National Crowdfunding Association of Canada
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March 7, 2013

Mr. John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8

Re: Response to OSC Staff Consultation Paper 45-710

Dear Mr. Stevenson,

Please find attached our response on behalf of the National Crowdfunding Association of Canada **(NCFA Canada)** with respect to the **OSC Staff Consultation Paper 45-710** '**Considerations for New Capital Raising Prospectus Exemptions'** released on December 14, 2012.

We applaud the Ontario Securities Commission **(OSC)** for leading this initiative and providing NCFA Canada and its members with the opportunity to participate in this highly important consultation process. As a grass roots association we are actively engaged with both social and investment crowdfunding stakeholders and communities across the country.

As a community-based and membership driven group, we are here to provide education, awareness, and advocacy on behalf of our members. We look forward to contributing further input into the planning, analysis, framework development and implementation stages of a prospective crowdfunding exemption in Ontario.

Please feel free to contact us at any time to discuss further.

Sincerely,

Craig Asano
Founder and Executive Director
NCFA Canada
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Enclosure

The National Crowdfunding Association

Education, Awareness and Advocacy

Fostering a dynamic, vibrant and inclusive Crowdfunding industry in Canada

OSC Staff Consultation Paper 45-710

NCFA Canada Board
March 7, 2013

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About NCFA Canada

- The National Crowdfunding Association of Canada (**NCFA Canada**) is a cross-Canada non-profit with a mandate to be inclusive in providing **education**, **awareness** and **advocacy** in the rapidly evolving crowdfunding industry.
- NCFA Canada is a community-based and membership-driven entity that was founded at a grass roots level to fill a national need in the marketplace.
- Members and prospective members are industry stakeholders (e.g., portals, experts, service providers and enablers), small businesses using crowdfunding to fund their initiatives and investors seeking to learn more and get connected with a relevant and national membership peer network.

Overview

The Importance of SMEs to the Canadian Economy

- Small to mid-sized enterprise businesses **(SMEs)** are the lifeblood of the Canadian economy. From the corner laundry mat to the emerging high tech software company there were a total of 1,138,761 SMEs in 2010 according to Industry Canada. By definition, SMEs include micro-enterprises (1-4 employees), small businesses (5-100) and medium sized businesses (101-500).
- In 2010, SMEs hired 48.3% of the entire workforce while 25% or a quarter of the Canadian population was self employed entrepreneurs. Stated differently, almost one in every two persons is directly affected and reliant on the SMEs for their livelihood. In 2009, SMEs represented 28% of Canada's total GDP and also accounted for $68 billion in exports, or 25% of Canada's total export value.[1]
- SMEs play a significant role as a feeder system. Successful smaller companies may grow, acquire other businesses or assets, and possibly become larger public companies.

SME's Funding Challenge

- There is a funding gap that exists for Canadian start-ups and SMEs to raise small amounts of capital (*i.e*., up to $1-2 million) that is not currently being satisfied by friends and family networks, angels, incubator/accelerator programs and venture capital **(VC)** groups.
- Traditional institutions and alternative lenders have strict lending requirements that most start-ups do not qualify for. Many small businesses cannot get a line of credit approved by their bank (or revive credit lines) due to poor sales or insufficient collateral to support their loan requests.
- Many small businesses are asked to front money to initiate a funding process or are advised to pay for expensive financial and legal planners to develop detailed business plans and prospectus documents that exceed the budget and viability of many start-ups and SMEs.
- Incubators and accelerators are excellent options, however there are only a limited number of placements available (*e.g*., most programs are operating at maximum capacity) and they generally focus on a niche industry.
- VC has been on the decline. In 2000, $5.9 billion was invested in 1,007 Canadian start-ups, according to Thomson Reuters, compared to just $1.1 billion in 2010 that was raised by 357 Canadian firms representing an alarming decreasing trend in a ten year period. VCs are incentivized to participate in larger funding transactions and the average deal sizes are mismatched with the needs of SME issuers.[2]

1 http://www.cbc.ca/news/business/smallbusiness/story/2011/10/04/f-smallbiz-by-the-numbers.html
2 http://www.theglobeandmail.com/report-on-business/streetwise/canadian-venture-capital-stuck-in-deep-rut/article616668/

What's at Stake?

