

## Comments on OSC Staff Consultation Paper 45-710 by J.S.Vickers

By introduction, I have spent in excess of 25 years in the financial markets of Canada at impact levels (i.e. retail banker, corporate banker, investment banker, TSE new listings, Director of private and public companies, founder/entrepreneur/start-up advisor/office of private companies).

I agree with OSC Staff's position's view that more capital has to be made available to start-ups up to SMEs (collectively, "SSME") which remain in the private market until they are large enough to access public market capital or the abundance of capital that is available for companies whose revenue approaches and/or exceeds \$10 million per annum. Naturally, this will be done in maintaining the integrity of all capital markets, the usual investor protections, registrants and the companies/issuers.

My view is to open up the SSME capital market to make it a more fluid market and do it my straight-forward mechanisms that do not add excessive costs to any participant and to leave the existing regime as it is (with several exceptions.). Also to make the supervision of the market in line with the SME Institute or similar of the OSC where there are experts in SSMEs.

My comments to the Consultation Questions follow the section below which describes a new approach to SSME funding.

Create a new exemption as follows: **the SSME Exemption.**

Investor:

1. Individual investors can invest up to an aggregate of \$5,000 per year into SSMEs (any number of them) regardless of their situation.

Security:

2. Security sold will be restricted to convertible security (i.e. "SSME Instrument") which is convertible at a fixed value or at a future value (i.e. next financing – usual to venture capital market) as it allows future fundings not to overly dilute or hurt the SSME investor and allows management to do its job. The SSME Instrument can be voting or non-voting and can have a coupon or interest rate payable allowing for accrued returns (i.e. money grows independent of issuer growth). SSME Instrument can only be traded in compliance with all laws, rules and regulations as well as in compliance with private company trading restriction (i.e. Board approval required to trade/sell).
3. Rights and protections, such as anti- dilution protection, tag- along rights and pre- emptive rights, should be universal under the exemption (i.e. full shopping list provided and issuer + investor select the ones they want). This way investors cannot complain (or worse pursue legal action) after they have invested. Investors have to take risk ownership under this environment.
4. Full capital structure of issuer to be provided as well as current shareholders.

Maximum Funds Raised:

5. SSME can raise up to \$1.5 million under this exemption.

Initial Offering Documentation:

6. Full Powerpoint, Financials (i.e annual and stub period financial statements, if available OR

projection for start-up – all unaudited), Executive Summary (including Curriculum Vitae on management, founders, existing investors) and Term Sheet (with detailed Use of Funds where disbursements are reported on at fiscal year end with management report – investors have the right to request granular disclosure). A Business Plan is an option but I do not think it is necessary/mandatory. The information listed will also require the potential investor to do some home work to ensure they are satisfied with the investment they are making.

7. No requirement on the SSME to use a registrant to facilitate the funding. The issuer would be a 'registrant' by virtue of using this exemption.
8. Utilization of the legal profession would ensure compliance as well as the OSC SME Institute.

#### Continuous Disclosure:

9. Quarterly Report to be completed 45 days past quarter end being a one/two page report with comment on operations, use of proceeds, progress, etc.
10. Monthly Report would also be done much the same as is done on the CNSX now. This report would be modified for SSMEs as they are not public as yet.
11. FYE financial statements to be audited 12 months after the year in which the first capital raise pursuant to SSME exemption (i.e. if raised \$200,000 on May 15 2013 and FYE is December 31 – have to audit December 31, 2014 financial statements – can apply for exception if SSME is in financial hardship)
12. Normal continuous disclosure rules and regulations apply for material events, etc..
13. Given today's technologies, issuers can easily disclose company events/news (without disclosing confidential solutions/products and/or competitive advantage) via email distribution lists – this is now ubiquitous in the investing community in Canada.

#### Disclosure Hall:

14. Utilize facilities of CNSX for companies to post their Offering Documentation, Continuous Disclosure, Financing documentation, news, etc. in their existing 'Disclosure Hall'.
15. Cost of this service would be minimal (e.g. \$250 to \$500 per filing).

#### Going Public Obligation:

16. Utilization of the SSME Exemption obligates the SSME to 'go public' when they reach a minimum of 150 shareholders (excluding management, directors and insiders).
17. 'Go Public', in the minimum means becoming a reporting issuer in the jurisdiction of the Province of Ontario with no requirement to trade – this is up to the SSME and the investors/shareholders. Naturally, the SSME would now have to meet all of the usual requirements for compliance of a reporting issuer.
18. This is required in order to keep SSMEs moving forward and pushing their strategy of growth as well as education of/experience in public markets.

