, few studies have been devoted to this specialized stock exchange, either from an economic or regulatory perspective. None of the existing studies has sought to analyze the relevance of the AIM model for Canadian stock exchanges, and, more broadly, the competitiveness of Canadian capital markets. From this perspective, the following analysis seeks to fill this research gap by providing a better understanding of AIM.

Specifically, the objectives of this article are twofold. First, this article examines the extent to which AIM has been successful with Canadian issuers. Second, it discusses whether the AIM model is informative for the regulatory approach followed by Canadian stock ex-

² See, e.g., S. Avrey, "Canadian tech firm goes public - in U.K." *The Globe and Mail* (7 March 2007) B4; S. Stewart, "Towering London" *The Globe and Mail* (7 April 2006) B1.

³ London Stock Exchange, "AIM: the most successful growth market in the world," in London Stock Exchange, *Joining AIM: A Professional Handbook*, (London: White Page Ltd., 2005) 4.

⁴ J.C. Coffee, "Racing Towards the Top?: The Impact of Cross-Listing and Stock Market Competition on International Corporate Governance" (2002) 102 Colum. L. Rev. 1757; E. Chouinard & C. D'Souza, "The Rationale for Cross-Border Listings" (2003-2004) *Bank Can. Rev.* 23.

changes. The article is divided into three parts. Part 1 presents empirical evidence on AIM, concentrating on Canadian companies getting listed on this exchange. Part 2 highlights the different regulatory approaches of AIM and Canadian exchanges through a comparison of listing and ongoing requirements. Part 3 assesses the extent to which the AIM model is informative for Canadian stock exchanges. This article concludes by discussing whether policymakers should import the AIM model in Canada.

1. LISTING BY CANADIAN COMPANIES ON THE ALTERNATIVE INVESTMENT MARKET: A LOOK AT THE EVIDENCE

(a) Overview of the Alternative Investment Market

Since its creation in 1995, AIM has attracted an increasing number of companies and has thus experienced spectacular listing growth. Over the last ten years, the number of companies listed on AIM went from 10 in 1995 to 1240 in June 2005.⁵ AIM succeeded to the Unlisted Securities Market and was meant to cater to smaller and fast growing companies. A look at the issuer base of AIM indicates that AIM nonetheless attracts a wide variety of companies that have a broad range of market capitalization. In fact, about half of the listing on AIM is in the market capitalization range of \$25 million to \$250 million, which makes it more directly competitive with the Toronto Stock Exchange ("TSX"), than with the TSX Venture Exchange ("TSXV").⁶

Although AIM caters mostly to U.K.-based companies, it has attracted an increasing number of foreign-based companies during the same period, from 3 in 1995 to 157 in June 2005. Most notably, AIM has witnessed a spectacular growth in its international listings over an eighteen month period that extended from January 2004 to June 2005. Two-thirds of AIM foreign-based companies (or 104 companies) listed during that period.

In terms of industries, foreign-based companies listed on AIM come predominantly from the natural resources sector, with close to 50 per

⁵ This section of the article relies on data marshalled by the TSX Group as of June 2005. See TSX Group, *A Look at London's Alternative Investment Market (AIM)* (2005) (on file with the author).

⁶ See also Osborne Clark, *Is AIM the New NASDAQ?* (2006) at 5.

cent being in the oil and gas or mining industries. The importance of this sector is also evidence by the fact that resource companies accounted for about 65 per cent of the market capitalization of AIM foreign-based companies in June 2005. The data also indicate that the recent surge in international listings growth has been mainly fuelled by mining and oil and gas companies. These companies accounted for 43 per cent of the 104 foreign-based companies listed during the eighteen month period extending from January 2004 to June 2005.⁷ More precisely, it is worth emphasizing the importance of gold companies among resource companies, which accounted for about half of the resource companies that listed during that period.

Interestingly, the TSX and TSXV issuer base is quite similar to that of AIM from an absolute perspective. In June 2005, a total of 153 foreign-based issuers were listed on the two Canadian exchanges. During the period ranging from January 2004 to June 2005, the number of international listing on the two exchanges has grown 32 per cent, with the addition of thirty-seven new foreign-based companies. Natural resources companies are also prevalent among international companies listed on the TSX and TSXV. They account for close to 60 per cent of the number of foreign-based companies and 67 per cent of their total market capitalization. Likewise, between January 2004 and June 2005, 30 of the 37 new international listings came from natural resources companies. These companies were, however, mostly small-cap issuers as they represented only 29 per cent of the market capitalization of the new international listings during that period.

(b) Some Statistics on Canadian Issuers Listing on the Alternative Investment Market

(i) The Profile of Canadian Issuers Getting Listed on AIM

As of 30 June 2005, Canadian companies accounted for about 20 per cent of the foreign-based companies listed on AIM. Of the 31 Canadian companies listed on AIM, 23 were interlisted with the TSX and 5 with the TSXV. There were 3 Canadian companies solely listed on

⁷ The market capitalization of those new international companies from the natural resources sector was also significant, amounting for 48 per cent of the total market capitalization of new international listings during that period.

AIM.⁸ It is interesting to note that the majority of Canadian companies seeking listing on AIM have done so following January 2004. Prior to that date, there were only 9 Canadian companies listed on AIM. This observation is in line with the evidence presented above that indicates that listing by foreign-based issuers has surged since January 2004. Note that this fast pace seems to have somewhat declined. Six Canadian companies have listed on AIM during the period of 1 July 2005 to 28 February 2006, with the bulk of the new listings concentrated in the summer of 2005.

The majority of interlisted companies come from the natural resources sector, with 22 out of 28 companies in the mining or oil and gas sectors as of June 2005. Natural resources companies also account for an impressive 89 per cent of the total market capitalization of interlisted companies. Still, it is worth emphasizing that both in terms of the number of interlisted companies and market capitalization, companies in the mining sector are ultimately those that dominate. Further, companies involved in gold production or development accounted for about 22 per cent of the resources companies, and about the same proportion of the total market capitalization.

(ii) *Why do Canadian Issuers List on AIM?: The Perspective of Market Participants*

Since January 2004, there have been a significant number of Canadian companies seeking listing on AIM. To gain a better understanding of the reasons for this sudden surge of Canadian listings on AIM, we have sought to gather empirical evidence through discussions with "market participants"⁹ in Canada and in the U.K., analysis of the data on listed companies, and consultation of press releases issued by Canadian companies. What emerges from the research is a complex picture where different factors play out to explain the attractiveness of AIM for Canadian companies.

At a general level, Canadian companies get listed on AIM to raise financing and expand their shareholder base. By getting admitted on AIM, Canadian companies have access to the London market which

⁸ There were three U.K. companies that were interlisted on the TSX.

⁹ Market participants refer to companies, investment banks, and corporate lawyers in Canada and the U.K.

provides them with the opportunity to gain exposure to a vast pool of investors. London is the largest centre in the world for the trading of international securities and this position clearly makes it attractive for overseas companies that wish to extend their shareholder base. Further, when they list on AIM, Canadian companies have access to a market increasingly populated by sophisticated investors, as institutional investors now control over 40 per cent of the AIM market.¹⁰ Following their admission on AIM, Canadian companies are likely to become known by a greater number of sophisticated investors and analysts. Most importantly, market participants have pointed out that sophisticated investors in the U.K. are inclined to invest in small- and medium-sized companies, even though they are overseas companies. Thus, AIM is an interesting platform which allows companies to make offerings to raise amounts of £10 million to £15 million (CND\$20 million to CND\$30 million), especially since the offerings can be conducted more easily through private placements with institutional investors. This renders the market more receptive to Canadian companies and facilitates the extension of their investor base.

More specifically, if AIM is attractive for Canadian companies of the resources sector, it is partly due to London's reputation as one of the primary mining financial centres of the world. Based in London, AIM enables resource companies to enter a sophisticated market that provides both a source of capital and a community of knowledgeable professionals. Some have nonetheless emphasized that the London market is not as sophisticated as the Toronto market in this sector. At any rate, it is interesting to note that the value of institutional investor holdings in the resources sector accounted for close to 40 per cent of total institutional investments on AIM in 2005.¹¹ A related feature of AIM is its perceived expertise or experience in trading securities from companies operating in the natural resources sector. This perception may generate a clustering effect as companies in those sectors choose to list on AIM to benefit from its expertise and experience. In turn, clustering may lead companies to list on AIM to join their peers and thereby signal their quality. To summarize, Canadian companies may therefore list to join a cluster on

¹⁰ See Growth Company, *Institutional Investors in AIM 2005*; Clark, *supra*, n. 6 at 4, 7.

¹¹ Growth Company, *ibid.*

AIM as it is seen as being dominant and enjoying a following of significant sophisticated investors and analysts.

When seeking to understand the recent increase in the number of Canadian resource companies listing on AIM, it is however important to have in mind an important conjectural factor – the growth in commodity prices. On the demand side, this growth has fuelled the need of financing by resource companies pursuing their development and expansion. On the supply side, it has increased the interest of U.K. institutional investors in resource companies. The influence of this factor should not be understated as it may have accelerated the decision of Canadian companies to list on AIM to benefit from its advantages over the recent months. This raises the question as to what would happen in a downturn. The experience of European junior stock exchanges in the 1980s and 1990s serves as a cautionary note. For instance, after having benefited from positive economic conditions, the U.K. Unlisted Securities Market (“USM”), AIM’s predecessor, was hit by rising interest rates and the recession of the early 1990s. The failure and bankruptcies of listed corporations that ensued stripped the USM of its former identity as an exiting market, rendering it an inferior segment of the market.¹² Hence, the ability of AIM to sustain a downturn resides in there being solid companies in sufficient numbers to preserve its reputation. Otherwise, there is a risk that investors – especially institutional investors – flee the market, creating thereby a vicious illiquidity circle that will harm the market.

For companies involved in research and development, market participants have suggested that AIM is interesting in that it provides an alternative to another round of financing with venture capital firms. As seen below, AIM’s listing requirements are flexible and this facilitates entry by smaller companies. Moreover, some have mentioned that the London market is more receptive than Canadian markets to offerings from companies in the technology sector. They submit that AIM thus offers valuations that are as attractive as those of NASDAQ without the regulatory burden of being listed in the U.S. Without dismissing this possibility, we must underline that the Canadian companies from those

¹² S. Rasch, *Special Stock Market Segments for Small Company Shares in Europe – What Went Wrong?*, ZEW Discussion Paper No. 94-13 (Mannheim, 1994).

sectors remain marginal on AIM, so the advantages of AIM in this respect has not so far materialized in listings.

To explain the attractiveness of AIM for Canadian companies, it is tempting to refer to the possibility to use the "fast-track route" to get admitted. As discussed further below, the fast-track route enables companies listed on recognized foreign stock-exchanges to join AIM using a streamlined admission process. The evidence indicates, however, that the fast-track route is not that popular. Over the period of January 2004 to June 2005, there were 104 new international listings on AIM. Only 23 of the foreign companies used the fast-track route. Likewise, of the 16 Canadian companies that interlisted on AIM during that period, only 7 used this possibility. Discussion with market participants sheds light on these results. It appears that the fast-track route is not a viable option when companies seek financing as the level of disclosure under that procedure is considered to be insufficient by investors. This observation is substantiated by the experience of Canadian companies. All of the companies that interlisted without using the fast-track route were raising financing concurrently with their admission on AIM.

Finally, some market participants have pointed out that AIM is not a very liquid market. However, indepth research conducted by Board *et al.* shows however that Canadian securities interlisted on AIM have overall seen substantial turnover in London.¹³ In fact, in 2005, "AIM turnover in TSX listed stocks represented 29% of the total (TSX + AIM) trading in those stocks."¹⁴

2. THE LISTING REQUIREMENTS OF THE ALTERNATIVE INVESTMENT MARKET

(a) General Admission Criteria

(i) *Two Different Regulatory Approaches: Principles-based versus Rules-based*

AIM and the TSX and TSXV use two different approaches to regulate admission. AIM relies on a principles-based approach. Pursuant

¹³ John Board *et al.*, "The LSE's AIM Market: Effect on Returns and Trading of Canadian Stocks" in Task Force to Modernize Securities Legislation in Canada, *Canada Steps Up*, vol. 5 (Toronto, 2006).