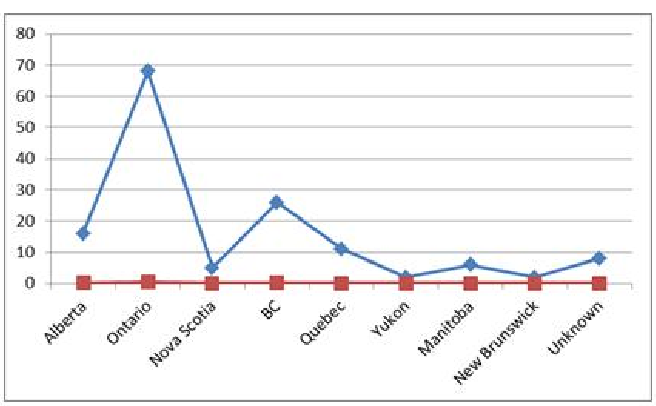
- Fundamentally there's a strong need to ensure SMEs have the proper access to capital to innovate and develop competitive products/services to bring to Canadian and global markets.
- Without a clear funding roadmap for small businesses or an efficient and legally viable capital formation process many valid business ideas will not get funded in Canada.
- Crowdfunding has gained a lot of momentum in North America and Europe. Equity crowdfunding is currently legally permitted in many countries, such as Australia, UK, Netherlands and the US will soon be added to the growing list with the passing of the Jumpstart Our Business Start-ups Act **(JOBS Act)**[3] last April 2012.
- Canada needs to review its securities laws to ensure they are current and suitably meet the needs of SME issuers and their ability to connect with prospective investors (funders) and successfully raise early stage capital from online market places.
- Otherwise, Canada risks losing its Canadian funded ideas and best entrepreneurs to countries with more supportive funding environments and access to capital (e.g., United States) that are keen to commercialize on Canadian start-up ventures.
- Canada will continue to slide down global innovation rankings and the economy will suffer as a result negatively impacting job creation and Canada's strategic social-economic advantages.[4]

National Crowdfunding Survey in Canada

NCFA Canada has partnered with the Exempt Market Dealers Association of Canada to develop and host the National Canadian Crowdfunding Survey in Canada (link to survey). The purpose of the survey was to obtain a better understanding of the various stakeholder opinions on legalizing equity Crowdfunding in Canada and to provide Canadian securities regulators with feedback on many of the issues the OSC and the CSA are seeking input to.

Overview of Survey Responders

We received a total of 144 survey responders from NCFA Canada's crowd:
- 100% of responders represented start-up and/or SME issuer views
- Almost 75% were a planned portal or service provider
- 70% / 25% identified themselves as non-accredited / accredited investors
- 12 self-identified as registrants including EMDs, investment dealers, or portfolio managers



Responders by Province

Alberta	16	11.1%
Ontario	68	47.2%
Nova Scotia	5	3.5%
BC	26	18.1%
Quebec	11	7.6%
Yukon	2	1.4%
Manitoba	6	4.2%
New Brunswick	2	1.4%
Unknown	8	5.6%
total	144	100.0%

3 http://en.wikipedia.org/wiki/Jumpstart_Our_Business_Startups_Act
4 http://www.ncfacanada.org/poor-innovation-ranking-dims-the-lights-on-canadas-competitiveness-and-prosperity/

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Selected Preliminary Survey Results

NCFA Canada is in the process of aggregating the survey data results into a research paper/report that will be prepared by newly joined NCFA Canada Advisory Board member, Douglas Cumming, Professor and Ontario Research Chair, York University – Schulich School of Business, and released shortly. Until then, based on the raw data responses, we can derive and share the following high level learnings:

Should we Adopt a Crowdfunding Exemption?
- 95.7% of responders voted that Canada should adopt a crowdfunding exemption under applicable securities laws
- 74.8% of survey participants were moderately to extremely familiar with crowdfunding.
- Overall, approximately 90% of survey responders agreed or strongly agreed that there would be significant benefits for both SME issuers and investors by adopting a crowdfunding exemption.

Investor Motivations to Make an Investment through Crowdfunding (Ranked in Order):
1. Innovation and entrepreneurism
2. Financial incentives
3. Non-financial incentives
4. Direct access to entrepreneurs
5. Diversification
6. Networking

Should Canada Move Ahead or Follow the SEC and FINRA?
- 60.6% of survey responders agreed or strongly agreed that Canada should move ahead and finalize crowdfunding rules and regulations (23.1% were undecided)

Pilot Project
- 73.7% of survey responders believed that Canada should approve a crowdfunding exemption on a trial or limited basis initially.
- 43.3% or the majority of survey responders answered that the trial should be based on a limited period of time.
- A very low 5.6% clearly indicated that a crowdfunding pilot project should not be restricted to a particular industry or sector.

Investor Limits and Restrictions
- 72.9% of the responders voted that the investment cap should be $10,000-$15,000 or more in a 12 month period.
- 64.2% of responders indicated that there should not be any further caps on the funds that can be invested with a single crowdfunding issuer within a 12 month period.

Issuer Limits
- 45% of responders voted that the aggregate amount of capital that an issuer should be able to raise in a 12 month period is up to $2,000,000.
- 45% of responders indicated that there should not be a limit.

Secondary Market
- 64.4% of survey responders believed that securities should be free-trading after a period of time
- 83.7% of survey respondents indicated that crowdfunding securities should be eligible for second market trading after 12-24 months of the original purchase.
- Note, by way of comparison and under the US Jobs Act there is a moratorium on transferring shares within one year from the date of issuance, unless the transfer is to an accredited investor or back to the company.

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Prospective Crowdfunding Exemption

NCFA Canada advocates that a crowdfunding exemption in Canada will increase the awareness of Canadian start-ups, support innovation and entrepreneurism, create jobs and contribute to the total GDP and export base of the economy.

Proposed Implementation Principles

To cultivate the benefits of investment crowdfunding frameworks, regulators must strike the right balance between protecting investors while ensuring efficient capital formation for SMEs. To assist with this task, NCFA Canada has developed eight (8) high level implementation principles to be used as guidelines when considering the costs and benefits of a prospective crowdfunding exemption in Canada.

