Ontario Centres of Excellence

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February 11, 2013

Mr. John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor
Toronto, ON
M5H 3S8

Dear Mr. Stevenson:

Please find attached a submission on behalf of Ontario Centres of Excellence (OCE) with respect to the OSC Staff Consultation Paper 45-710, Considerations for New Capital Raising Prospectus Exemptions.

OCE appreciates the opportunity to participate in the consultation process.

Sincerely,

Thomas A. Corr

Dr. Tom Corr
President and CEO

enclosure

OSC Exempt Market Review

Ontario Centres of Excellence

Where Next Happens

OSC Staff Consultation Paper 45-710
Considerations for New Capital Raising Prospectus Exemptions

Submission by Ontario Centres of Excellence
February 12, 2013

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Introduction

Ontario Centres of Excellence appreciates the opportunity to participate in the consultation process, and we hope our comments are helpful with respect to future crowdfunding considerations.

Background

Ontario Centres of Excellence (OCE) drives the development of Ontario's economy by helping to create new jobs, products, services, technologies and businesses. In partnership with industry and academia, OCE co-invests to commercialize innovation that originates in the province's colleges, universities and research hospitals. Areas of focus are energy and environment (including water); advanced manufacturing; advanced health technologies; information, communications technologies and digital media; and social innovation.

Along with providing support for technologies and ideas with demonstrated commercial potential, OCE supports and invests in early-stage projects, where the probability of commercial success and potential total return on innovation are both substantial. This includes assistance and financial support to pre-incorporated and early-stage technology start-ups, providing young entrepreneurs with just enough capital to get an idea off the ground.

Ontario's Funding Gap

Through our mandate, OCE has gained a strong sense of the high numbers of young entrepreneurs seeking funding for new ideas and technologies. We receive well over 1,000 expressions of interest in our programs each year for various amounts of funding. Only about half of these qualify for our programs and are eligible for funding.

The funding gap for start-ups in Ontario and Canada is well documented. Venture capital investments have been steadily decreasing over the past decade and there are far too few angel investors to make up the difference or meet the need. Venture capital investments under $500,000 are rarely made and most funds prefer ventures that are able to support investments of $2 million or more. Angel investors are unlikely to consider investments under $50,000.

Ontario's Innovation Culture

This funding gap presents a significant challenge for the province's young entrepreneurs. And, as other jurisdictions including the U.S. move to legalize alternative funding avenues such as crowdfunding, Ontario risks seeing increasing numbers of its most promising agents of innovation relocating outside the province as a means of accessing the financing required to commercialize their ideas and develop businesses. The introduction of crowdfunding in Ontario would help retain companies in the province. In fact, the ideal scenario would be for all the Canadian provinces to come together to arrive at a national crowdfunding system so that an individual doesn't have to reside in Ontario in order to invest in an Ontario company. This would help give the initiative the scale it would need in Canada to be successful.

Recommendation

OCE recommends that Ontario take steps to make this avenue for investment possible to unsophisticated investors on a trial basis. As a general principle, there should be an attempt to minimize rules and regulatory requirements associated with 'crowdfunding' to encourage participation. Consumer protection is best achieved by imposing a limit on the amount an individual can invest and requiring basic disclosure with respect to identification of owners, regular financial statements and notices when there is a significant change in the product offering or what has been promised to investors.

It's important to recognize that while the introduction of crowdfunding can play a role in helping some entrepreneurs raise capital, it will not address the primary reasons that start-ups often fail. This has more to do with a lack of networks and relationships, the lack of experience and ability to properly define the customer need and a lack of business judgement. Ontario's success in building an innovation economy depends on ensuring start-ups get the advice and training they require to develop a competitive business.

RESPONSES TO CONSULTATION QUESTIONS

Would a crowdfunding exemption be useful for issuers, particularly SMEs, in raising capital?

This would provide an additional fundraising route for SMEs to raise capital, particularly those that are early stage and too early in their development to be of interest to angel investors, venture capitalists, or banks.

Have we recognized the potential benefits of this exemption for investors? What would motivate an investor to make an investment through crowdfunding?

Allowing individuals who wouldn't otherwise be eligible to invest in projects and young companies opens the window for more Ontarians to participate in the province's innovation culture. Many would no doubt be attracted by the prospect of participating in the development of a new product; being among the first to own an innovative product; or simply speculating on what they see to be a promising venture with some potential for a financial return.

Can investor protection concerns associated with crowdfunding be addressed and, if so, how?

Investor protection is a key concern that must be effectively addressed without undermining the intent of crowdfunding to widen the net of potential investors by relaxing investment regulations in some cases. Generally speaking, OCE recommends avoiding an overly bureaucratic and cumbersome approach that would deter participation. The most effective measure for limiting investor exposure would be to set a limit on the amount an individual can invest as a means of minimizing exposure to risk.

Another level of protection could involve holding investors' money in escrow until a minimum threshold of investment is achieved. This would enable investors to get their money back in cases where an investee is unable to raise a minimum base level of funds.

Disclosure is also an important component of consumer protection. This should include identifying information about the investees; a statement about what they plan to do with the investment and how they will execute their plans; specifics about what the investor will receive in return for the investment; and any significant events or development in the life of the company that would have a deterrent effect on investment.

It might also be worth considering a technical solution that would halt investments and allow for a cooling off period should a product or company generate an investment frenzy that leads some to make hasty investment decisions. This, too, could be managed through an escrow arrangement.