¹⁴ Board *et al.*, *ibid.*

to this approach, AIM rules do not establish specific requirements to be met by companies seeking admission. Rather they require that every company seeking admission appoint a nominated advisor (“nomad”) and a broker.¹⁵ As seen below, the role of the nomad is to assess whether the company is suitable for the market. When making this suitability assessment, the nomad has considerable discretion since the concept of suitability is defined generally by AIM rules. Thus, admission on AIM rests ultimately on the analysis made by the nomad.¹⁶ Canadian stock exchanges follow a rules-based approach to regulate admission and provide detailed requirements that must be met by companies seeking listing.¹⁷ While they do contain some qualitative criteria, the specific listing requirements of Canadian exchanges tend to be very objective and leave less room for discretion.

(ii) *The Assessment of the Suitability of the Company Seeking Admission on AIM*

The AIM rules do not provide for detailed prescriptive entry criteria. The task of assessing the suitability of a company for admission to AIM rests with the nomad. Following the rules, the nomad has the responsibility of confirming in writing to the exchange that the applicant and the securities that are subject of the listing application are appropriate to be admitted to AIM.¹⁸ This requires that the nomad ensures that “the admission and conduct of a company do not impact adversely on the reputation and integrity of the Exchange.”¹⁹ In other words, the nomad acts as a gatekeeper for listing on AIM.²⁰ More precisely, its role can be labelled as that of a “bouncer”.²¹

¹⁵ London Stock Exchange, *AIM Rules for Companies*, Rule 1 [Aim Rules].

¹⁶ More technically, the issuer must have no restrictions on the free transferability of its shares. It must also be registered as a public limited company or the equivalent. Finally, it must also abide to the AIM rules which set out disclosure obligations to gain admission, as well as ongoing obligations for listed issuers.

¹⁷ See G.R.D. Goulet, *Public Share Offerings and Stock Exchange Listings in Canada*, (North York: CCH Canadian Ltd., 1994).

¹⁸ *AIM Rules*, *supra*, n. 15, Rule 39, Schedules 6 and 7.

¹⁹ C. Aaronson, “The Role of the Nominated Advisor in an AIM Flotation” in *Joining AIM*, *supra*, n. 3 at 20-21.

²⁰ On gatekeepers, see J.C. Coffee, *Gatekeepers: The Role of the Professions in Corporate Governance* (Oxford: Oxford University Press, 2006).

²¹ R.H. Kraakman, “Gatekeepers: The Anatomy of Third-Party Enforcement Strategy” (1986) 2 J. L. Econ. & Org. 53.

To assess whether an issuer is appropriate for admission on AIM, the nomad conducts a detailed review of the salient dimensions of the company's activities and organization. More specifically, the nomad reviews the following elements: management, corporate governance, business viability, market potential, and working capital. In light of this analysis, the nomad evaluates whether the company "will enhance the market's reputation and has a realistic chance of delivering real value to shareholders."²² This assessment ultimately seeks the same goal as the traditional listing requirements that purport to ensure the efficiency, fairness, and liquidity of the stock exchange. However since there are no fixed criteria, the nomad has more flexibility in making the suitability analysis.

Exceptionally, the AIM rules impose an escrow requirement that nomads must oversee. Where a company has a track record of less than two years it must ensure that all related parties and applicable employees have their securities locked-in for one year following admission. Related parties include directors, shareholders with more than 10 per cent of the share capital, and their respective families. Applicable employees are those that own more than 0.5 per cent of the share capital, or possess price sensitive information. In theory, where a company has been independent and earned revenue for the previous two years, no escrow requirements apply, and this allows owners to substantially reduce their ownership in the company. In practice, nomads typically impose escrow requirements even where the company would be exempted under AIM rules.²³ They require such arrangements to foster investor confidence and ensure that the market will be orderly in the first few days following admission.

The suitability analysis done by the nomad on AIM touches on similar issues as those dealt with by the specific listing requirements of Canadian exchanges. Since AIM rules provide no indication as to the suitable public distribution, net tangible assets, earnings, and working capital, the nomad will make its own appreciation to state on suitability. Although it is tempting to argue that AIM has a clear-cut advantage over Canadian exchanges in this respect, caution is warranted.²⁴ Even though

²² AAronson, *supra*, n. 19 at 22.

²³ See, e.g., Clark, *supra*, n. 6 at 7.

²⁴ M.J. Robinson, "Raising Equity for Small and Medium-sized Enterprises Using Canada's

they are more precise, the listing requirements of Canadian exchanges offer some flexibility that enable them to respond to the needs of smaller companies. It is doubtful that the financial and asset requirements preclude small companies with a history of earnings from listing. Likewise, although smaller companies tend not to have significant working capital, the working capital requirement may not weigh too heavily on them since they can meet the requirements in several ways. The public distribution requirements allow smaller companies to raise financing through relatively small offerings. Finally, the Capital Pool Company Program ("CPC") is seen by some as being responsive to the needs of small companies that need to raise financing on the public markets.²⁵ Still, it is important not to overstate the contribution of the CPC as its success is debatable in light of the quality and performance of the companies involved. In fact, some have argued that it is not advisable to encourage listing at a precocious stage of development, as does the CPC.²⁶

(iii) *The Nominated Advisor as a Stock Exchange Gatekeeper*

The nomad is the hallmark of the AIM. The nomad is both a gatekeeper and an advisor. It is a gatekeeper in that it is responsible toward AIM to decide whether an issuer is suitable for admission. The nomad acts also as an advisor to the issuer by providing assistance and guidance through the flotation process, as well as after flotation to ensure that it complies with AIM rules.

The LSE has the authority to grant the status of nomad. In order to obtain approval from the LSE as nomad, the applicant must satisfy the following minimum criteria.²⁷ First, it must be a firm or company. Second, it must have practiced corporate finance for two years. Third, it must have acted as the principal corporate finance advisor in three relevant transactions during the two-year period. A relevant transaction includes an initial public offering, a take-over bid, and other major

Public Equity Market" in P.J.N. Halpern, ed., *Financing Growth in Canada* (Calgary: University of Calgary Press, 1997) at 607-608 (making a similar point prior to the restructuring of Canadian stock exchanges in 1999).

²⁵ P. Puri, "Local and Regional Interests in the Debate on Optimal Securities Regulatory Structure" in A.D. Harris, ed., *It's Time: Research Studies* (Ottawa: Wise Persons' Committee, 2003) 205 at 231-33. See also Robinson, *ibid.*, at 611-18.

²⁶ C. Carpentier and J.M. Suret, *Bypassing the Financial Growth Cycle: Evidence from Capital Pool Companies*, 2004s-48, Cirano Scientific Series (2004).

²⁷ AIM, *Nominated Advisor Eligibility Criteria*, April 2005.

corporate transactions for publicly listed companies in the European Union or elsewhere in the world. Finally, the applicant must employ at least four qualified executives. A qualified executive "is a full-time employee of an applicant who is involved in giving corporate finance advice and who has acted in a corporate finance advisory role, which includes the regulation of corporate finance, for at least three years and in at least three relevant transactions."²⁸

In addition to these criteria, the LSE will assess whether the recognition of the applicant as nomad might endanger the reputation or integrity of AIM. This assessment will involve the consideration of the following elements:

- whether the applicant is adequately regulated;
- the applicant's standing with regulators;
- the applicant's general reputation;
- whether the applicant or its executives have been the subject of adverse disciplinary action by any legal, financial, or regulatory authority;
- whether the applicant is facing such disciplinary actions; and
- insofar as relevant, the commercial and regulatory performance of its clients to whom it has given corporate finance advice.

If the applicant satisfies these requirements, then it is entered on a register of firms authorized to act as nomads, which is maintained by the LSE. As of May 2006, there were about 84 nomads recognized by the LSE, of which 55 per cent act also as brokers on AIM. Most nomads are investment banks or corporate finance firms, some of which are major American institutions, such as Credit Suisse, J.P. Morgan, Morgan Stanley, and Merrill Lynch. Still, it is interesting to note that five of the major global accounting firms are also nomads. As of this date, there was only one Canadian nomad, Canaccord Adams.

Once it is recognized by the LSE, the nomad must respect the ongoing responsibilities set forth in the AIM rules.²⁹ At a general level, the nomad must abide by its responsibilities pursuant to the AIM rules.

²⁸ *Ibid.*, at 2.

²⁹ Aim Rules, *supra*, n. 15, Rule 39.

Specifically, the nomad and its executives must be independent from the AIM companies for which it acts. It must not have and must take care to avoid the semblance of a conflict between the interests of the AIM companies for which it acts and the interests of any other party. At a more technical level, the nomad must ensure that it continues to meet the minimum eligibility criteria, and that it has proper procedures and records. Finally, it must pay the annual fees as set by the LSE.

Given the important role that nomads play in the AIM regulatory framework, the LSE monitors their performance.³⁰ The LSE has the power to conduct a formal review of the nomad. It also has the power to remove an employee as a qualified executive where the circumstances indicate that the latter can no longer be considered to be qualified. Finally, the LSE can take disciplinary action against a nomad where it is in breach of its responsibilities under the eligibility criteria, or has failed to act with due care and skill, or has impaired the reputation and integrity of AIM through its conduct or judgment. In such a case, the Exchange may censure the nomad, remove it from the register, and/or publish the action it has taken and the reasons for it.

The nomad plays a central role in the admission process. In addition to assessing the suitability of companies seeking listing, the nomad coordinates the contribution of all professionals involved in the process, identifying their responsibilities and setting up the timeline. It participates in the drafting of the admission document along with the company and the other professionals. In the latter part of the process, the nomad oversees the compilation of the various parts of the admission documents. Finally, it drafts and issues the pre-admission statement that must produce the company, as well as the formal application documents.

The relation between the nomad and the issuer does not end upon the latter's admission to the LSE. The rules of AIM require that the nomad maintain an advisory relationship with the issuer. At a general level, the AIM rules provide that the nomad must be available at all times to advise and guide the directors of the company about their obligations to ensure compliance on an ongoing basis with these rules.³¹ It must liaise with the LSE where requested to do so by the exchange or

³⁰ See notes and accompanying text.

³¹ Aim Rules, *supra*, n. 15, Rule 39.

the AIM company, and provide the LSE with any other information it may reasonably require. Moving to the specific, according to the rules, the nomad has the responsibility to ensure that the company complies with its continuous disclosure obligations.³² This responsibility is central to the nomad's work following admission: "Much of the work [of the nomad] will involve advising on the need for announcements and on their form and content."³³ Aside from these responsibilities, the nomad may also furnish advice to companies with respect to corporate governance matters that are not covered in the AIM rules.

In this context, one benefit of the nomad system could be that it allows for a more tailored approach to disclosure. The nomad, through its knowledge of the market, has arguably the ability to identify the information that is relevant for investors. This may reduce compliance costs for issuers as they avoid having to disclose information that is of no specific value or interest to investors. Since the nomad is acting as regulator, this framework can reduce the risk of non-disclosure of important information by issuers for "good reasons". The possibility of issuers being subject to a more tailored disclosure regime could render more attractive the prospect of a continuing relation with the nomad.

A cursory look at the requirements of Canadian stock exchanges may suggest that they provide an equivalent to the nomad with the sponsor. On the TSX, sponsorship by a participating organization³⁴ of the TSX is a factor in the consideration of the suitability of an applicant. It is theoretically mandatory for all companies, except for companies listing under the senior issuer criteria. The sponsorship letter purports to give the TSX an assessment of the applicant and evidence of market support for the company's stock. The participating organization must also confirm whether the issuer satisfies all the listing requirements and comment on the company's ability to meet its obligations as a Canadian public company. On the TSXV, a sponsorship report produced by a participating organization of the exchange is required to be filed by an applicant for listing on the exchange in connection with any application for a new listing.

³² See also *infra* notes and corresponding text on the continuous disclosure requirements and the role of the nomad.

³³ AAronson, *supra*, n. 19 at 34.

³⁴ Participating organizations are securities firms that comprise the shareholders of the TSX.

