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John Stevenson  
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**Re: OSC Staff Consultation Paper 45-710 – Considerations for New Capital Raising Prospectus Exemptions**

Thank you for your invitation to comment on the comprehensive and thoughtful paper “Considerations for New Capital Raising Prospectus Exemptions”. Thanks also for attending and participating in the many crowdfunding events, held over the past number of months. Having the opportunity to engage directly with your staff has been both helpful and informative.

Our organization is HiveWire Inc. – a Canadian crowdfunding provider working with organizations to implement crowdfunding and crowdsourcing solutions. We are a young company (less than two years old) with a core team of five members. We have partnered with the Centre for Social Innovation to deploy a rewards based crowdfunding platform to support social innovation ([www.csiCatalyst.org](http://www.csiCatalyst.org)) that launches on March 20, 2013. At present, we are working with organizations and individuals that have a keen interest in unlocking the power of the crowd to support their businesses. Prior to launching HiveWire Inc., we conducted a comprehensive global review of this nascent industry and have added to this background research with the development of a proprietary dataset of tens of thousands of cross-platform crowdfunding campaigns.

**Crowdfunding: A New System**

The large increase in crowdfunding globally demonstrates that this industry is not simply a flash in the pan, but rather a systemic shift. Crowdfunding is more than a process suited to allowing capital to flow to areas of our economy that are not attractive to the traditional providers of capital. Importantly crowdfunding has stepped in to fill several market needs, from microfinance and community development, to supporting long shot innovation initiatives by researchers, students, and everyday citizens. While crowdfunding is commonly thought of as a process to facilitate capital flows through the Internet, it also clearly raises issues of economic inclusiveness and the cost of capital.

It is important to note that when the public invests in crowdfunding, it is seeking and receiving many different types of returns. This is in stark contrast to the returns that are demanded by



capital markets and sophisticated investors, where the return must be well above that of the risk-free rate. There are multiple specific examples, from Kiva to Kickstarter, where the capital provided to the projects would simply not be found in other places. As such, when developing a regulatory framework we encourage you to consider the additional social benefits that serve public interests. These social benefits range from community engagement and participation to local economic activity far below the interest of the traditional providers of capital.

Crowdfunding has been seen the world over to fill a gap that the traditional providers of capital have left vacant. This funding gap is obvious when examining the funding landscape, with Banks requiring securitization before loaning to individuals with little to no track record, Angels looking for specific opportunities (e.g. mobile apps and telecommunication), and Venture Capitalists seeking 10x returns. Such a gap is particularly relevant in the Ontario context where we face a stagnating economy, decreasing manufacturing output, and an urgent and pressing need for global competitiveness. By providing funding to those parts of our economy that have traditionally been omitted, crowdfunding is directly supporting those that want to be productive, yet have been constrained by access to capital. The need for innovation and economic output within Ontario is a real and pressing issue, and as such our regulatory environment must be structured in a way that maximizes the opportunities available to all Ontarians for capital formation. In summary, crowdfunding for Ontario contains within it the possibility for increased global economic competitiveness.

This comment will focus on the following topics:

- Ontario's Participation in Crowdfunding
- Diversity and Access to Funding
- Investment Limits
- Fraud and Investor Protection
- Specific Feedback

### **Ontario's Participation in Crowdfunding**

Ontario has a clear choice as to whether or not it will allow its citizens to engage with this emerging tool, either in proportion to emerging global standards or with significant restrictions. Our view is that if the restrictions placed on crowdfunding prohibit significant participation by Ontarians in debt and equity based crowdfunding, then we will simply be denying them an opportunity to enhance our society. This opportunity lies in allowing Ontarians to directly support innovations coming out of research universities, SMEs, and local organizations, by providing the incentive to earn real returns (in addition to the non-standard returns discussed previously).

Recently Bloomberg Businessweek reported that New York-based Prodigy Network (know for marketing the Trump SoHo Hotel Condominium) is soliciting thousands of investors to purchase



a slice of a skyscraper in exchange for a share of rent and property appreciation<sup>1</sup>. Prodigy has a building under contract for purchase in downtown Manhattan for \$58 million, and is raising \$26 million of that total in equity from individual investors in over 11 countries. Importantly, these investors exclude Americans due to U.S. securities laws that are of course similar to our own. If Ontario does not allow ordinary investors to participate, we may certainly still feel the effects of crowdfunding on our local market, as companies aggregate funds in other markets (as a form of regulatory arbitrage) and invest here.

Without having regulations in place that will allow Ontarians to participate, our local markets will be impacted through an influx of foreign capital. These global capital flows are increasing, and as the Internet reduces the friction inherent in transferring capital, we'll see smaller and smaller investors being able to participate in the aggregation of capital.

### **Diversity and Access to Funding**

To allow crowdfunding, in all of its forms, is to allow fair and efficient access to capital. In many respects, crowdfunding provides the most efficient access to capital, allowing for successful funding raises to take place in extremely short time frames (e.g. 30 days). We know that having limited access to capital based on gender, race, or (dis)ability is neither fair nor efficient, yet there are clear indications of inequality in our system that directly impact many Ontarians. The Kauffman foundation has presented research that only 4-9% of all VC funding goes to women owned businesses<sup>2</sup>, and closer to home on March 7th the Bank of Montreal released a poll titled "One-Third of Women interested in Becoming Business Owners Within the Next Decade". This poll is noteworthy in that it uncovered information that is immediately relevant to the OSC's consideration of crowdfunding. Specifically the poll identified that *"42 per cent of potential women entrepreneurs believe access to capital would be the largest challenge if they were to start their own business"* and when examining Ontario specifically, this number climbs to 50%<sup>3</sup>.