#### Clarification:

19. SSME Exemption can be utilized with other exemptions.

**20.** All existing laws, rules and regulations apply to the SSME and its management. Education booklet should be provided to same and/or OSC Education Program for SSMEs.

# Comments to Consultation Questions

## OSC STAFF CONSULTION PAPER 45-710

### **Page 12 - Consultation Questions – Relationship with the Issuer**

1. Is the 50 security holder limit under the private issuer exemption too restrictive? If so, what limit would be appropriate? Please explain.

This number is fine given the rules governing the type of security holder.

2. Should the OSC consider re- introducing the closely held issuer exemption in addition, or as an alternative, to the private issuer exemption? If yes, should the conditions be changed?

It should be introduced in addition to the closely held exemption. No other changes.

3. Should the OSC consider adopting a family exemption, that allows for securities to be issued to an unlimited number of family members of the directors, executive officers or control persons of the issuer or its affiliates? Please explain.

Yes. It is vital to have more sources of financing from friends and family as this is the first stage to fund a company....so called 'love money'.

4. Are there other changes that should be made to the current Ontario exemptions referred to above?

At this time, no.

### **Page 28 – Consultation Questions - Crowdfunding**

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

Yes as an exemption all on its own. Please see my opening 'SSME Exemption'.

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

Staff has recognized benefits for investors. Please note that crowdfunding (to this point) does not include securities. By moving it into the securities laws arena, crowdfunding will find more success.

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

Prior to crowdfunding (or similar exemptions), all and/or small investors did not and do not have access or knowledge of early stage investment vehicles (i.e. companies who can become future success stories). The crowdfunding vehicle opens up capital formation to earlier stage companies and is definitely needed in Canada which in my view remains starved at the SSME levels.

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

Investor protection concerns can be dealt with as we introduce crowdfunding to the masses. The best way is by limiting the amount that an investor can risk on an annual basis. This limit also comes with the clear warning that an investor can not realize a return on their investment being that is a SSME. It is time that some responsibility for investing (no matter the risk) be pushed back onto the investor and stop the perennial top down hand-holding currently seen in Canada.

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

fraud?

Answered above as far as the investor is concerned. As for the issuer (management, directors, insiders, large shareholders), we should require Personal Information Forms process as per the OSC, TMX, CNSX, etc. be utilized. It is a privilege and not a right to access capital markets and rely on the trustworthiness of the marketplace. This would also help to address any money laundering issues.

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

No. The investment comes with its risks and the investor undertakes them when they take on the investment. The hand-holding has to stop at some point.

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

Generally, no. Good companies will take calls from their investors and/or educate them as they proceed. After all, this will be the first source of capital after raising the initial money. Having said that, it is important to have standards = reporting requirements at all levels. Today's technologies make this an inexpensive process. Further, please see my SSME Exemption above. Issuers should have some level of reporting (which has been tabled) and this would also form part of the issuers education/experience as they grow and approach the public markets for future capital.

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?

To this point I started this document with the SSME Exemption. Start it as a universal structured vehicle that has simple and clear obligations. Do it for a 36 to 60 month period. The use of the existing capital raising framework would suffice and portals are not necessary. A singular disclosure portal is would be best as per CNSX's Disclosure Hall for investors to follow the SSMEs as well as future investors. Please note the SSMEs will have their own interest in promoting themselves through their own portals = their individual websites.

## **Page 31 – Consultation Questions – More Crowdfunding/Portal**

### **Issuer restrictions**

1. 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. The limit should be from \$1.5 million to \$3.0 million. Issuers should be allowed to raise up to \$3.0 million using all exemptions – perhaps it can be higher, say \$5.0 million but each exemption would have a limit. If the issuer is taking advantage of the 'public' to raise capital, it should be clear that it will be a reporting issuer and will trade its stock on a market as the core of its capital formation strategy. Again, I suggest \$1.5 million under my SSME Exemption.

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

No. This is not the purview of security laws. Full stop. The investors can make this determination pursuant to their investment in the issuer. The issuer would naturally be incorporated here.

### **Investor protection measures**

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

Given the level of risk and the goal to have more investors providing capital at the SSME level, yes. It is attached to the particular exemption which does not preclude larger amounts via other exemptions (i.e. accredited investors, private company, etc.). I suggested \$5,000 per investor per annum without restrictions.