The sponsorship requirement is not, however, frequently relied upon. It is the practice of the TSX not to require sponsorship for companies that get listed as part of an initial public offering as the participation of investment dealers and their liability for prospectus disclosure provide sufficient comfort. Sponsorship is only required in particular circumstances where pointed issues have to be resolved, either with respect to the issuer, its management, or its operations. Likewise, the TSXV rules provide that sponsorship is not required in the case of a listing pursuant to an initial public offering, where the prospectus is executed by at least one member of a participating organization. Further, the exchange may exempt an issuer from all or part of the sponsorship requirements if certain conditions are met.³⁵

Even if it were more frequently used, the institution of the sponsor would remain quite different from the nomad. First, the sponsor operates within the detailed framework established by the exchanges' rules that regulate admission. Thus, it has far less discretion than the nomad. Second, unlike the nomad, the sponsor is not acting as a representative of the exchange to assess the suitability of companies or to enforce exchange rules. Finally, there is no obligation for a listed company to retain a sponsor following admission.

(iv) *The Costs of Going Public and of Listing*

Companies seeking to get listed and raise financing on AIM must incur various expenses. They must pay for the services of professionals involved in the admission and offering processes. They must also incur listing fees with AIM. The following is a standard estimate of the costs provided by one market participant:

Nomad:	£50,000 to £125,000;
Lawyers:	£100,000 (company) and £40,000 (nomad);
Accountants:	£30,000 to £50,000;
Investor relations:	£5,000 to £15,000;
Printing costs:	£10,000 to £20,000;
Road show:	£10,000 to £30,000; and
Exchange fees:	£4,180

To these expenses that range between £250,000 to £380,000 (or

³⁵ See section 3.4 of Policy 2.2 of the TSXV: "Sponsorship and Sponsorship Requirements".

CND\$500,000 to CND\$760,000), it is necessary to add the commission that the company must pay to the brokers, which is typically of 8 per cent of the total proceeds of the offering. Thus, if AIM is used to make an offering of £10 million (or CND\$20 million), the direct expenses would range between 10.5 per cent and 12 per cent of gross proceeds.³⁶

In Canada, many factors influence the costs of going public and listing, including the exchange on which the listing is sought. One should consider the following costs that may be incurred in connection with a listing: securities commissions' fees (which depend upon the number of jurisdictions in which the issuer is filing a prospectus); sponsor fees; accounting, auditing, and legal fees; investment dealers' fees; costs associated with printing; transfer agency; investor relations; expert reports; etc. A recent study indicates that the direct costs of going public in Canada, excluding capital pools offerings, amount to 9.45 per cent of gross proceeds for offerings of the equivalent of £10 million (or CND\$20 million).³⁷ In other words, for offerings of similar size, there would not appear to be a cost advantage of going public on AIM.³⁸

(b) The Admission Process

The Canadian exchanges and AIM have different admission processes. On AIM, companies can take the standard route which takes about three to six months to complete. This route involves the drafting of an admission document that provides extensive information on the company as a prospectus. The admission document is not vetted by exchange authorities. Prior to the official admission date, the company must then disclose a pre-admission document, which is basically an announcement of the listing. Alternatively, companies already quoted on recognized stock exchanges can use the fast-track route, which involves a lighter disclosure regime. On Canadian exchanges, the listing process can take between two to three months and involves the production of various

³⁶ More generally, some have mentioned that total costs of admission on AIM are approximately 5 to 12 per cent of the gross proceeds raised. See P. Finlan, "Mining Companies Go Public on the AIM" (2005-2006), 22:2 Mining Law Monitor 6, 7.

³⁷ M. Kooli & J.M. Suret, *How Cost-Effective Are Canadian IPO Markets?* Cirano Scientific Series, 2002-83 (2002) at 12.

³⁸ See also V. Heffernan, "AIM Steps Up Marketing Drive in Canada: Recruiting Efforts Down Under Pay Off for Secondary Market" (2002) 88:8 The Northern Miner 9 (AIM listing is costly).

documents along with the prospectus, which are actively reviewed by exchanges authorities.

(i) *Admission Documents*

(A) Standard route

Issuers applying for listing on AIM must prepare an admission document that will be submitted to exchange authorities. The contents of the admission document are established by the AIM rules as well as by practice. Although there are few requirements with respect to format, the admission document tends to be structured and formatted in a similar way developed by practitioners.

The admission document contains four main parts.³⁹ The first part deals with non-financial matters and provides a description of the business, the activities, the organization, and the governance of the company. This part also discloses the risk factors relevant to the company. The second part contains the financial information, and specifically, the historical financial information relating to the company and its subsidiaries for the last three years, and the accountant's report certifying that the historical information shows a true and fair view of the company's financial information. It may also contain *pro forma* financial information if the nomad considers that it would be useful to underscore the impact of flotation. Where the company operates in a specialized area, such as technology, intellectual property, mining, or oil and gas, the professional advisors will usually require the production of an expert's report "to give prospective investors sufficient information on which to base their decision on whether to invest in the company,"⁴⁰ which will become the third part of the admission document. Fourth, the back end of the admission document sets out information on matters such as the company's legal structure and share capital, material contracts, material legal proceedings, management related information, executive compensation, substantial shareholders, and related party transactions. In addition, in this fourth part, the directors make two important statements. One deals with the adequacy of the company's working capital and

³⁹ AAronson, *supra*, n. 19 at 30-32.

⁴⁰ M. Audley, "Role of the corporate lawyer in an AIM flotation" in *Joining Aim, supra*, n. 3 at 74.

provides that "in their opinion having made due and careful enquiry, the working capital available to [the company] and its group will be sufficient for its present requirements, that is for at least twelve months from the date of admission." The other is a responsibility statement pursuant to which directors accept responsibility for every statement contained in the admission document. Finally, the company must disclose any other information that it reasonably considers necessary to enable investors to form a full understanding of the assets and liabilities, financial position, profits and losses, prospects of the company, and the rights attaching to the company's securities.

Where the company undertakes fundraising in conjunction with its admission on AIM, it will have to comply with the prospectus rules of the Financial Services Authority if it makes an offer to the public. In such a case, the prospectus will serve as the admission document. This will entail additional disclosure requirements for the company so that the information provided by the admission document is equivalent to that which would be required in a prospectus. Moreover, the admission document will need to be approved by the U.K. Listing Authority. However, market participants have pointed out that companies usually made private placements on AIM rather offers to the public. Where the fundraising does not constitute an offer to the public, the company will be able to use the "standard" admission document to proceed to the placing of its securities. In either case, the admission document serves as a "pathfinder", that is, the equivalent of a preliminary prospectus, by the brokers to market the securities and assess the level of investors' interest.

The admission document is a key document for the company in the listing and fundraising processes. It must thus be prepared with care by the company and its advisors. For directors, this is even more important given that they are responsible for the accuracy of the admission document and for ensuring that there are no material omissions.⁴¹ Further, the nomad and broker will require that the company and its directors sign a placing or introduction agreement where they will namely give

⁴¹ AIM Rules, *supra*, n. 15, Rule 31. Where the company produces a prospectus in lieu of the admission document, directors are liable for misrepresentations following the Prospectus Rules. See S. Gleeson & H.S. Bloomenthal, "The Public Offer of Securities in the United Kingdom" (1999) 27 *Denv. J. Int'l L. & Pol'y* 359, 431.

warranties that the contents of the admission document are accurate and not misleading.

As mentioned above, the nomad manages the admission processes. It assists the company in the drafting of the admission document. It circumscribes the work of the lawyers and of the auditors, and determines whether additional expertise is required. The lawyers of the company conduct the legal due diligence review, as well as the verification process that seeks to ensure that the admission document is not misleading. The accountants review the company's financial information and assist in the preparation of the financial information to be disclosed. It appears that this verification process "is not dissimilar to the Canadian-style due diligence undertaken by underwriters in connection with prospectus offerings but generally requires a more formal and detailed written analysis of the information in the admission document."⁴² Thus, the verification "can be a lengthy and time-consuming exercise."⁴³

Once it is completed, the admission document is produced to the exchange authorities. It must be made available publicly, free of charge, for at least one month from the admission of the company's securities.

(B) The fast-track route for quoted issuers

Since 2003, the AIM rules provide for a fast-track admission procedure for issuers that are listed on recognized foreign stock exchanges. The purpose of the fast-track route is to "make it easier for smaller growing companies across the world to join AIM" by providing a streamlined admission process.⁴⁴

To use the fast-track route, a company must be a "quoted applicant", that is, it must have had its securities traded on an AIM designated market for at least eighteen months prior to applying to have those securities admitted on AIM. AIM designated markets include namely the "main market" of the TSE, which excludes the TSXV. In addition, a company seeking to use the fast-track route must also abide by more technical requirements. First, the company must prepare its financial statements in accordance with the U.K. or U.S. GAAP, or with International Accounting Standards ("IAS"). Thus, a Canadian issuer has to

⁴² Stikeman Elliott, *Aiming High: Listing on London's Alternative Market* (May 2004) at 2.

⁴³ *Ibid.*

⁴⁴ *Supra*, n. 3 at 14.

reconcile its financial statements prepared in accordance with Canadian GAAP with one of these recognized reporting standards prior to admission. Second, the company must take appropriate steps to ensure the electronic settlement of its securities.

The most significant advantage of the fast-track route is that the company does not have to produce an admission document. To the extent that it does not make an offer to the public, the company need only to make a pre-admission announcement that will provide the exchange with the information required by the AIM rules, and that will be disseminated to the public. As seen below, the pre-admission document prepared by companies following the fast-track route will be more detailed than for companies admitted following the standard route. Still, the fast-track route reduces the length of the admission process significantly, to about four to six weeks, compared with three to six months for the standard route.⁴⁵

(1) The pre-admission document

Companies following the standard route must provide the LSE with a pre-admission document at least ten business days prior to the expected date of admission to AIM. The pre-admission document is a straightforward document that discloses basic information about the company such as its business, its directors, and important shareholders, and the securities in respect of which it seeks admission.

For companies that use the fast-track route, the pre-admission document will contain additional information. Most importantly, beyond these specific requirements, the schedule provides that a quoted applicant must disclose information equivalent to that required for an admission document that is not currently public. Although this requirement may seem to be a broad provision that significantly diminishes the advantages of the fast-track option, it may be satisfied by making this information available publicly at an address in the U.K. or a website address accessible to users in the U.K. Thus, the company does not have to assemble all this information into an admission document, and the pre-admission document will be substantially shorter than the latter.

⁴⁵ Stikeman Elliott, *supra*, n. 42 at 3.

(C) The listing application document

Any company getting listed on AIM, including those joining through the fast-track process, must submit an application form at least three business days prior to the expected date of admission to the LSE. The application form is a short document that provides basic information on the company, as well as declaration and undertakings with respect namely to compliance with the AIM rules. Where the company is using the fast-track route, it must also submit an electronic version of its latest report and accounts. In any case, the application form must be accompanied by the nomad's declaration which includes confirmation of the responsibilities of the nomad as set out in the AIM rules.

(ii) *Admission to Trading on AIM*

On AIM, admission will become effective when the LSE issues a dealing notice to that effect following the process described above. Theoretically, the exchange has the discretion to assess the applicant's suitability for AIM. The AIM rules provide that the exchange may make the admission subject to a special condition. Moreover, where there are reasons to doubt the applicant's appropriateness, the exchange may delay the admission and require further due diligence. Ultimately, it may refuse admission if the applicant does not comply with any special condition imposed, or if the applicant's situation is such that admission would be detrimental to the orderly operation or reputation of AIM. However, this power is rarely used by exchange authorities in practice.

In comparison with AIM, Canadian exchanges play a more active role in the review of applications and in the admission of the securities to trading. When the TSX is satisfied that the application documentation is in order, the application is submitted to the exchange's Listings Committee. The Listings Committee may require additional information in order to clarify certain areas of the applications. It may also consult the TSX Listings Advisory Committee, which is comprised of securities industry actors.

Following completion of the assessment, the TSX will either (i) grant conditional approval (subject to meeting conditions within a 90-day period); (ii) defer its approval pending resolution of specified issues to the satisfaction of the exchange; or (iii) decline the application.⁴⁶ Such

⁴⁶ At least six months must pass before the applicant becomes eligible for reconsideration.

decision is generally rendered within 60 days from the date of receipt of complete documentation. Once the listing has been approved, the posting of the securities for trading may take place shortly thereafter, but, as a general rule, not more than 90 days after approval of the application.

