



## THE KEMBALL GROUP

Achieve More. Keep More.

March 7<sup>th</sup> 2013

John Stevenson

Secretary

Ontario Securities Commission

20 Queen Street West

19<sup>th</sup> Floor Box 55

Toronto, Ontario M5H 3S8

RE: OSC Exempt Market Staff Consultation Paper 45-710: Prospectus Exemption Based on Investment Knowledge (6.2). and (6.3)

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Dear Mr. Stevenson:

The Kemball Group's comments below are in addition to our response previously emailed to you dated February 11, 2013.

The Kemball Group fully supports both the concept and premise as stated in The Consultation Paper. When coupled with a plain language acknowledgement of the risks involved signed by the purchaser, the administrative concerns raised in The Consultation Paper are avoided whilst investors are clearly made aware that they are trading where many an angel fears to.

The Consultation paper sets out a far better approach than the current one, but then proceeds down a wrong path. The means set out in 6.2 and some items in Appendix B will actually exacerbate the problem of providing capital from "sophisticated" minds and hands to high potential entrepreneurs. In our view the current accredited investor approach fails to pass any test of logic applicable to the issuance of securities by early stage high potential firms. This undermines the credibility of securities legislation and creates incentives to ignore it or evade it.





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Based upon the overall tenor of The Consultation paper we believe the OSC could easily devise an administratively simple and enforceable knowledge based exemption without abandoning its investor protection mandate and eschew illogical rules that impeded those willing to supply capital to early stage firms. We hope our whole hearted support at the concept level is reflected in the following responses and our Attachment comments.

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### Consultation Questions

#### General

- An exemption based upon investor knowledge and coupled with a warning focused risk acknowledgement form and process would be of substantial value to issuers if the OSC kept a data base of such transactions and or of investors seeking a blanket exemption for early stage investing.
- Given the trepidation most investors have concerning the prospect of a loss of capital, clear simple warnings would provide adequate protection. Enforcement would be simple if the issuer were required to have OSC or other third party confirmation of investor accreditation. Having the signed form in their possession before the funds could be released for use by the issuer would be feasible and should form part of the corporate minute book and shareholder register in any event.

#### Specific Terms

- No relevant work experience exists. Those in the securities industry, save venture capitalists focused on early stage firms, do not glean it in their day to day work life.
- The only “educational” qualification we are aware of is attendance at seminars offered by The National Angel Capital Organization and The Angel Capital Association. Active participation in an angel group provides the apprentice angel opportunities to learn from others as they review and invest in opportunities.
- Work experience criteria – a null set see above





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- No educational qualifications of the type proposed exist. Neither MBA, nor CFA or any degree or professional qualification we are aware sufficiently arms its holders. In fact those with such qualifications are more likely to do harm than good.
- See second bullet in list above for “proxies for sophistication”

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The thinking underlying our responses is based upon our knowledge that the dominant issues surrounding financing early stage firms are not primarily financial. The quote in the Analysis Section of the Attachment explains why we take this view.

### Exemption based on registrant advice (6.3)

From the perspective of making more capital available to early stage firms in theory the existing exemption could prove valuable. Unless the registrant earns no direct fee from such a transaction and personally co-invests, the alignment of immediate incentives is perverse. In our experience the party with a fully managed account does not use this part of their portfolio for “angel” transactions.

Would it not be worth considering withdrawal of the existing exemption or fold it into the knowledge based one along the lines of our proposal?

While we are clearly on the side of the angels, we trust that our response conveys a reasoned balance between:

1. the economy’s need to make capital available to early stage firms in the amounts required to exploit the opportunity from knowledgeable people, the right hands, without imposing transaction costs or facilitating the casual use of the term “accredited” for administrative ends and generating counterproductive outcomes for entrepreneurs and angels; and
2. having in place reasonable assurances that money is not readily available from those who are not made aware that they may not comprehend what is involved and thus be the wrong hands regardless of the sum involved.





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The reality of the market place for the supply of funds is that it takes a team of facilitators months and months to nurture the development of an early stage firm. We see the role akin to that of investment banking for firms seeking to go public. In short, it takes a team to build a new team. We believe the mindset underlying current securities legislation and the resultant practices erect barriers to financing entrepreneurs that are not necessary for investor protection.

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Yours truly,

Peter Kemball

CEO





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Attachment

### Analysis and Suggestions

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Analysis. The simple expression of received wisdom within the venture capital community; better to back "A" people and a "B" product than fund "B" people and an "A" product. The implied challenge for early stage investors was set out more than a half century ago by a Harvard Business School Professor, Gen. George Doriot;

"We have to judge a man and an idea. The two cannot be divorced.

"Judging, measuring, evaluating a man as he is today is not too difficult. There is a record of what he has done under the circumstances.

"Where the problem is very much harder is where one wants to foresee how the person to be considered to create and build an enterprise will behave and perform in an entirely new and changing environment very often, if a new technique or method or idea is involved a new environment has to be created."

Were one to pick a discipline providing the capacity to judge the entrepreneur's ability to deal with known unknowns and unknown unknowns over many years, none comes to mind, CFA, MBA, CA, LLB do not enhance the ability to make the particular judgment which is the crux of the "investment" decision. (The writer has an MBA, taught finance at the university level, passed the CSE, operated as a limited market dealer, operated a finance business for two plus decades, and has made investments in early stage firms.)

In a financial context, nothing prepares people for making such judgments except hands on apprenticeships. It is a field where one gets the test and then the lesson. In our view and experiences the only classroom educational experiences of value are courses provided by the National Angel Capital Association and its US counterpart the Angel Capital Association.

Suggestion. The best available alternative at this time would be to couple an explicit acknowledgement of "risk" when using the exemption and undertake a proactive program of urging joining a





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formal angel group, urging that all individual members of formal angel groups take one or more courses from the two organizations.

The next best option to provide investor protection would be to urge angels operating outside formal angel groups to also pursue courses offered and or developed by these organizations. In this we suggest that family and friends be considered angels.

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Attendance at the seminars or courses, in person or online offered by NACO and ACA would be sufficient proof of “knowledge”.

We suggest the following items be included on the risk acknowledgment form:

Provide summary statistics on failure rates on the risk acknowledgement form as the preface to the following items:

1. Satisfaction that the CEO has the personal capacity to create and build a new business.
2. Obtained reference checks on the person or key persons as would any employer from a party in the business of doing such checks.
3. Were it to occur, loss of all funds is acceptable to the undersigned in this instance.
4. Recognition that if their circumstances were to change unexpectedly, there would be no realistic possibility of getting their money back to meet such need for funds as might arise when it arises.

Not quite as daunting as the words over the hospital transom, Abandon all hope ye who enter here, but close enough.

The form should be submitted to the OSC and available to the issuer and all co-investors on demand.

