CFA Societies Canada

Canadian Advocacy Council

120 Adelaide Street West, Suite 2205
Toronto, ON M5H 1T1

+1 (416) 366 3658 tel
www.cfacanada.org

June 23, 2020

VIA EMAIL

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Me Philippe Lebel
Corporate Secretary and Executive Director, Legal Affairs
Autorité des marchés financiers
Place de la Cité, tour Cominar
2640, boulevard Laurier, bureau 400
Québec (Québec) G1V 5C1
consultation-en-cours@lautorite.qc.ca

The Secretary
Ontario Securities Commission
20 Queen Street West 22nd Floor
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

Dear Sirs/Mesdames:

Re: CSA Notice and Request for Comment Proposed National Instrument 45-110 *Start-up Crowdfunding Registration and Prospectus Exemptions* (the "Proposed Instrument")

The Canadian Advocacy Council of CFA Societies Canada[1] (the "CAC") appreciates the opportunity to provide the following comments on the Proposed Instrument.

---

[1] The CAC is an advocacy council for CFA Societies Canada, representing the 12 CFA Institute Member Societies across Canada and over 18,000 Canadian CFA charterholders. The council includes investment professionals across Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. Visit www.cfacanada.org to access the advocacy work of the CAC.

We understand that the Proposed Instrument is intended to harmonize the framework for crowdfunding by start-ups and early stage issuers. It will provide a prospectus exemption to non-reporting issuers to distribute eligible securities through an online portal, and a dealer exemption for those funding portals.

As a general comment, we are supportive of measures taken to try to assist small and emerging companies to finance growing operations while strongly emphasizing investor protection. We also agree with steps to harmonize registration and prospectus exemptions across jurisdictions for ease of use by issuers and investors. Before turning to our responses to the consultation questions included in the Proposed Instrument, we offer the following views on the importance of imposing proportionate due diligence and related obligations on funding portals to protect investors from fraud or other unfair or improper practices, and additional disclosure obligations on issuers and funding portals.

Obligations of Funding Portals

The Proposed Instrument does not appear to place any responsibility on funding portals to screen issuers before posting their offering documents online, beyond taking reasonable measures to confirm that the issuer's head office is in Canada. Other jurisdictions, such as Australia and the United States, place additional obligations on funding portals to reduce the risk of fraud, including:

- conducting background checks on the issuer and its principals (i.e., directors, officers, and control persons);
- reviewing the issuer's proposed offering document to confirm that it appears to contain the required information and presents that information in a clear manner; and
- refusing to post an offering document if the funding portal has a reasonable basis for believing the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection (e.g., as a result of deficient or unclear disclosure).[2]

We believe these steps are reasonable and should be required of funding portals under the Proposed Instrument. In respect of background checks, an issuer and its principals could be required to meet the same standards imposed on the portal and its principals under section 3(1)(r) of the Proposed Instrument (i.e., they cannot have been the subject of specified proceedings in the last 10 years, including claims related to fraud, theft, breach of trust, illegal distributions, or allegations of similar conduct).

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow. There are more than 175,000 CFA charterholders worldwide in 164 markets. CFA Institute has nine offices worldwide and there are 158 local member societies. For more information, visit www.cfainstitute.org.

[2] See 17 CFR § 227.301; ASIC, Regulatory Guide 262 *Crowd-sourced funding: Guide for intermediaries* (2018) at 33, 36-37.

Funding portals also should play a role in confirming issuers have measures in place to track and communicate with the holders of the securities these issuers would offer and sell through the portal. For example, a funding portal could be required to secure representations from the issuer that it possesses these capabilities (e.g., through engaging a transfer agent), as is the case in the United States.[3] Alternatively, funding portals could be required to assist issuers in providing registrar and transfer agent type functions to help issuers monitor and communicate with their security holders, particularly as it relates to social media communications.

Disclosure Obligations

Investors may not be cognizant of the fact that each additional financing by the issuer will dilute their investment, and thus the risk warning (or other similar warning prominently displayed by the portal) should specifically address the risk of dilution due to additional financings, whether through the portal or otherwise. Issuers should be required to notify investors (through the portal or otherwise) of any additional financings.