Principle	Concept	Description
1. Harmonious	Collaborative development	The collaborative development of a harmonized set of crowdfunding regulations to benefit Canada as a whole.
2. Inclusive	All sectors and industries	To be as inclusive as possible to a broad-based range of sectors and industries to encourage balanced growth in communities across the country.
3. Transparent	Disclosure rules and crowd intelligence	Support transparent disclosure and crowd intelligence as a means to help government and industry prevent, identify and report potential fraud and abuse to authorities within a timely manner.
4. Adaptive	Innovative market adaptation	To ensure crowdfunding regulations support market evolution enabling innovation to flourish.
5. Robust	Efficient capital formation	A regulatory framework that gives SME issuers and investors (funders) the confidence that there is a robust framework in place capable of efficient capital formation, and one that is collectively supported by the eco-system.
6. Open	No jurisdictional restrictions	Enable a vehicle to allow businesses to accept investment (and funding) from other jurisdictions on a limited basis encouraging competiveness, collaboration and cross border participation.
7. Additive	New channels and source of funds	Ensure crowdfunding regulations are designed to open up largely a new source and channel of funds by minimizing the impact and overlap with existing exempt market exemptions.
8. Protective	Investment caps and reasonable due diligence	Protect investors by limiting investment exposure, promoting education, fraud detection and implementing a fair and reasonable amount of due diligence and compliance without overly burdening the process.

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NCFA Canada Responses to OSC Staff Consultation Paper 45-710: Questions and Answers

#	Question and Answer
	General Questions: OSC Staff Consultation questions sourced from page 28
1.	**Would a crowdfunding exemption be useful for issuers, particularly SMEs, in raising capital?**

Yes, a crowdfunding exemption would benefit the majority of SME issuers by substantially increasing the accessibility to early stage capital required to create, innovate and grow their businesses.

Below are some of the major benefits that have been widely documented:

a) Access to a New Source of Cost Effective Capital:

- A crowdfunding exemption would allow SME issuers to raise small contributions of funds from a much larger pool of prospective investors, the general public or 'unsophisticated investors', in a cost effective and efficient manner. The average equity crowdfunding period from launch to completion is 60-90 days (source: Massolution Industry study 2012; 8.2 weeks), as opposed to 6-9 months in the current process.
- Advancements in technology allow online documents to be safely and securely stored, and deal flow history to be easily tracked adding transparency to the process.
- Crowdfunding allows SME issuers that are located in rural areas to raise funds from general public investors that may be concentrated around more urban and populated centres. This allows funding to reach rural communities and other non-mainstream groups, and stimulates growth and entrepreneurship in unprecedented ways.
- We encourage a study that compares the cost, productivity and impact of investing funds in equity crowdfunding markets (e.g., the Australian Small Scale Offerings Board [ASSOB] as a benchmark) with the current funding channels currently available to Canadian SME issuers.

b) Feeder System:

- Crowdfunding markets are feeder systems for prospective VCs and institutional investors that prefer to invest in companies at a later stage who have a proven track record and scalable business model to offer their clients.
- Funding raised from crowdfunding markets will allow SMEs to strengthen their offerings and grow their businesses to a point where they then become attractive to prospective VC and institutional deal makers.
- Crowdfunding investors may be given the opportunity to exit their positions in the event of a significant VC deal.

c) Market Research and Product Validation:

- Crowdfunding markets would allow SME issuers to research and validate their product offerings and business models in a diverse public context, encouraging them to be more aware, competitive and ultimately create stronger business/product offerings.
- The feedback and research ('crowd intelligence') garnished from prospective investor comments and online support (e.g., like, follow) is invaluable to both entrepreneurs and prospective investors; it may drive entrepreneurs to pivot their offerings, and/or get VCs who are tracking early progress and traction, to sit up and take notice.
- Crowd intelligence combined with modern fraud detection algorithms, and defined processes, will also help to detect and reduce occurrences of fraud.

d) First Customer Traction:

- Pre-ordering models can be combined with equity crowdfunding frameworks that allow SME issuers to start collecting pre-orders before production of a product, service or solution has started.
- This will serve to bolster confidence for entrepreneurs and investors alike, and encourage both manufacturing and distribution planning activities.

e) The Power of the Crowd:

- Once committed, investors will contribute to the success of their investment. In addition to providing funding, crowd investors become avid supporters, marketing representatives and connectors that reach out to their private networks and make warm introductions on behalf of SME issuers.
- SME issuers will also benefit from social media marketing and the recognition inherent in the crowdfunding process.

f) Organizational Preparedness:

- SME issuers that undertake the arduous task of preparing, managing and executing a successful campaign in public crowdfunding markets will benefit from the organizational due diligence and relentless focus required to participate in such an offering.