(c) Ongoing Obligations of Listed Issuers

Once admitted on AIM, companies are subject to ongoing obligations in order to retain their AIM quote. The disclosure rules of the U.K. Listing Authority, to which are subject companies listed on the LSE's Main Market, do not apply to AIM companies. Instead, the main body of rules that govern the ongoing obligations of AIM companies are set out in the AIM rules, which generally impose fewer and less onerous obligations than the LSE's Main Market rules or the rules of other main markets such as the TSX and TSXV. A key difference between AIM and other markets is that rather than being regulated directly by a securities regulator, AIM companies are supervised by a nomad.

(ii) Disclosure Obligations

(A) Timely disclosure of price sensitive information

AIM imposes timely disclosure obligations to ensure that investors remain informed of all price sensitive information. AIM rules require that a listed issuer disclose, without delay, through a Regulation Information Service ("RIS"),⁴⁷ any new developments that are not public knowledge concerning a change in its financial condition, its sphere of activity, or the performance of its business or its expectation of performance, which, if made public, would be likely to lead to a substantial movement in the price of its securities.⁴⁸ As a general principle, reasonable care must be taken to ensure that any information so disclosed is not misleading, false or deceptive, or does not contain material omissions.⁴⁹ The AIM rules also expressly require that specific events or developments be promptly notified.⁵⁰ Where it is proposed to announce at any meeting of shareholders information that might lead to

⁴⁷ A wire service approved by the LSE for the distribution to the public of AIM announcements and included within the list maintained on the LSE's website.

⁴⁸ AIM Rules, *supra*, n. 15, Rule 10.

⁴⁹ *Ibid.*, Rule 10.

⁵⁰ *Ibid.*, Rule 17.

substantial movement in the price of those securities, arrangements must be made for public disclosure of that information through RIS so that the disclosure at the meeting is made no earlier than the time at which the information is publicly disseminated. Ultimately, AIM disclosure obligations require that listed companies provide to investors all material information in a timely fashion. While the wordings of the AIM rules obligations may somewhat differ with the Canadian timely disclosure regime, there are no significant differences in this respect between the two regulatory regimes.

(B) Corporate transactions

The AIM rules specifically require notification⁵¹ of certain corporate transactions, such as substantial transactions,⁵² related-party transactions,⁵³ reverse take-overs,⁵⁴ and disposals resulting in fundamental changes of business.⁵⁵ As a general rule applicable to all of the above-listed transactions, disclosure must include the following: (i) particulars of the transaction, including the name of any company or business, where relevant; (ii) a description of the business carried on by, or using, the assets that are the subject of the transaction; (iii) the full consideration and how it is being satisfied; (iv) the effect on the issuer; and (v) any other information necessary to enable investors to evaluate the effect of the transaction upon the issuer.

⁵¹ "Notification" is defined in the AIM rules as the public disclosure of information through an RIS.

⁵² A substantial transaction is one which exceeds 10 per cent in any of the class tests (as such tests are defined in Schedule 3 of the AIM rules). The class tests are defined in Schedule 3 of the AIM rules. They are the gross asset test (gross assets subject of the transaction/gross assets of the AIM company X 100), the profit test (profit attributable to the assets subject of the transaction/profit of the AIM company X 100), the turnover test (turnover attributable to the assets subject of the transaction/turnover of the AIM company X 100), the consideration test (consideration/aggregate market value of the ordinary shares (excluding treasury shares) of the AIM company X 100), and the gross capital test (gross capital of the company or business being acquired/gross capital of the AIM company X 100).

⁵³ A related party transaction means any transaction whatsoever with a related party which exceeds 5 per cent in any of the class tests.

⁵⁴ A reverse takeover is a transaction where any of the ratios relating to defined class tests exceed 100 per cent or where there is a fundamental change in business, board or voting control of the company.

⁵⁵ Any disposal by an AIM company which, when aggregated with any other disposal or disposals over the previous twelve months, exceeds 75 per cent in any of the class tests, is deemed to be a disposal resulting in a fundamental change of business.

Companies engaged in one of those operations must provide specific information that supplements the general disclosure requirement. Thus, in the case of related party transactions, disclosure required in connection with a related party transaction must also include (i) the name of the related party concerned and the nature and extent of its interest in the transaction; and (ii) a statement that with the exception of any director who is involved in the transaction as a related party, its directors consider, having consulted with its nomad, that the terms of the transaction are fair and reasonable insofar as its shareholders are concerned.⁵⁶ Notification made in connection with a RTO must contain the above-noted general information and the information required for related-party transactions, insofar as it qualifies as such. Finally, any agreement that would effect a disposal resulting in a fundamental change of business must be disclosed along with the above-mentioned general transaction information, and, as the case may be, the information required for related party transactions.

A comparison of the AIM disclosure obligations with the Canadian obligations is not easy. At first glance, it may appear that the AIM rules impose more stringent disclosure requirements. Indeed, a cursory reading of Canadian regulation indicates that it is only where an issuer completes a "significant acquisition"⁵⁷ of a business or related business that it is subject to disclosure obligations. Pursuant to the significant acquisition disclosure obligations, the issuer must, subject to certain exceptions, file with the relevant securities regulatory authorities, a business acquisition report ("BAR") containing prescribed information

⁵⁶ AIM Rules, *supra*, n. 15, Rule 13.

⁵⁷ Generally, an acquisition of a business or related businesses is a "significant acquisition" for a public company with securities listed on the TSX if the acquisition results in any of the following: (a) the reporting issuer's proportionate share of the consolidated assets of the business or related businesses exceeds 20 per cent of the consolidated assets of the reporting issuer; (b) the reporting issuer's consolidated investments in and advances to the business or related businesses as at the date of the acquisition exceeds 20 per cent of the consolidated assets of the reporting issuer as at the last day of the most recently completed financial year of the reporting issuer ended before the date of the acquisition; or (c) the reporting issuer's proportionate share of the consolidated income from continuing operations of the business or the related businesses exceeds 20 per cent of the consolidated income from continuing operations of the reporting issuer. However, an acquisition of a business or related businesses is a "significant acquisition" for a public company with securities listed on the TSXV only if the any of the three above significance tests is satisfied using a 40 per cent threshold rather than a 20 per cent threshold: s. 8.3, National Instrument 51-102, *Continuous Disclosure Obligations* [NI 51-102].

within seventy-five days of the significant acquisition.⁵⁸ The required information contained in the BAR, in some cases, may include, among other things, annual, interim, and/or *pro forma* financial information.⁵⁹

However, to have a complete picture of disclosure obligations, it is important to emphasize that security holder approval may be required in connection with a significant transaction either pursuant to Canadian corporate and securities statutes or stock exchange rules. Security holder approval will trigger additional disclosure obligations for the company under the proxy regime. Further, related-party transactions, reverse takeover bids, and fundamental changes are specifically regulated either by corporate law, securities regulation, or stock exchange rules.⁶⁰ Regulation imposes a shareholder approval requirement as well as specific disclosure obligations for those operations.

(C) Periodic reporting

Companies listed on a Canadian exchange are subject to extensive periodic disclosure obligations enacted out by securities regulation.⁶¹ The obligations establish requirements concerning the information that must be disclosed annually and quarterly. AIM rules impose less stringent disclosure requirements than Canadian securities regulation. An AIM-listed company must issue its annual audited accounts as soon as possible after they have been approved but no later than six months after its financial year-end.⁶² The AIM rules mandate that the annual accounts be prepared in accordance with U.K. GAAP, U.S. GAAP, or IAS. It is acceptable to provide accounts prepared in accordance with other accounting principles as long as they contain notes

⁵⁸ NI 51-102, *ibid.*

⁵⁹ A company is exempt from filing a BAR if it has, in connection with the significant acquisition, filed an information circular or a filing statement prepared in accordance with the rules of the TSXV if (i) such disclosure document contains the information and financial statements that would be required by a BAR; (ii) the date of the acquisition is within nine months of the date of the information circular or filing statement; and (iii) there has been no material change to the terms of the acquisition from those disclosed in the information circular or filing statement: s. 8.1(2), NI 51-102, *ibid.* A CPC that files an information circular in connection with a qualifying transaction is also exempt from filing a BAR.

⁶⁰ See, e.g., *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 173; OSC Rule 61-501, *Insider Bids, Issuer Bids, Business Combinations and Related Party Transactions*.

⁶¹ NI 51-102, *supra*, n. 57. See M.G. Condon, A.I. Anand & J.P. Sarra, *Securities Law in Canada*, (Toronto: Emond Montgomery, 2005) 347.

⁶² Aim Rules, *supra*, n. 15, Rule 19.

reconciling the differences between such principles and either U.K. GAAP, U.S. GAAP, or IAS.⁶³ Other than the requirement to file annual accounts and half yearly reports, an AIM company is not currently subject to any annual filing requirements such as annual information forms, management's discussion and analysis, and annual reports.

With respect to interim disclosure requirements, AIM-listed companies must establish a half-yearly report in respect of the six-month period from the end of the financial period for which financial information has been disclosed in its admission document and at least every subsequent six months thereafter (apart from the final six-month period preceding its accounting reference date for its annual accounts) within three months of the end of the period. The half-yearly report must be presented and prepared in a form consistent with that which will be adopted in the company's annual accounts having regard to accounting standards to such annual accounts.⁶⁴

Finally, note that there are no certification requirements for the CEOs and CFOs of AIM companies as there are for issuers listed on Canadian exchanges by virtue of Rule 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*.

(D) Shareholders' meetings and communications

In Canada, securities regulation and exchange rules provide some prescription concerning shareholder meetings and communications that supplement corporate statutes. Again, the AIM rules are less demanding as they require only that any document sent by a company to its shareholders must be available to the public at the same time for at least one month, free of charge, at an address announced to RIS.⁶⁵

⁶³ However, note that AIM intends to mandate IAS for all AIM companies for financial years commencing on or after 1 January 2007.

⁶⁴ AIM Rules, *supra*, n. 15, Rule 18.

⁶⁵ *Ibid.*, *supra*, n. 15, Rule 20. An electronic copy of the document must be sent to the LSE.

(ii) *Legal and Illegal Insider Trading*

(A) Insider reports

Canadian securities regulation imposes strict reporting requirements to insiders.⁶⁶ Insider reporting obligations are much lighter on AIM. Pursuant to this regime, companies must notify the market as soon as they become aware of trading by directors.⁶⁷ Generally, the nomad will require that the company adopt an insider trading policy that compels directors to notify as soon as they trade in the securities. Also, the company must notify without delay whenever it becomes aware of any trade made by any shareholder holding at least three per cent of the total voting rights in the company where such trade results in an increase or decrease of such holdings through any single percentage.⁶⁸ Thus, AIM rules do not impose direct reporting obligations to insiders as is the case in Canada, nor do they impose early-warning disclosure requirements. It is only through the oversight made by the company that insider trading may be disclosed to investors. When the company detects insider trading, reporting must however be done without delay, unlike under Canadian regulation where there is a delay of ten days.

(B) Insider trading and tipping

Insiders of a Canadian public company (and other persons who are in a special relationship with such company) are prohibited from (i) trading in the securities of the company with knowledge of a material fact or a material change with respect to the company and not yet publicly disclosed; and (ii) informing another person or company, other than in the ordinary course of business, of a material fact or a material change with respect to the company before the information has been generally disclosed.⁶⁹

Pursuant to AIM rules, securities of a listed company may not be traded by its directors or "applicable employees" during a trading "closed period".⁷⁰ In this context, "applicable employees" are those employees

⁶⁶ D. Johnston & K.D. Rockwell, *Canadian Securities Regulation*, 3rd ed. (Toronto: Butterworths, 2003) 174. See, e.g., *Ontario Securities Act*, R.S.O. 1990, c. S-5, s. 107 [OSA].

⁶⁷ AIM Rules, *supra*, n. 15, Rule 17.

⁶⁸ *Ibid.*, Rule 17.

⁶⁹ OSA, *supra*, n. 66, s. 76.