Crowdfunding holds enormous potential to allow women entrepreneurs access to capital by allowing them to monetize their social networks. Our own proprietary research and dataset shows us that at least 28% of crowdfunding projects are created by women, demonstrating that women are embracing this new tool.

Lastly, if women are having difficulty accessing capital, one can easily imagine that the situation for visible minorities and those with disabilities is similar if not more dire. Crowdfunding, due to its meritocratic nature of capital allocation, holds the chance to alleviate some of these issues (related to inclusion) that face our capital markets.

### **Investment Limits**

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<sup>1</sup> Source: <http://www.businessweek.com/articles/2013-01-24/crowdfunding-for-real-estate-buy-a-slice-of-a-skyscraper>

<sup>2</sup> Source: <http://www.forbes.com/sites/lesliebradshaw/2012/01/10/how-women-are-getting-left-out-of-the-venture-capital-game/>

<sup>3</sup> Source: <http://newsroom.bmo.com/press-releases/bmo-poll-one-third-of-women-interested-in-becomin-tsx-bmo-201303070858380001>



The impact of specific investment limits for individual investors utilizing crowdfunding will hold a significant impact for the potential for SME's to raise capital with this tool. Consider for a moment that the average rewards based crowdfunding raise is approximately \$4,000 versus the average investment-based campaign being \$112,000<sup>4</sup>. Individual investment limits of no more than \$2,500 per project, and an annual limit of \$10,000, is too restrictive for campaigns while simultaneously limiting the potential gain for investors. This limit is also in contrast to demonstrated successful crowdfunding raises, that have successfully pooled investor funds in significantly larger increments<sup>5</sup>.

Furthermore, it is not at all clear why a limit on offerings of \$1.5 million is being considered. If a company holds significant potential and gains market validation through consumer engagement and investment, then why limit the raise? Had the Pebble Watch<sup>6</sup> conducted an equity raise under this sort of framework it could have ran up against the limit on offerings within the first 6 days of its 38 day raise, precluding it from raising an additional \$8.7 million.

### **Fraud and Investor Protection**

Fraud in any area of the financial system should not be tolerated, and crowdfunding is no different. Rather, room should be made for the crowd to observe, detect, and report fraud as it occurs. There is already a clear example of how the crowd can play a role, as with the role-playing video game fraud case that was caught by the crowd on the Kickstarter platform<sup>7</sup>. If the regulator provides a clear mechanism for the public to report fraud, then concerns about this issue can be reduced and mitigated. What is required is for crowdfunding platforms to provide feedback mechanisms and discussion areas for projects, as well as a monitoring protocol for projects that are submitted.

The larger issue facing consumers is education surrounding the failure risk inherent with any new business venture. The crowdfunding industry must play a strong part in educating consumers, letting them know the risk to their capital. While this is less important with regard to donation-based crowdfunding, it plays a significant and important role in equity-based crowdfunding. Fortunately, there are many web-based tools that can be employed to mitigate this risk, educate the consumer, and maintain an auditable record that can demonstrate that an investor was both informed of the risk and consented to bearing that risk. These tools include duration based page-timing, online testing, cooling off periods (as included in the review), and double opt-in consent provisions (via email etc.).

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<sup>4</sup> Source: <http://www.thecrowdcafe.com/investment-crowdfunding-average-transaction-size/>

<sup>5</sup> See example above: New York-based Prodigy Network

<sup>6</sup> Source: <http://www.kickstarter.com/projects/597507018/pebble-e-paper-watch-for-iphone-and-android>

<sup>7</sup> Source: <http://www.bbc.co.uk/news/technology-17915305>



## Specific Feedback

Please find below feedback to specific consultation questions.

**Question:** *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?*

- Any restriction on introducing crowdfunding within Ontario will stifle the market and not act to provide sufficient access to capital.
- Crowdfunding is an accepted economic activity within several major markets globally, and therefore has already been trialed.
- A restriction based on industry does not further address the twin needs of providing access to capital for SMEs or protecting investors.
- Restricting crowdfunding to a specific portal would limit consumer choice, alter market pricing, and is outside of the philosophy of both market competition and crowdfunding.

**Question: Issuer restrictions** – *Should there be a limit on the amount of capital that can be raised under this exemption? If so, what should that limit be?*

- We do not believe that a limit should be placed on the amount of capital raised. It is our view that the market will decide the appropriate amount of capital an opportunity merits.
- We do not feel that a limit will further protect individual investors.

**Question: Issuer restrictions** – *Should issuers be required to spend the proceeds raised in Canada?*

- Issuers should not be required to spend the proceeds raised in Canada. We believe that it is important to allow Canadian businesses, regardless of size, to be able to take advantage of international opportunities for expansion and investment.
- There are no restrictions on how corporations may spend money raised from capital markets, so it is unclear to us why funds raised through crowdfunding should merit additional restrictions.

**Question: Investor protection measures** – *Should there be limits on the amount that an investor can invest under this exemption? If so, what should the limits be?*

- We believe that the Ontario public deserves more leeway to make financial choices with regards to crowdfunding, and we do not agree with individual investment limits.
- If investment limits must be considered, it is more reasonable to index those limits to income.
- We feel strongly that a total investment limit of \$10,000 is far too restrictive.



- It must be considered by the regulator that Ontarians do not have restrictions placed on their capital allocation decisions with respect to gambling. Therefore it does not follow that they should have limits placed on them with respect to investing via crowdfunding.

**Question: - 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 obligations should a funding portal have?*

- Funding portals should be required to conduct a minimum level of due diligence on investment opportunities.
- Regular reporting to the OSC should be required.

## **Conclusion**

Thank you for your time and attention. We appreciate this opportunity to provide our input.

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Asier Ania

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