2. Have we recognized the potential benefits of this exemption for investors?

Yes. A crowdfunding exemption would benefit investors in a number of ways as detailed below:

a) Participation:

- A crowdfunding exemption would give Ontarians the opportunity to participate in a much broader scope of exempt market investment opportunities including early stage start-ups that are currently restricted to accredited investors (only 4% of the Ontario public). Investors will be able to participate with very minimal investment requirements (e.g., $100).

b) Diversification:

- Investors will be able to diversify their portfolio, in a self-directed manner, and have much more control over their investment decisions at a local level. This allows investors to bypass the traditionally disconnect that commonly exists between the needs and preferences of large public companies versus small individual public investors.
- Investors will have the ability to choose an online crowdfunding portal that best suits their interests (e.g., industry or product niche) and appetite for financial risk versus return by spreading small amounts of capital across a number of preferred crowdfunding investments.

c) Standardization:

- Attributable to the advancements of technology, crowdfunding frameworks have the potential to standardize, professionalize and streamline communications and interactions between investors and SME issuers using tried and tested online tools, such as encrypted documents, digital signatures, webinars, online templates, collaborative information sharing forums, multi-media, group polling, analytical tracking, measurement, and advanced reporting.
- For example, crowdfunding would help streamline and formalize the often inefficient “Friends and Family” raise.

d) Local Businesses:

- Investors that choose to support local community businesses will potentially receive double or triple the returns on their investment (e.g., ROI + Social Impact Returns). The concept has been referred to as `locavesting`.
- Investing in local community businesses through crowdfunding will directly and/or indirectly impact the social and economic value of the geographic area that investors choose to support.
- Investors will also expand and strengthen their local area connections, some of which may result in long lasting 'win-win' relationships that are carried forward.

e) Engagement:

- Another major benefit for investors is the ability to connect directly with the project founders/creators and participate in the creative process by providing valuable feedback and research.
- For many unaccredited investors, this interaction and sense of community involvement with like-minded 'arm chair' investors and/or entrepreneurs is a source of positive engagement.

f) Confidence:

- By participating in crowdfunding investments, investors may be encouraged to launch their own entrepreneurial pursuits, which positively affects the 'big picture' by stimulating creativity, innovation, confidence and the economy. "Investors today, entrepreneurs tomorrow".

3. What would motivate an investor to make an investment through crowdfunding?

Investor motivations can be categorized into Market Motivators and Portal and Campaign Motivators.

A. Crowdfunding Market Motivators

Market motivators can be further broken down into financial and non-financial rewards. While non-financial rewards may be difficult to quantity, there has been a lot of research and traction indicating that they have a significant impact in motivating investors to make an investment through crowdfunding.

a) Financial Incentives

- **ROI:** Access to a wide range of investment options and the ability to participate in these investments on an ownership level in exchange for potential financial gain (loss).
- **Secondary Market:** given the potential illiquid nature of crowdfunding securities, the idea of having crowdfunding securities eligible for second market trading after 12-24 months after original purchase was highly supported by survey responders (87.3%)
- **TFSA and RRSP Eligible:** allow investors to participate in crowdfunding exemptions from qualifying TFSA and RRSP accounts. TFSA/RRSP sourced funds could represent a portion (e.g., 50%) of an investor's annual 12 month aggregate investor limit.

b) Non-Financial Rewards

- **Product:** Access to early stage innovative products that may never be available in traditional market channels.

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- **Innovation:** Ability to get as close as possible to innovative ideas and the entrepreneurs/owners behind them
- **Social Impact:** Some investors participate because they are interested in supporting a cause and affecting change in their lives and communities (*e.g.,* environment or affordable housing). Socially motivated investors often support a project because they want to contribute to the solution (not the problem). Crowdfunding could be the catalyst for mobilizing private capital for public good in magnitudes never seen before.
- **Empowerment (Range):** Crowdfunding empowers citizens to directly address issues that are meaningful to them that may become part of the solution to many of the problems facing Canadian society as a whole.

B. Crowdfunding Portal and Campaign Motivators

Below is a list of equity crowdfunding components that are likely to motivate investors to participate in a crowdfunding transaction on a specific portal or invest in a particular issuer (campaign):

a) Portal History:

- The cumulative transactional history of a portal, such as number of issues, success rate and ROI will be a key determinant in motivating new prospective investors to participate. Repeating history is not guaranteed and all investments come with varying levels of risk.
- Beyond the standard portal due diligence, investors must perform their own analysis to select good investments from the bad.

b) Issuer Management Experience:

- Leadership teams and board/advisory (as applicable) have demonstrated experience and the appropriate qualifications to execute the proposed business plans.

c) Signaling:

- SME issuers that provide clear intent to either go public or have a substantial portion of the shares acquired by a Venture Capital firm is a strong investor motivator. Market signals such as the participation of a large number of investors in a specific issue will influence investment trends.

d) Progress Monitoring:

- SME issuers that provide regular company updates and communications with prospective investors is a way to track progress and traction over time (e.g., compare forecast with history).

e) Background Checks:

- Criminal background and identify checks should be conducted for directors and management of SME issuers and portals.

f) Prototype or Existing Product/business:

- Having an existing business in place with a minimum viable product or prototype. This gives investors' confidence in management's ability to plan and execute.

g) Business plan:

- A clear representation of the business model and vision, such as use of proceeds, product/service offerings, production costs, revenue forecasts, risk disclosure (and mitigation).

h) Funding Strategy:

- A clear statement of funding plans including other planned sources of funding including debt (e.g., against company assets), future funding needs.

i) Amount of Equity Offered:

- SMEs that retain as much equity as possible is a positive indicator to prospective investors that they expect future cash flow from the business that they are launching or operating.
- Founders who own a substantial stake in the start-up can better align the interests of founders and funders. The higher the amount of equity on offer negatively impacts the number of investors attracted (source: signaling in equity crowdfunding)

j) Exit Strategy:

- A representation of how the issuer plans to return investment funds plus net proceeds back to investors so that they can realize a return on their investment.

k) Shareholder Voting:

- A clear statement of crowdfunding shareholder voting entitlements and/or restrictions. For example, what issues can the crowd vote on? Can investors assign a proxy? Are investors required to nominate a single trustee to act in the best interests of the crowd, and if so, are there any restrictions?

l) Share Transfer:

- A clear statement of the circumstances in which the investors can transfer/sell their shares

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

Below are a number of methods the OSC may wish to explore to address investor protection concerns:

a) Statutory Declarations:

- Statutory declarations are used in other forums including the insurance industry to protect against fraud. In some cases, the purpose of a declaration is to make it easier to convict or successfully bring a civil suit for perjury (lying under oath in a sworn statement) or misrepresentation as opposed to obtaining a judgment for criminal or civil fraud.
- In the crowdfunding context, management/directors/sponsors of SME issuers, portals and investors must not submit false or misleading representations (including representations via social media).

b) Statutory Civil Remedies:

- There must be clear statutory remedies for crowd investors including restitution of benefits and monies paid by investors as a result of wilful misrepresentations, fraud or, as above, lying under oath in a statutory declaration.[5]

c) Spot Audits:

- The OSC or an equivalent industry supported regulatory organization should be entitled to conduct a

[5] Similar to the *Insurance Act,* R.S.O. 1990, C I.8, s. 447(5).

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reasonable number of spot audits annually of portals and issuers with an obligation to report and address any suspicions of fraud to the appropriate authorities.

d) Education and Risk Acknowledgement from the Purchaser:

- Industry best practices and standards need to be developed and offered to all crowdfunding participants by way of online media including tutorials, videos, podcasts, articles and whitepapers.
- Industry associations and financial and academic institutions should offer industry recognized non-mandatory courses to those interested in pursuing crowdfunding education via course work.
- Portals should provide robust FAQs (how to's) and administer purchase risk acknowledgement forms in a clear and transparent manner.

e) Background Checks:

- Criminal background and identify checks should be conducted for directors and management of SME issuers and portals (if appropriate for the circumstance and not overly burdensome or expensive for participants).

f) Disclosure (at the time of purchase):

- Investors should have access to a reasonable amount of information pertaining to the investment allowing them to make a suitable decision to participate in the offering or not, without being overly burdensome to the process at hand.
- SME and Portal Directors should disclose personal information required to conduct a criminal background check

g) Non-Compete Clauses

- Whether by way of a shareholders' agreement or OSC rules, there should be restrictions or regulations on the company's founders, management and directors from competing in the same line of business during and for a reasonable time after their employment.
- Investors will lose faith and confidence in the process if management and founders abandon the company and compete with them.

h) Fraud Detection:

- Collectively, the eco-system needs to ensure that fraud is swiftly detected and the appropriate deterrents are in place.
- Industry should support a self-regulating environment that allows crowd intelligence to play a significant role in the fraud detection process using advanced algorithms and practices in research/beta today.
- A centralized shared database could be established to track and protect the interests of the entire industry from potential cases of fraud and abuse. All occurrences of fraud and potential red flags could be stored and cross referenced, protecting the reputation of regulators, portal operators, service providers and investors associated with crowdfunding industry.

i) Portal Duty and Obligation to Report Fraud:

- Portals should have a legal duty and obligation to report suspicions of fraud to the Ontario Securities Commissions or related governing body.
- Investors should have a statutory or rule based cause of action against portals where they knew or ought to have known of fraud or suspicious conduct that goes unreported.
- Investors and Portals should not be liable (civilly) (ex. for slander) for reporting suspicions of fraud to the OSC for further investigation.

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j) On-going Disclosure:

- Successfully funded SME issuers should provide shareholders with an annual snapshot of unaudited financial statements, and brief business update summarizing historical performance and future plans.
- Issuers should also be responsible for maintaining the company's basic share registry information once this information has been received from a facilitating portal or qualifying third party service provider.

k) Investment Limits:

- Limiting unsophisticated investors to an aggregate cap of $10,000 to $20,000 per 12 month calendar period is the simplest and most effective way to protect investors.
- 72.9% of survey responders reported that investor caps should be set above $10,000

l) Restriction of Credit Card Payments:

- While third party escrow and payment solution providers should be allowed to facilitate payment transactions, portals should be restricted from accepting direct credit card purchases.

m) Escrow Account and Disbursement of Funds:

- Funds should be held in a third party escrow account and only released if the full funding target is achieved (and minimal cooling off period surpassed) with a maximum of 25% subscription overrun allowed before the offering is closed.
- Portals wishing to provide escrow account services must meet the qualifications of a compliant escrow account services provider.

n) Withdrawal Right:

- A cooling off period that allows investors a two business day right of withdrawal from the date of their investment decision. Portals must ensure escrow payment services implement and administer these rules. Note: any gaming of the system to artificially inflate purchases needs to be monitored and addressed accordingly.
- Applicable withdrawal fees should be allowed (e.g., chargeable to the purchaser to cover expenses).

o) Effective Dispute Resolution:

- The process for certifying a class proceeding in Ontario is quite complex and expensive. Any dispute or individual claim arising from an investment would not be large enough to warrant independent legal action. However, a claim on behalf of all, or a group of investors may warrant legal action.
- The crowdfunding model would greatly benefit from a streamlined template (e.g., shareholders agreement) or legislation to the effect that all disputes be settled by way of private arbitration and expressly allow for investors to commence arbitration as a class.

p) Sponsorship Concept From Australia:

- The Australian sponsorship crowdfunding model was reviewed in a research paper that analyzes 'equity signals in crowdfunding' on a world leading equity crowdfunding portal called The Australian Small Scale Offerings Board **(ASSOB)**[6]
- The self-imposed sponsorship model requires that all SME issuers participating on the ASSOB platform must engage at least one sponsor or professional business advisor, such as an accountants, corporate advisor, business consultant, financial broker, or lawyer, prior to getting listed on the portal.

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[6] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2161587

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	▪ Sponsors assist entrepreneurs to prepare a set of online offering documents that follow a similar structure: 1) key investment highlights, 2) milestones achieved to date, 3) letter from the managing director, 4) business model, 5) market analysis, 6) financial projections, 7) purpose of the capital-raising, 8) offering details, 9) ownership structure, and 10) descriptions of the management team and external board members. ▪ Sponsors generally receive a mix of cash and 'sweat equity' for their services. They vet all companies seeking to get listed on the ASSOB portal, and give investors the confidence and information that they seek to make an effective investment decision.
5.	**What measures, if any, would be the most effective at reducing the risk of potential abuse and fraud?**
	(see Question #4 above)
6.	**Are there concerns with retail investors making investments that are illiquid with very limited options for monetizing their investments?**

	Yes, although with clear direction from the OSC and support from SME issuers and the eco-system, many of the expected and related issues can be reduced and/or managed.
	
	a) Education and Awareness
	▪ Investors need to be aware of the risks associated with investing in crowdfunding securities.
	    o Collectively, the industry, government, academia and relevant associations must come together to promote awareness in this regard and provide some forms of non-mandatory investor education.
	    o Portals should be encouraged to provide educational tutorials and robust FAQs.
	    o Investors must spend time to educate themselves (caveat emptor) and understand the risks involved prior to purchasing crowdfunding securities.
	
	b) Purchaser Risk Acknowledgement
	▪ Investors should be required to formally and explicitly acknowledge the high risk nature of the investment, limited liquidity and their ability to withstand the possibility of losing some or all of their investment.
	
	c) Investor Liquidity Plan
	▪ SME issuers that have a transparent and clear investor liquidity plan will benefit by providing a strong positive signal to prospective investors.
	▪ At a predetermined point in time or triggered by the achievement of a revenue/asset growth target, a company may express intent to payback investors in a number of ways, such as:
	    o Paying dividends
	    o Buying-back shares from organic revenues
	    o Buying-back shares from debt recapitalization
	    o Selling the company (*e.g.,* angels, VC, pooled funds)
	
	d) Share Transfer Options:
	▪ Under the US Jobs Act there is a moratorium on transferring shares within one year from the date of issuance, unless the transfer is to an accredited investor or back to the company.
	▪ Further issues that may need to be addressed include:

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- Can crowd investors take security on their shares or otherwise encumber their shares?
- Can the company buy back the shares, if so, on what terms and how will they be valued?
- Will secondary market trading be permitted? If so, what limitations will be placed on secondary market trading?

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

Yes, however there are possible solutions for the OSC to explore that could deal with this issue effectively.

a) Standardized Shareholder's Agreement

- While there will be exceptions, a standardized shareholder's agreement would streamline communications, reporting and decision making processes fundamental to the business.

b) Streamlined Communications and Voting

- SME issuers can use technology to inform, educate and distribute regular updates to crowdfunding shareholders rather than rely on expensive hard copy mail-outs. Companies that establish a regular line of communication with their shareholders will also benefit from their consistent feedback.
- Online polling/voting platforms can be used to facilitate key business decision making allowing issuers to fulfill their obligations to shareholders in an efficient and cost effective manner.

c) Limiting Crowd Investor's Rights

- **Trustee:** One option the OSC may wish to explore is having one individual be appointed to act as the trustee or proxy for all shareholders and their votes with crowd shareholders agreeing to the appointment of the trustee in advance of investing.
- **Non-Voting Class:** Another option may be to have crowd shares issued as a separate non-voting class.
- **Voting Rights:** There are certain management functions which investors, or a designated proxy representing a group of shareholders, should always be entitled to vote on at shareholder meetings including those set out in the Ontario *Business Corporations Act*. Other matters crowd investors should be entitled to vote on may include voluntary winding up and substantial changes to the nature of the business.
- **Other Considerations:** The OSC will have to address how or whether it will ensure shareholders do not encumber their shares, how to account for share transfers, and Family Law matters. For example, where an individual who owns shares is divorced or insolvent and his shares become the subject of divorce or insolvency proceedings. How or can the individual's shares be transferred to creditors or spouses?