What measures, if any, would be the most effective at reducing the risk of potential abuse and fraud?

Again, it's important to arrive at an approach that reduces potential for abuse and fraud without creating a disincentive for investees to participate. This can be achieved partly by creating a system that is public and transparent. At minimum, individual investees should be required to provide identifying information (i.e., they are who they say they are) and other basic details about the project and ongoing developments.

There is also an argument for creating another level of accountability by building in the capacity to make public comments regarding the company and the project. However, this might result in an inordinate amount of time being spent by investees in rebutting comments and always carries the risk of abuse by competitors attempting to discredit a project.

If it is felt the Ontario Securities Commission should play a formal role in preventing abuse/fraud, it's recommended that their involvement take the form of a checklist (e.g., have you ever been sued) and a review of company documents related to ownership and a business plan. However, this should not become an onerous process requiring certified documents.

Are there concerns with retail investors making investments that are illiquid with very limited options for monetizing their investments?

Yes, there is potential for some investors to have unrealistic expectations related to crowdfunding investments. Setting a limit on the individual investment would help to address this. An investor could wait many years before seeing any kind of financial return. Crowdfunding investors must be prepared to be very patient in waiting for results and should, in fact, understand they may never see a return on their investment.

Are there concerns with SMEs that are not reporting issuers having a large number of security holders?

There should be transparency in this regard as working with a large number of security holders can be an impediment to decision-making. This can be a disincentive to some investors who conclude ownership is too diffused and vague. As a result, it can sometimes make difficult to attract follow-on funding. Companies that don't intend to give shareholders a voice should explicitly stipulate that all rights of decision-making rest with those appointed by management In many cases, however, crowd-funding has not taken the form of an equity investment.

If we determine that crowdfunding may be appropriate for our market, should we consider introducing it on a trial or limited basis? For example, should we consider introducing it for a particular industry sector, for a limited time period or through a specified portal?

Yes, it would be useful to introduce any crowdfunding approach on a trial basis to allow for review and modifications as issues become apparent. A trial period of approximately three years would allow sufficient time for the public to become aware of this investment exemption and for any significant problems to emerge. OCE would recommend against singling out a particular industry sector for crowdfunding as this would undoubtedly lead to individuals attempting to redefine and force fit their projects to qualify under a specific category.

Issuer Restrictions

Should there be a limit on the amount of capital that can be raised under this exemption? If so, what should the limit be?

Yes, there should a limit as a means of containing exposure to risk.

Should issuers be required to spend the proceeds raised in Canada?

No, a reciprocal approach would be preferred. An ideal approach would allow Ontario investees to accept investments from outside the province and the country and Ontario investors to invest outside of Ontario and Canada.

Investor Protecton Measures

Should there be limits on the amount that an investor can invest under this exemption? If so, what should the limits be?

Yes, in recognition that this approach would encourage participation from naïve investors there should be a limit, perhaps in the area of $5,000 to $10,000.

What information should be provided to investors at the time of sale as a condition of this exemption? Should that information be certified and by whom?

This should include a basic description of the investment opportunity; a list of existing shareholders and managers; and unaudited financials if the company is operating.

Should issuers that rely on this exemption be required to provide ongoing disclosure to investors? If so, what form should this disclosure take?

Yes, there should disclosure in the form of regular financial statements and an update of the project status relative to its promised milestones and deliverables.

Should the issuers be required to provide audited finanicial statements to investors at the time of the sale or on an ongoing basis? Is the proposed threshold of $500,000 for requiring audited financial statements (in the case of a non-reporting issuer) appropriate?

No, as it would be overly burdensome, time consuming and costly to require investees to provide audited financial statements and unnecessary given other measures that have been recommended here to limit exposure for investors.

Should rights and protections, such as anti-dilution protection, tag-along rights and pre-emptive rights, be provided to shareholders?

This should be done at the discretion of the investee.

Funding Portals and Other Registrants

Should we allow investments through a funding portal (similar to the funding portals contemplated by the crowdfunding exemption in the JOBS Act)? If so:

> **What obligation should a funding portal have?**
>
> **Should funding portals be exempt from certain registration requirements? If so, what requirements should they be exempted from?**

Yes, funding portals create a structure for interaction that would be useful for both investors and investees. However their role should be mininal and not require them to assume any liability or be the exclusive offerers of the crowdfunding service. Funding portals should exists soley for the purpose of facilitating transactions and be free of obligation or requirements. The portal should clearly disclose any financial relationships and/or interest in the investee organizations. The portal should also clearly disclose how it is paid by the investee or investor in the transaction. A funding portal could, however, play a role as the body that holds money in escrow if it is decided that investors should be able to get their money back when a minimum level of investment is not achieved. If funds are held in escrow, the portal should be subject to applicable supervision, similar to that provided by a legal firm (e.g., funds held for real estate transactions) or banking organization.

Should a registrant other than the funding portal be involved in this type of distribution? If so, what categoy of registrant? Should additional obligations be imposed on the registrant?

An investee who meets the legislated requirements of a crowdfunding program in obtaining funds from investors should have the option to proceed in raising funds without being required to place the offering on a funding portal. An investee should not be penalized for being able to arrange their own investor funding without going through a funding portal that would charge for its services.

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We would be pleased to address any questions or comments you may have regarding our submission. You may contact Dr. Tom Corr, President and CEO, Ontario Centres of Excellence at 416-861-1092.