⁷⁰ AIM Rules, *supra*, n. 15, Rule 21.

likely to be in possession of unpublished price-sensitive information in relation to the company because of their employment with the company, a parent company, or a subsidiary. In addition to any period when the AIM company is in possession of unpublished price-sensitive information (or where it is reasonably probable that such information will be required to be publicly disclosed), a closed period includes the following:

- the period of two months immediately preceding the preliminary announcement of the company's annual results (or, if shorter, the period from the relevant financial year-end up to and including the time of announcement);
- if it reports only half-yearly, the period of two months immediately preceding the notification of its half-yearly report or, if shorter, the period from the relevant financial period end up to and including the time of the notification, and
- if the company reports on a quarterly basis like TSX-listed companies, the period of one month immediately preceding the announcement of the quarterly results (or, if shorter, the period from the relevant financial period-end up to and including the time of the announcement).

The LSE may permit the sale of securities by a director or applicable employee during a close period only to alleviate a severe personal hardship. Nomads will generally insist that an AIM company adopt an insider-trading policy to comply with the above.

Insiders of AIM-listed companies are subject to the insider trading prohibitions under English law. Insider trading in the U.K. is a criminal offence.⁷¹ Generally, it is illegal for anyone to purchase or sell or otherwise deal in securities of any public company with knowledge of price-sensitive information relating to the securities of that company affecting that company that has not been publicly disclosed or published through the prescribed channels. It is also illegal for anyone to inform any other person of non-public price-sensitive information. Therefore, personnel of a company with knowledge of confidential or price-sensitive information about the company, its subsidiaries, its joint ventures, or third parties in negotiations of potential material transactions, are prohibited

⁷¹ *Criminal Justice Act 1993* (U.K.), 1993, c. 36, s. 52.

from trading or dealing in securities of that company or of any such third party until the information has been fully disclosed.

(iii) *Corporate Governance*

(A) General governance requirements

In Canada, securities regulation impose a number of corporate governance requirements on listed issuers. In contrast, AIM rules do not specifically cover issues of corporate governance.⁷² Unlike companies listed in Canada, AIM companies are not required to have audit, nominating, or compensation committees of the board of directors. AIM does not even require independent directors. However, companies will often ask their nomad for advice on corporate governance or other issues that are not specifically covered in the AIM rules. It is indeed one of the nomad's duties to advise on what is appropriate from the perspective of corporate governance and what is necessary to protect the market's reputation.

The corporate governance arrangements of AIM companies have not been the subject of detailed studies. A notable exception is the work of Mallin and Ow-Yong, which is unfortunately now somewhat dated.⁷³ Their study of AIM companies based on admission documents revealed that corporate governance arrangements were affected by two factors: whether the nomad was also the broker and whether the company raised new capital on admission. A salient finding of the study is that when one of these factors is present companies had "better" corporate governance arrangements. Specifically, a higher proportion of those companies had audit and compensation committees, and disclosed their corporate governance policies in their admission document. The results suggest that companies raising new capital improve their governance arrangements to get a better valuation. In this respect, they support the enabling approach to corporate governance. More puzzling is the fact that the nomads appear to impose governance arrangements of "higher quality" where they also act as brokers. It is unclear why the nomads would be more strict in this respect.

⁷² The Combined Code on Corporate Governance does not apply to AIM companies.

⁷³ C. Mallin & K. Ow-Yong, "Corporate Governance in Small Companies – the Alternative Investment Market" (1998) 6 Corp. Gov. Int'l Rev. 224.

Despite the absence of specific corporate governance requirements, the AIM rules require that AIM companies ensure that their directors accept full responsibility, collectively and individually, for their compliance with the rules; disclose without delay all information that needs to be disclosed in accordance with the rules insofar as that information is known to the directors or could with reasonable diligence be ascertained by the directors; and seek advice from their nomad regarding their compliance with these rules whenever appropriate and take that advice into account.⁷⁴

Finally, note that the Quoted Company Alliance, which represents small- and medium-sized enterprises listed on AIM, has recommended that AIM-listed companies provide disclosure with respect to their corporate governance practices, even though the Combined Code does not apply to them.⁷⁵ This recommendation purports to respond to requirements of institutional investors by setting the governance of AIM companies at a higher level. The guidelines cover similar issues as the Combined Code. They require that companies publish a corporate governance statement annually that describes how they achieve good governance.

(B) Operations subject to shareholder approval or exchange oversight

Canadian exchanges rules impose various controls over certain operations conducted by listed companies to ensure the protection of investors. AIM rules do not provide for similar requirements. Shareholder approval is required when the company undertakes a reverse take-over, and a disposal that results in fundamental change in the business. AIM requires that it be informed of any notification of the timetable for any proposed action affecting the rights of the existing shareholders of an AIM-listed company.⁷⁶ Any amendments to the timetable proposed by the AIM company, including amendment to the publication details of a notification, must be immediately disclosed to AIM.⁷⁷

⁷⁴ AIM Rules, *supra*, n. 15, Rule 31.

⁷⁵ Quoted Companies Alliance, Launch of QCA Corporate Governance Guidelines for AIM Listed Companies (13 July 2005).

⁷⁶ AIM Rules, *supra*, n. 15, Rule 24.

⁷⁷ *Ibid.*, Rule 25.

(iv) *Costs of Maintaining a Listing*

On AIM, listed companies must pay an annual fee of £4,180 (CND\$8,360). A pro rata annual fee is payable by new applicants, no later than three business days prior to admission to trading. In addition, the company must retain a nomad throughout the year, and this requirement entails a cost of £30,000 to £75,000 (CND\$60,000 to CND\$150,000) according to market participants consulted. Legal fees are arguably rather marginal given the role played by the nomad.

The costs of maintaining a listing on Canadian exchanges is less straightforward because the fees vary with market capitalization. The following chart indicates the sustaining fees payable annually by all issuers for maintaining a listing on the TSX. Such fees are charged the first week of February and are charged on a pro rata basis at the time of listing for those issuers that list on the exchange during the year.

<i>Market Capitalization</i>	<i>Base Fee</i>	<i>+ Variable Fee Rate</i>
<i>Less than \$100M</i>	\$10,000	0.0080%
<i>\$100M to \$500M</i>	\$18,000	0.0075%
<i>More than \$500M</i>	\$48,000	0.0070%
<i>Maximum</i>	\$80,000	

Additional listing fees will be charged if additional securities of the issuer are listed on the exchange. Other fees may also be charged if the issuer proceeds with certain transactions requiring a filing with the TSX.

The following chart indicates the sustaining fees payable annually by all issuers for maintaining a listing on the TSXV:

<i>Market Capitalization</i>	<i>Minimum</i>	<i>Maximum</i>	<i>Fee Calculation</i>
<i>Less than \$5M</i>	\$3,500	\$3,500	Flat fee
<i>\$5M to \$100M</i>	\$3,500	\$30,000	\$3,500 + \$100 for each \$1,000,000 in market capitalization or part thereof above \$5 million
<i>More than \$100M</i>	\$15,000	\$30,000	\$15,000 + \$100 for each \$1,000,000 in market capitalization or part thereof above \$100 million

Additional listing fees will be charged if additional securities of the issuer are listed on the exchange. Filing and other fees may be charged if the issuer proceeds with certain transactions or operations requiring a filing and/or an approval of the exchange.

A recent TSX Ipsos Reid Survey indicates the cost of maintaining a listing on the TSXV is about \$57,000, excluding corporate overhead allocation.⁷⁸ The costs include commission and exchange fees, legal and accounting expenses, and shareholder communications and transfer agents. This makes the TSXV competitive with AIM with respect to the cost of maintaining a listing. Unfortunately, no similar data exist for the TSX.

(d) **Summation**

The preceding comparative analysis reveals three broad differences between the models used by AIM and Canadian stock exchanges to regulate their markets.

⁷⁸ D. Gordon, *The Costs of Going Public and Staying Public* (Calgary: Canadian Listed Company Association, 2003).

The first is the choice made by AIM in favour of a principles-based approach to govern admission. This choice contrasts with the classic rules-based approach used by Canadian exchanges. Despite this difference, the criteria on which companies' suitability for listing is assessed tend to be the same on AIM and Canadian exchanges. However, the principles-based approach gives greater latitude to adapt the suitability analysis to the particularities of companies seeking listing. Further, it is important to point out that companies seeking listing on AIM and on Canadian exchanges are subject to extensive disclosure obligations that deal with essentially the same matters. In other words, the principles-based approach does not translate into a lower level of disclosure for companies getting listed. Finally, in terms of costs, it is difficult to consider that the principles-based approach of AIM translates into significant savings that render it more attractive than Canadian exchanges. Indeed, the suitability analysis conducted by the nomad is more detailed and idiosyncratic and therefore involves significant costs. With respect to disclosure, since AIM rules mandate the communication of similar information to investors as Canadian exchanges, savings are at best marginal.

The second difference relates to the scope of ongoing obligations imposed on listed companies. AIM has less stringent periodic disclosure requirements than Canadian exchanges. Moreover, AIM has much lighter corporate governance requirements than Canadian exchanges. The lower level of ongoing obligations is arguably compensated by the nomad who advises listed companies on disclosure and corporate governance. The nomad can adapt the disclosure and governance practices of the companies to their particularities and the needs of investors. The result is a more tailored approach that may yield some economies for listed companies. It is important to stress that these economies are real only if the nomad gets it right, that is, selects the disclosure and governance practices that investors value, while leaving the others aside. Otherwise, if companies have disclosure and governance practices of lower quality, investors will simply discount the value of the securities offered, leaving no net benefits. Still, the AIM approach calls into question the cost-effectiveness of the current disclosure and governance obligations imposed by Canadian securities regulation.

Finally, the corporate governance requirements of AIM are more lenient and flexible than those applicable to Canadian exchanges, which are inspired by the American model. This enables listed companies to avoid being subject to corporate governance requirements that are ill-suited to their characteristics and impose unnecessary compliance costs. In this respect, it is interesting to note that American companies are seeking listing on AIM to avoid the requirements imposed by the *Sarbanes-Oxley Act*.⁷⁹

3. POLICY IMPLICATIONS: HOW IS THE ALTERNATIVE INVESTMENT MARKET MODEL INFORMATIVE FOR CANADIAN STOCK EXCHANGES?

(a) Framing the Issue

(i) *The Importance of Stock Exchanges for the Competitiveness of Canadian Capital Markets*

Stock exchanges perform three central functions in capital markets.⁸⁰ First, they play a crucial role in providing liquidity to securities. Second, they have a screening function that assists investors in assessing the quality of companies and of the securities listed. Finally, they act as regulator by making rules that govern trading and companies' governance, as well as ensuring the enforcement of those rules.

The functions of stock exchanges are valuable for investors and issuers. Thus, stock exchanges are considered to be key market infrastructure entities.⁸¹ As the IOSCO aptly summarizes:

The fair and efficient functioning of an exchange is of significant benefit to the public. The efficiency of the secondary market in providing liquidity and accurate price discovery facilitates efficient raising of capital for commercial enterprises, benefiting both the wider corporate sector and the economy as a whole. The failure of an exchange to perform its regulatory functions properly will have a similarly wide impact.⁸²

⁷⁹ E. Brown, "London Calling" *Forbes* (8 May 2006) 51.

⁸⁰ J.R. Macey & H. Kanda, "The Stock Exchange as a Firm: The Emergence of Close Substitutes for the New York Stock and Tokyo Exchanges" (1990) 75 *Cor. L. Rev.* 1007; A.M. Fleckner, "Stock Exchanges at the Crossroads" (2006) 74 *Fordham L. Rev.* 1.

⁸¹ B.S. Black, "The Legal and Institutional Pre-Conditions for Strong Securities Markets" (1999) *UCLA L. Rev.* 781.

⁸² International Organization of Securities Commissions, *Regulatory Issues Arising from Exchange Evolution*, Consultation Report of the Technical Committee (2006) at 6.

From this perspective, it is easy to understand that the presence of well-functioning exchanges is critical for the competitiveness of Canadian capital markets.

(ii) *Competitive Pressures and the Regulatory Model of Canadian Stock Exchanges*

Canadian stock exchanges operate in an increasingly competitive environment. If they are unable to discharge their core functions effectively, Canadian exchanges risk losing market share as they will be less attractive to companies. Specifically, companies will seek listing on more effective exchanges that will enable them to reduce their cost of capital. The departure of a significant number of companies could have some adverse impact for the reputation, operations, and, ultimately, the viability of Canadian exchanges.