8. 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 beneficial to conduct a pilot project to experiment with the best structure, regulations, rules and/or agreements to be entered.

The OSC may wish to consider the following **high level pilot project framework**:

- All issuers must be incorporated in Ontario or as a Canadian Federal corporation;
- The company's articles of incorporation and company by-laws should be tailored to OSC and legislative

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requirements to become an equity based crowdfunding company;

- The OSC should allow a limited number of portals to submit live exemptive relief applications, and based on their business models and specific features, allow them to operate under pilot conditions for a suitable trial period (e.g., 2 years).
- The trial period should be long enough to ensure sufficient time is budgeted to work through any implementation challenges and that pilot participants are given a fair chance to develop their respective operating models and recoup their pilot investments.
- Clearly defined pilot project goals and milestones should be defined, such that all parties understand their level of participation and risk/reward.
- In principle, effort should be made to allow a wide range of portal and service provider operators to participate in the pilot to best replicate the potential of the emerging industry.
- Investment caps should closely emulate the crowdfunding exemption rules being tested. SME issuers should be limited to raising between $1,500,000 and $2,000,000 in a 12 month calendar period. Investors should be limited to investing between $10,000 and $20,000 in a 12 month calendar period.
- A unanimous shareholders' agreement should be signed or electronically agreed to by all shareholders to address, *inter alia*:
    - i. Basic Financing Facts
    - ii. Share transfers;
    - iii. Basic Business Plan
    - iv. Basic Level Funding Plan
    - v. Voting Rights (if any)
    - vi. The Board of Directors (disclosure);
    - vii. Dispute Resolution;
    - viii. Representations and warranties;

Issuer Restrictions: OSC Staff Consultation questions sourced from page 31

9. 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, we feel that a suitable aggregate limit of capital that an SME issue should be allowed to raise under a crowdfunding exemption in any 12 month calendar period is between $1,500,000 and $2,000,000.

- From various conversations and extrapolated from our survey data results, we recognize that the funding gap exists for many types and sizes and businesses. Over time, it is possible to conceive crowdfunding as a source of capital for many types of issuers and not just those requiring small and limited amounts of capital.
- Some companies requiring more significant amounts of capital (*e.g.,* solar projects) may be deemed unsuitable investments by more conventional funding channels (*e.g.,* banks) yet the same company may be widely supported and considered an attractive option to a different type of investor.

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

No, this is too restrictive and may deter issuers from raising funds via a crowdfunding exemption in Canada. Provinces should work to harmonize crowdfunding exemption rules across the country.

- Ideally, Ontario SME issuers should be able to raise funds from qualifying Canadian and international investors. Issuers should be able to spend proceeds in an unrestricted way as per their operating business

	framework requires to remain domestically and globally competitive.
Investor Protection Measures: OSC Staff Consultation questions sourced from page 31	
11	**Should there be limits on the amount that an investor can invest under this exemption? If so, what should the limit be?**
	Yes, we feel that a suitable aggregate limit that investors should be allowed to invest under a crowdfunding exemption in any 12 month period is between $10,000 and $20,000. ▪ Investors that qualify under other exemptions that allow them to participate in investments at a higher or uncapped manner (*e.g.,* accredited investor) , should be able to
12	**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?**
	The following key information should be disclosed to an investor at the time of purchase including: ▪ Basic crowdfunding security facts about purchasing the issue and the rights and restrictions associated with the purchase. ▪ High level business plan information including use of proceeds, future funding plan and unaudited statements (managed approved), if available. ▪ Basic personal disclosure about SME issuers' directors and leadership team (to perform basic due diligence)
13	**Should issuers that rely on this exemption be required to provide ongoing disclosure to investors? If so, what form should this disclosure take?**
	Yes. 92.2% of survey participants agreed that issuers should provide a degree of on-going disclosure to investors after a crowdfunding offering is completed. **a) Unaudited Statements and Annual Updates:** ▪ Successfully funded SME issuers should provide shareholders with an annual snapshot of unaudited financial statements, and brief business update summarizing historical performance and future plans. **b) Basic Share Registry Availability:** ▪ Issuers should also be responsible for maintaining the company's basic share registry information once this information has been received from a facilitating portal or third party service provider.
14	**Should the issuer be required to provide audited financial 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, this is too expensive and onerous for start-ups and SME issuers. ▪ As an alternative to overly expensive audited financial statements, the OSC may wish to explore requiring SME issuers that have been operating for more than 3 years that also seek to raise in excess of $500,000 via