We also have concerns about the potential lack of disclosure on the financial condition of the issuer to investors. Under corporate or other applicable laws, an issuer's obligation to prepare and distribute annual financial statements after completing a crowdfunding offering will vary depending on its jurisdiction of incorporation and the type of securities it issues (e.g., equity vs. debt). We propose eliminating this potential source of confusion for investors by making the preparation of annual financial statements and their distribution to crowdfunding securityholders (or, at a minimum, their posting on the website of the funding portal and/or the issuer) an ongoing obligation of issuers that have completed a crowdfunding offering.

The fees payable by issuers to the portals will be required disclosure in the proposed offering document and included in the transaction confirmation sent by the issuer to the purchaser. We believe this information is important and should be prominent and in plain language in the disclosure documents and transaction confirmation.

General Comments

In an Issues Brief prepared by CFA Society Singapore entitled "Investment Geared Crowdfunding – Sourcing Equity and Debt Funding from the Crowd: Developing a Regulatory Framework" [4] the authors observed that investment-geared crowdfunding requires a comprehensive regulatory framework to develop its potential. Such a framework would include aspects such as transparency by issuers and platforms, due diligence and other safeguards for investors, and permitting only small and medium-sized enterprises to raise capital through crowdfunding. The brief includes a cross-jurisdictional study of crowdfunding frameworks, some of which include complaint and redress mechanisms.

---

[3] *Ibid,* 17 CFR § 227.301(b).
[4] "Issue Brief: Investment-Geared Crowdfunding - Sourcing Equity and Debt Funding from the Crowd: Developing a Regulatory Framework" (March 2014), online: CFA Society Singapore <www.cfasociety.org/singapore/Linked%20Files/issue-brief-crowdfunding.pdf>.

Over the longer term, if the exemptions are implemented the CSA may wish to study the size, capital structure, and business types of the issuers utilizing this prospectus exemption. Timely and effective enforcement will also be key to mitigating the risk of abuse and fraud.

Responses to Consultation Questions

We also wish to respond to the following specific consultation questions:

1. *We are considering repealing MI 45-108 because there has been no use of this regime. We also note that the adoption of the Instrument may reduce the need for market participants to rely on MI 45-108. Do you think MI 45-108 should be maintained? If so, please explain why.*

We do not believe it would be necessary to maintain MI 45-108 if the Proposed Instrument is adopted.

2. *We recognize the need to provide a balance in the Instrument between investor protection and streamlined, light-touch requirements for capital raising in the spirit of crowdfunding.*

The Instrument contemplates individual investment limits of $2,500 for each purchaser and $5,000 for each purchaser, if the purchaser has obtained advice from a registered dealer that such investment is suitable for the purchaser. We recognize there may be need for greater flexibility in capital raising and continue to consider whether to increase the individual investment limit to one or more of the following:

a. $5,000 for each purchaser;
b. $10,000 for each purchaser, if the purchaser has obtained advice from a registered dealer that such investment is suitable for the purchaser; and
c. a number in between those currently in the Instrument, and those mentioned above.

What would be an appropriate individual investment limit? Please explain and identify the investor protections you think support that amount.

We are of the view that the amounts that can be raised under the exemption per person are too low for the exemption to be a viable option for issuers when considering financing sources. The increased limits referenced above are still on the lower end, especially relative to the limits set by global counterparts. It would be helpful to be provided with more information with respect to why Canada's limits would need to be set at more conservative levels than elsewhere. For example, in Australia and the UK, our understanding is that the limits are higher—in Australia, A$10,000 per company every 12 months;[5] and in the UK, no limit provided the investor has obtained advice (otherwise, a

[5] ASIC, Regulatory Guide 262 *Crowd-sourced funding: Guide for intermediaries* (2018) at 6.

global limit of 10% of the purchaser's "net investable assets" applies to all exempt offerings the purchaser participates in over a 12-month period).[6] It also is our understanding that the exemptions appear to be working adequately and meeting the aims of the applicable regulatory projects.