Although we are far from such a catastrophic scenario, the recent surge of listing on AIM by Canadian companies is puzzling. Some may question whether this is a signal of dysfunctions in the operations of Canadian exchanges. However, when we examine the views expressed by market participants with respect to AIM, as well as empirical data, it is difficult to pinpoint a specific failure in the functions provided by the exchanges.⁸³ Still, the recent trend and relative success of AIM raises the issue as to whether AIM is doing something "right," and whether Canadian exchanges should be looking to AIM in order to remain competitive. In this respect, the comparison made above indicates that there are differences in the regulatory models and trading systems. AIM relies on a decentralized principles-based approach, whereas Canadian exchanges use a rules-based, centralized approach to regulate companies. AIM is a quote-driven market where liquidity is provided by market-makers, whereas Canadian exchanges remain primarily auction-driven markets, supported by market-makers.

Nevertheless, some may argue that the differences between AIM and Canadian exchanges are not preoccupying in that they simply reflect different strategies. The exchanges have different approaches because

⁸³ See Faegre & Benson, "American Springtime Blooms on AIM" Faegre Global Law Notes (16 March 2006), online: <<http://www.faegre.co.uk/global/article.aspx?id=4863>>: "However the key to the success of AIM will not be found by scouring the rule books or by comparing regulatory climates."

they cater to different types of companies. This argument loses its force in light of the data that show that AIM and the TSX attract companies of similar size and market capitalization. Thus, it appears relevant to examine whether AIM is doing something "right." Specifically, we will analyze whether the regulatory model used by AIM has some features that Canadian exchanges should consider importing in order to remain competitive. The assessment of the trading systems of AIM and of Canadian exchanges is beyond the scope of this article and will therefore be left aside.

(iii) *A Cautionary Note on Second-tier Exchanges*

AIM is a specialized exchange that is part of the portfolio of the LSE. When thinking about the lessons to be drawn from AIM for Canadian exchanges, a first question that may spring to mind is one of perspective: should we be considering the creation of a new stock exchange along the lines of AIM or the improvement of the operations of the existing exchanges?

The experience of European countries with junior stock exchanges, or second-tier markets, should serve as a cautionary note for those who may be thinking about the former option. Second-tier markets are essentially special segments that are created by stock exchanges in their equities markets with the objectives of lowering regulatory and cost barriers to entry for smaller companies.⁸⁴ Second-tier markets have been more popular in Europe where many stock exchanges have sought to establish special stock markets for smaller companies. The most notable European second-tier market initiatives have included the Mercato Ristretto in Italy, the Second Marché in France, the Officiele Paralle Markt ("OPM") of the Amsterdam Stock Exchange, and, prior to AIM, the Unlisted Securities Market ("USM") of the LSE.⁸⁵ These second-tier markets, which were all under the management of the main markets, purported "to bring access to public securities markets nearer to the

⁸⁴ G. Bannock, *European Second-tier Markets for NTBFs* (London: Commission of the European Communities, 1994) 7.

⁸⁵ M. Anolli *et al.*, "Second-tier Markets in Europe" in R. Buckland & E.W. Davis, eds., *Finance for Growing Enterprises* (London: Routledge, 1996) 223; G. Bannock, *European Second-tier Markets for NTBFs* (London: Commission of the European Communities, 1994) 27-103. See also R. Buckland & E.W. Davis, *The Unlisted Securities Market* (London: Clarendon Press, 1989); and G. Bannock & A. Doran, *Going Public—The Markets in Unlisted Securities* (London: Harper & Row, Publishers, 1987).

SMEs, providing lower costs of capital, the availability of equity capital in larger amounts, and the opportunity for exits for early stage investors."⁸⁶ The common approach adopted by the markets was to reduce cost barriers to entry by relaxing listing requirements.

Initially, European second-tier markets were considered to be a success as their implementation coincided with a very rapid growth in the number of new entrants.⁸⁷ The stock market collapse of 1987 and the following recession, however, marked the permanent decline of these markets.⁸⁸ Thus, the Mercato Ristretto, the Second Marché, the OPM, the USM, and other second-tier markets have been a failure.⁸⁹ Without minimizing the impact of the events of 1987 and of the recession, commentators argue that the failure of the European junior stock markets was caused by more important structural deficiencies. Bannock stresses that since second-tier markets were under the same management as the main exchanges, they were not actively promoted as "stock market managements [were] inevitably predominantly interested in the main market, which accounts for most of their income and prestige."⁹⁰ This lack of active promotion coupled with the relative similarities of listing requirements caused second-tier markets to be widely considered as merely ante-chambers for the main markets.⁹¹ Thus, issuers moved their listings to the main market as soon as practicable, with a depressing effect on volume and liquidity. Furthermore, because of their transitory nature, junior stock markets listed few high quality firms and thereby acquired a reputation of posting inferior securities.⁹² Some commentators also stressed that the relative dearth of institutional investors as buyers of small firm securities may have played an important role in preventing the market from developing efficiently and effectively.⁹³ Undoubtedly, the lack of institutional investments in second-tier markets

⁸⁶ Bannock, *ibid.*, at 7.

⁸⁷ *Ibid.*

⁸⁸ Commission des Communautés Européennes, Communications de la Commission, "Rapport concernant la faisabilité de la création d'un marché européen des capitaux pour les jeunes sociétés entrepreneuriales de croissance rapide", COM (95) 498 final at 6.

⁸⁹ Anolli *et al.*, *supra*, n. 85 at 225-26; Bannock, *supra*, n. 85 at 103-07. See also "Europe's second markets: Small, but not yet beautiful" *The Economist* (25 January 1995) 80.

⁹⁰ Bannock, *supra*, n. 85 at 112.

⁹¹ *Ibid.* Robinson, *supra*, n. 24 at 611.

⁹² Robinson, *ibid.*

⁹³ *Ibid.*

securities has dampened the development of efficient market infrastructures.

Admittedly, the recent success of AIM indicates that it is possible to create a vibrant second-tier market. Nonetheless, the number of high profile failures suggests that the creation of such a successful market requires a specific institutional setting. Given that the TSXV and the Canadian Trading and Quotation System already cater to small companies, it does not seem to be advisable to consider creating an additional specialized stock exchange in Canada along the lines of AIM. Rather, it is more appropriate to examine whether there are some features of the existing regulatory regime of Canadian exchanges that could be improved, in light of AIM's experience.

(b) An Assessment of the Regulatory Model of the Alternative Investment Model

(i) Competing Models to Regulate the Markets Operated

The comparative analysis of the AIM with Canadian exchanges reveals differences in the regulatory approach followed. The differences concern the regulatory techniques used, as well as the strategies used to implement regulation. The existence of those differences raises the question as to whether AIM relies on a regulatory approach that is "superior" to that used by Canadian exchanges.

(A) Techniques to regulate admission: rules versus principles

It is tempting to qualify AIM as an exchange that relies on a principles-based approach to regulate companies. In contrast, Canadian exchanges can be seen as using a rules-based approach. While there are some merits to this distinction, it should not be overstated. The principles-based approach of AIM is primarily found in the regulation of admission where the rules refer to a concept of suitability rather than to precise requirements. The ongoing obligations of listed companies are framed using a rules-based approach. Canadian stock exchanges regulate admission and ongoing obligations using a rules-based approach. However, there remain principles-based provisions throughout the rulebook, namely with respect to admission. Thus, the opposition between the rules-based and principles-based approach on Canadian exchanges and AIM is more striking with respect to admission than to ongoing obli-

gations. For the latter, it is more a question of the weight of regulation, with AIM having a lighter approach than Canadian exchanges especially in the broad area of corporate governance. From this perspective, it seems that any discussion of the merits of those two regulatory techniques should be done in light of the admission of companies, rather than of the regulation of the market as a whole.

The standard theory with respect to the regulation of admission by stock exchanges appears to support the rules-based approach. At a general level, the theory holds that listing requirements are quality standards that can convey information to investors on firm value. By seeking to list on a stock exchange, a company asserts that it meets the initial listing standards, that it intends to satisfy the ongoing listing standards, and that it is committed to respecting the exchange's corporate governance standards.⁹⁴ Thus, a listing application can be taken as an important expression of managerial confidence in the business prospects of the firm.⁹⁵ The information that signals a stock exchange listing is valuable to investors because it is costly to replicate for low-quality issuers who cannot meet the requirements.

There are some additional merits to the rules-based approach. Rules operate *ex ante* and are therefore more transparent. For investors, transparency is beneficial in that they know precisely what criteria companies have met in order to get admitted for trading in the various segments of the market. Further, since they are standardized, listing requirements may convey a clearer message to investors with respect to the quality of companies. For companies, transparency renders the application process more predictable. Assisted by their advisors, companies can readily identify whether they meet the listing requirements.

The most important drawback of rules is their rigidity. There is a risk that they create pointless rigidities that will prevent companies from getting admitted, where they do not fit in the framework, or that will force them to incur additional costs to satisfy the requirements. The principles-based approach of AIM provides a flexibility that could be

⁹⁴ J. Afflek-Graves *et al.*, "The Effect of the Trading System on the Underpricing of Initial Public Offerings" (1993) 22 *Fin. Mgmt.* 99 at 101.

⁹⁵ L.K.W. Ying *et al.*, "Stock Exchange Listing and Securities Returns" (1977) 12 *J.F.Q.A.* 415 at 416-418. See also D.S. Dhaliwal, "Exchange-Listing Effects on a Firm's Cost of Capital" (1983) *J. Bus. Res.* 139; and T. Grammatikos & G.J. Papaioannou, "The Informational Value of Listing on the NYSE" (1986) 21 *Fin. Rev.* 485.

seen as attractive for Canadian markets by allowing regulation to be more responsive to the diverse needs of companies.

Whether the Canadian regime lacks flexibility to the point that a shift to a principles-based approach should be considered appears doubtful. The minimum listing standards for exchange listing in Canada are similar or lower than those for markets in developing countries.⁹⁶ Exchange authorities do have some discretion in the application of listing requirements as they have pointed out. Moreover, the listing requirements of Canadian exchanges provide a rather flexible framework that allows smaller companies to get admitted for trading. For instance, the TSX permits listings by technology and industrial companies that have net tangible assets of \$1 million (tier 1) or even with no tangible assets (tier 3). Finally, even if they exist to some extent, those rigidities are not the reasons why Canadian companies have listed on AIM, since most of them are also interlisted on Canadian exchanges.

Besides, any consideration of the opportunity to shift to a principles-based approach demands that we factor in the drawbacks of this approach. Three are noteworthy. The first is the reduction in the transparency of the admission process, which can have adverse effects for investors and companies. Second, a principles-based approach implies the delegation of discretionary power to exchange authorities with respect to the suitability of the companies seeking admission. This likely entails additional costs as more analysis is required to assess suitability. Moreover, as the experience of AIM shows, companies may not be comfortable with such discretion to the extent that they have less control over the admission process given the elusiveness of the criteria relied upon to make the assessment. Third, shifting to a principles-based approach would mark a departure from the standard model used by most stock exchanges. Given the integration of North American capital markets, caution is warranted before implementing a regime breaking new ground. Indeed, it is necessary to consider what would be the reaction of American investors and regulators toward companies listed on a Canadian exchange governed by a principles-based approach with which they are not familiar.

⁹⁶ C. Carpentier *et al.*, *Initial Public Offerings: Status, Flaws and Disfunctions* (Industry Canada, 2003) 43.

(B) Outsourcing regulatory functions

A second distinguishing characteristic of AIM is its outsourcing of the responsibility for regulating companies to the nomad. From the outset, it must be acknowledged that such outsourcing is not per se limited to a principles-based model. However, to the extent that it is costlier to operate than a rules-based model, a principles-based model may require some form of outsourcing to remain competitive. Still, there are no reasons to think that under a rules-based model exchange authorities cannot outsource the assessment of applicants, or the supervision of listed companies, to a third party. For instance, Canadian exchanges could outsource the assessment of whether companies comply with listing requirements to professionals, such as investment dealers and corporate lawyers, by giving a new life to the sponsorship requirements. In the aftermarket, sponsors could have the obligation to continue to monitor the companies' compliance with exchange rules. Outsourcing these functions could generate economies for Canadian exchanges, which could enable them to concentrate their resources on enforcement or other priorities.