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	crowdfunding markets to have their financial statements 'reviewed' by a qualifying sponsor (or equivalent). ▪ For example, accounting firms offer less expensive 'review engagement reports' that involve a level of review and 'notice to reader' that ensure the financial statements comply with standard accounting principles allowing third parties to review and interpret the statements independent of a full audit. ▪ The financial industry and crowdfunding service providers should develop affordable products that meet the needs of crowdfunding SME issuers and the basic disclosure and reporting requirements that may be expected of them by prospective investors and regulating organizations.
15	**Should rights and protections, such as anti-dilution protection, tag-along rights and pre-emptive rights, be provided to shareholders?**
	These rights and protections should applied at the discretion of the issuer, which may be used to differentiate their offering in the market place while considering the additional costs to administer.
Funding Portals and other registrants: OSC Staff Consultation questions sourced from page 31	
16	**Should we allow investments through a funding portal (similar to the funding portals contemplated by the crowdfunding exemption in the JOBS Act)? If so:**
	Yes.
	a. What obligations should a funding portal have?
	A number of portal obligations should be considered, however alternative approaches should be taken where portal obligations become excessively onerous to the participation and compliance process. **a) Basic Disclosure:** ▪ Portals must declare their fees and how they get paid. They should also declare who the management team, board members and advisors are in the company. ▪ Portals should be required to provide basic aggregate historical funding information, such as total funding volume by industry, on a regular basis and at a minimum to the OSC. **b) Basic Fraud and Due Diligence:** ▪ Portals should take reasonable measures to prevent and report fraud. ▪ Portals should take reasonable measures to provide investor education and facilitate risk acknowledgement from the purchaser. ▪ Portals should perform reasonable due diligence of all crowdfunding issuers allowed to transact on their portal including rudimentary background checks of directors, founders and the leadership team. **c) Compliance:** ▪ Portals must ensure compliance with investor limits and issuer caps for all historical transactions that occur on its own portal. ▪ Portals should not advertise, provide investment advice, solicit or directly or indirectly negotiate the sale of a security without being subject to crowdfunding exemption specific dealer or advisor registration requirements. ▪ Portals should be allowed to provide escrow account services if they meet and maintain the qualifications of a compliant escrow account services provider. They should also be able to outside payment facilitation

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services to a qualifying third party solution provider.

b. Should funding portals be exempt from certain registration requirements? If so, what requirements should they be exempted from?

Yes, crowdfunding portals are not Exempt Market Dealers **(EMDs)** and thus should not be subject to the same requirements of an EMD (*e.g.,* regulatory capital requirement).

In principle, with the issuer caps and investor limits being proposed as part of the crowdfunding exemption, portals should be exempt from registration requirements that would be considered overly burdensome or too expensive to the detriment of the portals business operating capacity. For example, the regulatory capital requirements imposed on registered EMDs may be too restrictive for prospective crowdfunding portals depending on their business model.

Below are some examples of EMD registration requirements and how they may be applied in the context of a crowdfunding exemption:

- **Full KYC:** crowdfunding portals should be subject to full KYC requirements, which is a similar procedure to opening a bank account. Portals should know the authentic identity of all SME issuers.
- **Limited KYP:** portals should be required to perform basic due diligence and anti-fraud checks but ultimately perform less KYP than what is required by an EMD.
- **No Suitability:** crowdfunding portals should not be required to determine if an investment is suitable for an investor or not (*e.g.,* the investor is over 70 years old and thus may not be suitable to a high risk investment).
- **Regulatory Capital:** requiring portals to have a minimum operating capital of $50,000 seems overly burdensome to a portal that is targeting to help small businesses in an economically disadvantaged area with an average deal size of less than $100,000 and nominal transaction fee of 3%.

Tiered Categories:

- It is anticipated that a wide range of crowdfunding portals and service providers will exist, each with their own unique value proposition, and thus 'one size of registration requirements does not fit all'.
- The OSC should explore creating tiered registration requirements that best match the business model of the crowdfunding portal. An in-depth review should be conducted to identify how portals are likely to differentiate themselves in the market place, which may include an analysis of the following:
    - Operator type:
        - Crowdfunding Portal (*i.e.,* equity, lending, donation, reward, royalty-based)
        - Service provider (*i.e.,* third party due diligence provider, payment facilitation)
        - Crowdfunding search engine aggregator
        - Connector or enabler (*i.e.,* affiliate marketer or crowd builder of new subscriber emails)
        - White label portal software provider employing a commission model
        - Individual company (i.*e.,* SME issuers own 'portal' or wordpress plug-in)
        - Investment group(s) with separate pools of capital (*e.g.,* angels)
    - Industry or market focus (i.*e.,* general purpose, niche, cause, social impact)
    - The types of SME issuers that the portal will likely attract (*i.e.,* transaction volume, average deal size, projected success rate)
    - Operator services and/or transactions being offered to SME issuers, investors, prospects and

	facilitators (e.g., engagement pre/during/post issue o Operators financial model (*e.g.,* ability to operate a profitable and scalable business) o Degree of online versus offline activities ▪ A tiered approach would allow flexibility for adding or altering new categories to address new business models as the industry evolves and innovates.
17	**Should a registrant other than the funding portal be involved in this type of distribution? If so, what category of registrant? Should additional obligations be imposed on the registrant?**
	No other registrant should be involved. A funding portal should be able to complete a distribution without a registrant. ▪ If a funding portal has an investor that qualifies under another exemption (*e.g.,* accredited investor), they should be able to refer that investor to a registrant and be able to earn a referral fee in connection with the referral.