> 3. *Additionally, the Instrument contemplates a limit on aggregate proceeds raised by the issuer group during the 12-month period of $1,000,000. We recognize there may be need for greater flexibility in capital raising and continue to consider whether to increase the offering limit to one of the following:*
>
> *a. $1,500,000; or*
> *b. a number in between $1,000,000 and $1,500,000.*
> *What would be an appropriate offering limit? Please explain and identify the investor protections you think support that amount.*

We are of the view that the amounts that can be raised under the exemption per person are still too low for the exemption to be a viable option for issuers when considering financing sources. As a general principle, the exemptions are not intended to guarantee performance, but rather to aid in capital formation. Like our comments with respect to individual investor limits, these aggregate annual offering limits are set conservatively, and may be weighted disproportionately on concerns of potential investor loss versus fostering capital formation and/or efficiency in the capital markets. They do not provide small/eligible issuers with an attractive amount and cost of capital to leverage the crowdfunding tool to raise capital. In order to set the appropriate limit, the CSA could continue to review the capital raised across various exemptions (and across industries), as well as the limits set by their global counterparts. For example, Australia permits issuers to raise up to A$5 million through crowdfunding over each 12-month period.[7]

We note that the offering limit and individual investor limits must work together. If the offering limit is set too high relative to the individual investor limits, an offering could result in an unworkable number of small investors and the costs of communicating with such investors could become untenable for an issuer.

> 4. *Under the Instrument, issuers, and in some jurisdictions, the directors and executives signing the offering document will be subject to statutory liability if the offering document provided to the investor contains a misrepresentation. The purpose of statutory liability is to make recovery of damages easier for investors in the event of a misrepresentation in the offering document. We have heard that some issuers view statutory liability as potentially increasing the regulatory burden of using the start-up crowdfunding prospectus exemption. We also recognize that claims of misrepresentation by a purchaser may be unlikely given the low investment limits under the Instrument. Overall, we think that any added regulatory burden is balanced against the additional capital raising opportunities provided by the Instrument.*

[6] FCA, *A review of the regulatory regime for crowdfunding and the promotion of non-readily realizable securities by other media* (2005) at 2-3, online:<www.fca.org.uk/publication/thematic-reviews/crowdfunding-review.pdf>.
[7] ASIC, Regulatory Guide 262 *Crowd-sourced funding: Guide for intermediaries* (2018) at 6.

120 Adelaide Street West, Suite 2205
Toronto, ON M5H 1T1
+1 (416) 366 3658 tel
www.cfacanada.org

Do you think that statutory liability for misrepresentation in the offering document will deter start-ups and early stage issuers from raising capital using the Instrument? Is any deterrent justified when it appears unlikely that claims for misrepresentations will be made?

We believe the statutory liability for misrepresentation in the offering document is fair to impose, assuming the terms of the prospectus exemption itself are economical for the investors and eligible issuers. If the exemptions are set up in such a way that issuers can successfully raise needed capital, we expect that issuers would be more willing to accept some potential increase in the regulatory burden (i.e. the cost of ensuring the offering document does not contain a misrepresentation).

5. *The definition of "eligible securities" is limited to:*

- *common shares,*
- *non-convertible preference shares,*
- *securities, such as warrants, subscription receipts and simple agreements for future equity (or SAFEs), convertible into common shares or nonconvertible preference shares,*
- *non-convertible debt securities linked to a fixed or floating interest rate, and*
- *units of a limited partnership.*

The definition of "eligible security" was intended to reflect the type of securities a start-up or early stage issuers would likely be selling and to ensure that the exemption was not used to sell more complex securities, such as asset-backed securities and structured products. Are there other types of securities that it would be appropriate to include in the definition of "eligible security" (e.g. trust units, co-operatives member shares or other)? If so, what other type of securities and why?

We believe the list of eligible securities should be kept to a minimum and agree that issuers should not be permitted to sell more complex securities using these crowdfunding exemptions.

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at cac@cfacanada.org on this or any other issue in future.

(Signed) *The Canadian Advocacy Council of*
CFA Societies Canada

The Canadian Advocacy Council of
CFA Societies Canada