Leaving aside the choice between a principles-based and a rules-based approach, outsourcing makes sense only to the extent that it leads to more cost-effective regulation. At first glance, some may consider that decentralizing the regulation of applicants and listed companies with a nomad-like market participant would reduce regulatory costs in Canada through added competition. To assess this claim, it is necessary to analyze the extent to which a nomad system could be implemented in Canada and generate significant economies. This question is discussed in the next section.

(ii) *The Attractions and Challenges of the Nominated Advisor System***(A) The potential contributions of the nominated advisor**

The nomad is the hallmark of AIM's regulatory regime. It performs different functions in lieu of exchange authorities. More importantly, it may do so more cost-effectively than the latter.

(1) The nomad as a gatekeeper: certification and monitoring

The nomad acts as a gatekeeper for the admission of companies on AIM by assessing their suitability and vouching for them. The suitability assessment performed by the nomad replaces the detailed listing requirements and injects some flexibility in the admission process. The ability of the nomad to act as a substitute to detailed listing requirements is seen as one of its main advantages by many market participants.

The nomad performs another gatekeeping service as a sherpa by overseeing the compliance of the companies with AIM rules following admission. Following admission, the nomad also acts as a substitute for the detailed ongoing obligations that apply to companies listed on Canadian exchanges. Recall that the Canadian corporate governance regime provides more stringent requirements than the AIM regime. Disclosure obligations are also more extensive on Canadian exchanges than on AIM. In addition, public corporations in Canada are subject to corporate governance requirements that are more demanding. In fact, anecdotal evidence obtained from the consultation of market participants suggests that the more flexible rules of AIM render it attractive.

Through its regular contacts with companies, the nomad can contribute to enhance the quality of disclosure, as well as corporate governance in general, and thereby reduce the potential for investor abuses.⁹⁷ For instance, the nomad may insist that the company adopt an insider trading policy or implement certain corporate governance "best practices" recommended by the Combined Code.⁹⁸

The nomad system may thus appear to provide an alternative mechanism to protect investors in a more cost-effective way. This function is arguably unique in capital markets. Other reputational intermediaries do not have such close ties with issuers, nor do they have the responsibility of enforcing exchange rules. The ability of the nomad to act as a substitute to more detailed corporate governance requirements is certainly appealing. Many have criticized the governance requirements imposed on public corporations in Canada in the wake of the recent corporate scandals.⁹⁹ In the course of this research, market participants have ques-

⁹⁷ Mallin & Ow-Yong, *supra*, n. 73.

⁹⁸ *Ibid.*

⁹⁹ See, e.g., J. MacFarland, "Mr Dey's about face" *The Globe and Mail* (1 July 2006).

tioned the compliance costs these requirements generate, especially for smaller corporations. Others have cast doubts on their relevance.

Without calling into question the provision of these gatekeeping services by the nomad, some qualifications are warranted. The suitability assessment and monitoring made by the nomad is part of a principles-based approach that has its drawbacks, as mentioned above. In addition, the certification and monitoring functions are decentralized as they are discharged by each nomad in light of its own conception of what is a suitable company for AIM or what are "good corporate governance practices." There will be necessary variations in the analysis and interventions made by the nomads, and the variations will increase with the number of nomads. Thus, one limit to the certification provided by the nomad resides in the lower level of standardization in comparison with Canadian exchanges where the centralization of the evaluation process fosters a more uniform interpretation of the requirements. This problem is compounded by the fact that companies are not required to disclose their corporate governance practices nor compare them with a given benchmark such as the Combined Code. This renders the comparison and analysis of the corporate governance of listed companies more costly for investors and reduces the disciplinary pressure resulting from their assessment.¹⁰⁰

Also, the value of the certification and monitoring provided by the nomad primarily rests on its reputation. When a nomad vouches for a company by declaring that it is suitable, it places its reputational capital at risk. The signal that investors derive from a company's being qualified as suitable for AIM rests indirectly on their assessment of the nomad's reputation. Following admission, the reputation of the nomad retained by the company will influence investors' perception of its corporate governance quality. While it is a powerful mechanism, reputation has its own limit which may eventually undermine the value of the certification provided by the nomad.

Finally, it must be emphasized that the vast majority of Canadian companies getting listed on AIM are interlisted on the TSX or TSXV. With respect to certification, this means that there is certainly some free-

¹⁰⁰ See S. Rousseau, "Canadian Corporate Governance Reform: In Search of Regulatory Role for Corporate Law" in J. Sarra, ed., *Corporate Governance in Global Capital Markets* (Vancouver: UBC Press, 2003) 16-21.

riding on the part of the nomads as screening has already been made by Canadian exchanges given that they take to AIM companies that have satisfied listing requirements that attest of their quality. With respect to monitoring, interlisted companies have already submitted themselves to arguably stringent corporate governance requirements in Canada.¹⁰¹ Getting listed on AIM does not exempt them from the corporate governance requirements they face as Canadian issuers. Stated differently, it is currently difficult to argue that Canadian companies seek listing on AIM to avoid stringent corporate governance requirements and benefit from a cost-effective substitute to those requirements with the nomad system.

(2) The nomad as a sponsor

The nomad has a sponsorship role on AIM that may contribute to enhance the visibility of companies and firm value. In general, companies are brought to the market by firms that act as both nomad and broker. This combination arguably gives clout to the broker where it markets the companies. Furthermore, since the nomad remains associated with the companies following admission on AIM, the brokers may have indirect incentives to act as a sponsor in the aftermarket. Indeed, it is important for the nomad's reputation to appear as bringing to the market companies that are "suitable" for AIM, *i.e.*, that are – and remain – successful. To attain this objective, brokers may devolve greater efforts promoting the securities to investors following companies' admission, for instance through their institutional and retail networks, and maintaining continuous analyst coverage.

(B) A critical look at the nominated advisor model

(1) Agency problems affecting nominated advisors

Nomads act on behalf of both issuers and exchange authorities. From an economic perspective, the relationship that exists between a nomad and issuers or the exchange authorities can be qualified as being one of agency. It is well known that the interaction between agents and their principals gives rise to potential agency problems.¹⁰² Those prob-

¹⁰¹ Besides, it is important to emphasize that venture issuers do benefit from certain exemptions related to the application of corporate governance requirements.

¹⁰² See the seminal work of M.C. Jensen & W.H. Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure" (1976) 3 *J. Fin. Econ.* 305.

lems result from differences in the goals of agents and those of their principals, and from the existence of information asymmetries between the two. Agency problems may lead to various adverse effects for issuers, exchange authorities and, ultimately, investors.

A first problem relates to the nomad – exchange authorities axis. Under the current model, issuers pay nomads to assess whether they are suitable for AIM. They are paid by companies subsequently to admission to act as their sherpa. Some question whether the practice of issuers paying the nomads for the suitability analysis creates a potential conflict of interests. Specifically, they argue that under such circumstances, the nomad may be tempted to be complacent when analyzing companies' suitability for AIM given that it derives revenues from this analysis, as well as from acting for the companies in the aftermarket. Further, a nomad will not want to be seen as being too harsh when judging suitability in order to attract future business. Recently, the LSE launched a review of the regulation of AIM that provides support for this concern. Indeed, it appears that the exchange "has begun quiet consultations with a number of AIM brokers after it became concerned that some Nomads were taking fees for bringing their client to market and then failing to supervise their subsequent activities."¹⁰³

Although this problem is fairly easy to state theoretically, it is more difficult to assess the extent to which it actually materializes into abuses in the market. Indeed, so far, AIM has not been rocked by scandals calling into question the role of the nomads. Still, the recent surge in the number of recognized nomads may render this problem more acute for reasons discussed below.

A second problem relates to the Nomad – company axis. Given that the nomads' activities depend on their recognition by exchange authorities, they may be conservative when assessing the suitability of applicants. Specifically, they may bar from entry companies that they judge too risky in order to protect themselves from liability or sanctions from exchange authorities. Thus, some companies may not be able to access AIM and benefit from its services. Admittedly, this risk should not be overstated given that there are now close to one hundred recog-

¹⁰³ E. Simpkins, "Brokers up in arms at LSE move on nomads" *Telegraph* (23 April 2006), online: <<http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2006/04/23/cnlse23.xml>>.

nized nomads which will have different tastes for risk. A related critique is that nomads may be fairly intrusive in the operations of companies in order to discharge their responsibilities, and protect themselves. Management may lose some of its discretion with respect to their companies' compliance with AIM rules.

To the extent that they exist, both problems have potential consequences for investors. The first will harm investors when the nomad infers the wrong signal with respect to the quality of AIM-listed securities. The second will affect investors by limiting their investment opportunities where the nomad prevents companies from entering the market.

(2) Legal and market-based constraints influencing the behaviour of the nominated advisors

As many have noted, the reputation of a nomad is its most valuable asset. Even if every nomad must be recognized by exchange authorities, the value of the services provided by a nomad depends essentially on its reputation for accuracy, independence, and integrity. If a nomad has a reputation for erratic or biased analysis, investors will discount the value of its suitability analysis. If investors doubt the accuracy or independence of the suitability analysis of a particular nomad, issuers will, in turn, avoid soliciting the services of the latter and seek a more credible nomad to signal their quality and suitability. Thus, a nomad with a poor reputation will not be in business very long.

Because of its value, the reputation built by nomads provides an economic incentive to behave diligently and ethically, even in the absence of regulation. To build and maintain their reputations, nomads should be expected to put a concerted effort into providing high quality services since the superior value of their analysis will not go unnoticed by market participants, who will be willing to pay for them. As far as worries over nomad independence, because the fees derived from a given company form a relatively small portion of their total revenues, nomads should not be willing to risk damaging their reputation to please a particular company.

Despite its role in shaping nomads' behaviour, reputation has some limits. It remains a noisy indicator in that it may not be easy for investors to discern the reputation of nomads. Investors are only privy to nomads'

efforts indirectly through the performance of the companies that they take to the market. Thus, investors may attribute the same reputational effect to companies that fail for different reasons such as fraud, bad luck, or inaccurate screening by the nomad. Further, information which could help investors assess the reputation and quality of nomads is not readily available. This could become problematic with the recent surge in the number of nomads.

In addition to reputation, there are two legal constraints which can act as a check on the nomad. The first is supervision by regulatory authorities. Currently, exchange authorities monitor the nomad on an ongoing basis. They conduct an annual review of the nomad's activities. Exchange authorities may also visit nomads during the year on a more informal basis.¹⁰⁴ Where the exchange considers that a nomad is in breach of its responsibilities or has failed to act with care and skill or has impaired the reputation and integrity of AIM, it may impose sanctions such as censure, removal from registration, and publication of the action taken. For instance, the LSE has recently launched an investigation into the activities of a number of nomads "that have been involved with companies suspected of misleading the market and causing investors to lose money."¹⁰⁵ As many have noted, the monitoring by exchange authorities arguably plays a disciplinary role that supplements reputational sanctions given that if the nomad loses its registration, it is automatically forced out of business. It appears that, in the past, at least one yearly review has led to three nomads being disciplined and one excluded from AIM.¹⁰⁶ Nonetheless, the results of the monitoring are unfortunately not transparent for investors as exchange authorities disclose little information on its consequences, including enforcement actions. The opacity of the oversight activities hampers the ability of investors to use this information to assess the reputation of the nomads. Besides, monitoring of nomads by exchange authorities is not costless. If the risk of abuses become too important, the net benefits of outsourcing could prove to be limited.

Second, the civil liability of the nomad may supplement reputational sanctions. From a contractual perspective, the nomad can be held

¹⁰⁴ Mallin & Ow-Yong, *supra*, n. 73.

¹⁰⁵ Simpkins, *supra*, n. 103.

¹⁰⁶ Mallin & Ow-Yong, *supra*, n. 73 at 231.

liable toward the investors who purchase the securities distributed by companies as part of their admission. Since companies rarely use the prospectus process to issue securities on AIM, the liability of the nomad would stem from the subscription agreement or "placing letter" used. However, the standard practice is for placing letters to contain disclaimers that purport to absolve the nomad and broker from any liability. More generally, it would be possible for investors to bring common law actions against the nomad based on misrepresentation or fraud. It appears that such actions are rare in the U.K. in the context of AIM. Specifically, even though there is class-action legislation in place, class actions are rare in the U.K. because the threshold for certification is quite high.¹⁰⁷ Overall, the liability of the nomads is merely theoretical and can not be seen as having a strong disciplinary effect on their behaviour.

(iii) *Should the Nomad System Be Implemented in the Canadian Market?*

In light of the preceding discussion, is the implementation of a nomad system in Canada an option that should be considered by Canadian exchanges in order to enhance their competitiveness? The benefits of a nomad system have been identified above. They include the potential improvement of the accessibility of Canadian markets for smaller issuers, as well as a reduction in compliance costs. While those benefits cannot be dismissed, they should not be overstated as emphasized previously. Further, some restraint is warranted when looking at the recent success of AIM with Canadian companies. More importantly, even admitting that the nomad system of AIM is beneficial in the U.K., it is far from certain that it would be the case in the Canadian context because of institutional differences.

A first concern residing with the implementation of a nomad system in Canada relates to the fact that this model would run across the grain of the approach followed by North American stock exchanges to regulate their markets. Stated differently, it may not be compatible with the goal of harmonization, which has been identified as important for the implementation effective securities regulation.¹⁰⁸ The goal of harmonization

¹⁰⁷ R. Brant *et al.*, "AIM: Gateway to European Capital Markets" *Lexpert* (January 2006).

¹⁰⁸ Five-Year Review Committee, *Final Report – Reviewing the Securities Act (Ontario)* (2003) 34.

is far from being merely theoretical as it underscores the importance for securities regulation to avoid creating impediments to companies making multijurisdictional offerings.¹⁰⁹ The implementation of a nomad system in Canada requires thinking about the consequences of setting up a model that is unknown in North America, both from regulators and investors. Would regulators continue to give the same treatment to companies listed on an exchange relying on such an alternative system?¹¹⁰ Would investors price the securities of companies listed on such an exchange similarly or would they require a discount?¹¹¹ Alternatively, would institutional investors pressure companies to implement protections considered to be standard in North America, despite the elimination of those protections from the exchange's rules?

Another source of concern is whether the nomad system would work effectively in the Canadian context. As underlined above, there are some pitfalls to be avoided for the nomad system to deliver its benefits. So far, the particularities of the U.K. legal and institutional setting have contributed to the success of the nomad system. In Canada, doubts can be expressed as to whether similar conditions would exist. Following the implementation of the nomad system, there would be very few Canadian market professionals with nomad experience or with a proven track-record. Thus, there would be a transitory period where reputation would not be very effective, either as a signal for investors or as a check on the new nomads. Although this difficulty could eventually be overcome, this period would be marked by uncertainty and could be disruptive for the smooth operations of capital markets.

A more vexing issue in the long run would be the impact of the liability risk on the viability of the nomad system in Canada. Canadian capital markets are probably marked by a higher risk of litigation than the U.K.'s. In this respect, the closeness with the U.S. and the presence

¹⁰⁹ *Ibid.*, at 43.

¹¹⁰ For instance, when the *Sarbanes-Oxley Act* was adopted in the U.S., it was argued that it was necessary for Canadian regulators to follow suit in order to ensure that Canadian companies continue to have access to capital outside the country. See, e.g., D. Brown, "Investor Confidence: A Critical Asset" Remarks at the Corporate Reporting Awards (2002).

¹¹¹ Research conducted by J. Board *et al.*, "Report on Rate of return for AIM v. Official List Stocks and TSX and AIM volumes in Canadian Stock," Task Force to Modernize Securities Legislation in Canada, 2006 (draft report) indicates that investors do not see AIM as inherently more risky than the official list.

of American institutional investors are probably relevant factors. Additionally, class actions are easier to launch in Canada than in the U.K., and, indeed, have started to appear more frequently. Thus, in Canada, nomads would be subject to a higher risk of liability for their assessment of the suitability of companies, and for their advice on compliance with ongoing obligations, especially continuous disclosure obligations. Greater liability threat would affect the interest of market participants to become nomads. It would also influence the nomads' assessment and monitoring of companies. Specifically, they could be more conservative in their suitability analysis and more demanding in their oversight functions. Alternatively, they could require greater remuneration and stronger indemnification protections from companies in order to offset the risk they incur, rendering thereby their services expensive.

It could be argued that investment dealers would nonetheless be willing to take on this risk to the extent that a nomad system would mark the return of relationship investment banking. In such a framework, investment bankers would have a better understanding of the issuers' business, and enable them to manage liability risk more effectively. However, it is far from certain that relationship investment banking is desirable in Canada. Recent empirical research shows that relationship banking already exists in that issuers typically maintain close relations with one investment bank.¹¹² It appears that issuers do so in order to avoid information leakage to their product-market competitors. Because of this concern, the ability of issuers to choose an underwriter is significantly constrained. Issuers cannot easily replace an existing bank with another, and competition remains thus limited. These findings have important implications when thinking about the nomad system. By leading to even stronger ties between issuers and investment banks, the nomad model is likely to reduce further the ability of issuers to substitute away from an existing relation. The result could then be less competition in the investment banking industry in Canada. This is certainly worrisome given the high level of concentration that already exists in this industry.¹¹³

¹¹² J. Asker & A. Ljungqvist, "Sharing Underwriters with Rivals: Implications for Competition in Investment Banking" (22 May 2006) online: <<http://ssrn.com/abstract=868677>>.

¹¹³ McKinsey & Co., *The Changing Landscape for Canadian Financial Services* (Ottawa: Task Force on the Future of the Canadian Financial Services, 1998) 34; Canada, Depart-

In particular, introducing a nomad system in Canada would further strengthen the power of investment banks by giving them an additional power derived from their regulatory role. At a general level, increasing further the market power of investment dealers is not desirable given that competition is a key ingredient of a dynamic and innovative capital market. More specifically, the low level of competition coupled with the regulatory power of investment bankers acting as nomads create a significant risk of regulatory capture.¹¹⁴ Indeed, capture of the regulatory process is more probable where concentration is high.¹¹⁵ If regulatory capture were to occur, the regulation outsourced to the nomads would become subservient to the needs of the Canadian investment banking industry, rather than responsive to the public interest. Without dismissing the possibility that the position of investment banks acting as nomads is contestable – and thus that they remain subject to competitive pressures – the prospect of new players remains elusive given that reputation constitutes an important barrier to entry.

Finally, it is important not to lose sight of the Canadian exchanges' competitive position at the international level. As seen previously, the TSX does attract listing from foreign companies. The attractiveness of the TSX stems from its current attributes: its reputation, its regulatory regime, and its trading system. Since all of these attributes are priced, foreign companies choose the TSX on the basis of its ability to enhance their value. The implementation of a nomad system would do away with the screening and monitoring functions of stock exchanges. Whether a nomad system would be a close substitute of those functions is debatable given the concerns highlighted above. Thus, investors will have more difficulty assessing the quality of issuers. Companies could face a higher cost of capital as they will have to compensate investors for the additional risk perceived. In this light, caution is warranted when thinking about replacing the current regime with a nomad system.

If a nomad system is not a suitable option for Canada, does this mean that the status quo is satisfactory? The critiques voiced toward the

ment of Finance, *Canada's Securities Industry* (2002), online: <http://www.fin.gc.ca/toce/2002/cansec_e.html>.

¹¹⁴ For a similar preoccupation, see C. Carpentier & J.M. Suret, "The Canadian and American Financial Systems: Competition and Regulation" (2003) 29 *Can. Pub. Pol.* 431.

¹¹⁵ G. Becker, "A Theory of Competition among Pressure Groups for Political Influence" (1983) 98 *Quart. J. Econ.* 371.

current regime suggest that there is room for improvement. Two avenues merit consideration. First, the exchanges should review their listing requirements in order to determine whether additional flexibility can be instilled in the admission process without jeopardizing its screening function.¹¹⁶ In parallel, they should seek to further coordinate their continuous disclosure requirements with those set forth by securities regulation. At present, issuers are faced with two disclosure standards. Under securities laws, they must disclose “material change”, whereas following National Policy 51-201 and the TSX and TSXV policies, they must disclose “material information”.¹¹⁷ These different standards create much confusion as many have noted.¹¹⁸ In light of the new civil liability regime for deficient timely disclosure, it seems apposite more than ever that legislators and regulators adopt a unified standard to circumscribe issuers’ obligations.¹¹⁹

Second, interest in the nomad system brings to the forefront the adequacy of the Canadian response to the *Sarbanes-Oxley Act*. Canadian regulators have crafted a response to the American reforms with a piecemeal approach, using a series of rules and instruments. Although regulators have attempted to enact requirements that are more tailored to the particularities of the Canadian market, the current regime continues to draw criticisms because of the costs it involves, especially for smaller issuers.

Accordingly, if the modification to the current model affects negatively investors’ appreciation of how the TSX discharges its functions, companies will face higher cost of capital as they will have to compensate investors for the additional risk they perceive. The higher cost of capital will render the exchange less attractive to companies – and thereby less competitive at the international level.

¹¹⁶ For a similar suggestion in the U.S., see J.R. Macey & M. O’Hara, “The Economics of Stock Exchange Listing Fees and Listing Requirements” (2002) 11 J. Fin. Intermediation 297, 307.

¹¹⁷ OSA, *supra*, n. 66, s. 75; National Policy 51-201, *Disclosure Standards*, s. 4.1, s. 4.2; TSX Company Manual, s. 408; TSXV Policy 3.3, *Timely Disclosure*.

¹¹⁸ Ontario, *Five Year Review Committee Final Report: Reviewing the Securities Act (Ontario)*, (Toronto: Queen’s Printer for Ontario, 2003) 142; *Interim Report of the Toronto Stock Exchange Committee on Corporate Disclosure, Toward Improved Disclosure* (1996) 19 O.S.C.B. 8, 77.

¹¹⁹ J.D. Fraiberg & R. Yalden, “*Kerr v. Danier Leather Inc.*: Disclosure, Deference and the Duty to Update Forward-Looking Information” (2006) 43 Can. Bus. L.J. 101, 112.

CONCLUSION

Stock exchanges are key market infrastructure entities. The existence of well-functioning stock exchanges is an important determinant of the competitiveness of Canadian capital markets. In this respect, the attractiveness of AIM is intriguing for policymakers interested in the competitiveness of Canadian securities markets.

This article first sought to gain a better understanding of AIM's success in attracting investors and issuers, including more recently a number of Canadian public companies. What emerges from the research is a complex picture where market- and legal-based factors play out to explain the attractiveness of AIM for Canadian companies. Amongst those factors, the particularities of the London market have significant weight. Still, the alternative regulatory regime of AIM facilitates the ability of Canadian companies to tap into this market.

Given the relevance of the regulatory dimension, this article also explored whether the AIM model is informative for the approach followed by Canadian stock exchanges. Specifically, this article examined whether AIM is doing something "right," and whether Canadian exchanges should be looking to AIM's features in order to remain competitive. If they are unable to discharge their core functions effectively, Canadian exchanges risk losing market share as they will be less attractive to companies.

This article finds two salient differences in the regulatory models used by AIM and Canadian exchanges. The first difference pertains to the choice made by AIM in favour of a principles-based approach to govern admission, in contrast with Canadian exchanges that use a rules-based approach. The second relates to the scope of ongoing obligations imposed on listed companies. Ongoing disclosure and corporate governance requirements are lighter on AIM than on Canadian exchanges. Overall, on AIM, it is the nomad who substitutes for more detailed listing requirements and more rigorous ongoing obligations. Without an effective nomad system, it is doubtful that AIM would be a viable market with such a regulatory environment.

From this perspective, any attempt at importing some elements of AIM's regulatory model in Canada must include the transplantation of the nomad system. In this respect, this article shows that implementing a nomad system in Canada could prove a complex and risky task. In

fact, it is highly debatable whether an effective nomad system could develop in Canada. For this reason, this article does not recommend that policymakers seek to transplant the nomad system, and related features, of the AIM model in Canada.