4. 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 provided information should be: full PowerPoint, financial statements and/or in-house projections, capital table, Executive Summary, CVs on management, founders and existing shareholders and Term Sheet.

The information is to be certified by the issuer. It is pointless to spend money on professional other than lawyers at this stage of development. Please note the investors may ask for certifications as a condition of writing their cheques subject to the nature of the opportunity.

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

Yes. See my SSME Exemption above.

6. 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. Audited statements should not be required for SSMEs (start-ups and low or no revenue companies) at the time of the sale as it is a waste of growth money. Audit requirements should be defined in the exemption used. Please see my SSME Exemption above. Further, the marketplace will drive the requirement for audited statements.

The \$500,000 audit threshold is not appropriate for a non-reporting issuer. It should be mandatory once time and/or more investment is taken on = market driven.

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

Yes. These rights and protections should be in the exemption and made universal for all. The investor and issuer determine which ones apply to their situation. It can be imposed using the 'form' format.

### **Funding portals and other registrants**

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

No. We have enough avenues to provide investments from the investment community presently. This is especially true after creation of the EMDAs as well as the continuing efforts to make it a better system. Offer the 'portal registration' to the EMDAs. I suggest using disclosure for issuers (see Disclosure Hall approach in SSME Exemption) over registration.

If so:

What obligations should a funding portal have? **No comment.**

Should funding portals be exempt from certain registration requirements? If so, what requirements should they be exempted from? **No comment.**

9. 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?

Further to my comments above, let the existing registrants and the issuers (SSMEs) handle this. Do not create more structures to obfuscate the securities landscape.

### **Page 33 – Consultation Questions – OM Exemption**

1. Should an OM exemption be adopted in Ontario? If so, why?

No. The existing use for OMs is by accredited investors or those large entities on the exempt list (i.e. banks, funds, institutions, etc.) . Keep it that way. If they are imposed on SSMEs, the associated costs (legal, accounting, professional fees) would hurt the initiative of providing capital from many investors for SSMEs. It would become an artificial barrier driving investment from accredited investors only as they need the protections of the OM due to their shareholder base or wealth stature.

You will receive far more extensive feedback from the legal fraternity who will be 100% in favour of having an OM exemption. That in itself should tell you it is not a good thing.

2. Should there be any monetary limits on this exemption? If so, should those limits be in addition to any limits imposed under any crowdfunding exemption?

No comment.

3. Should a purchaser be required to receive investment advice from an adviser in order to rely on this exemption?

No. Whether it is the OM exemption or an SSME exemption or a portal exemption, no. Further the large retail brokerages down to the retail boutique brokerages to the EMDAs, should and would not want the liability. In fact, why would a retail broker even suggest to an investor to take money out of his account (where it earns his living = commissions/fees) to have it sit in an investment that may not be liquid for a couple of years or more. Self explanatory.

4. Should there be mandatory disclosure required in an OM? If so, what level of disclosure should be required?

No comment. If you go down this road make it prospectus level = keep the playing field level for liability documents.

5. Should we require registrant involvement as a condition of this exemption? If so, what category

of registration should be required?

No comment. Do not impose this exemption. It is draconian.

## **Page 36 – Consultation Questions – Sophisticated Investor Exemption**

### **General questions**

1. Would this exemption be useful for issuers, particularly SMEs, in raising capital?

Yes. We should have a 'sophisticated investor' exemption that is not based on the criterion of the accredited investor. Wealth.

2. Are there sufficient investor protections built into this exemption?

Yes. Given the criterion, these investors should be best qualified to judge the risk as well as the opportunity of investing in an SSME.

### **Questions on the specific terms of the concept idea**

3. Should we require an investor to satisfy both a relevant work experience condition and an educational qualification condition or would one suffice?

One would suffice. Have to add an education equivalency as other professions and academic credentials have merit. By example, I have a MA in Economics and have worked in corporate banking as well as TSE Listed Company regulation (ignore my investment banking experience for this argument) making me as well as if not more qualified than an MBA who sells detergent.

You can add a category that is a combination of education and work. For example, undergraduate degree in business, economics or similar plus relevant banking experience of five years.

4. How should we define the relevant work experience criteria?

Need to add equivalency definitions for work experience (see my example above). Utilize the services of an Human Resource professional to get the definition right = qualified to make decisions on business strategies, investment decisions, budget decisions, etc.

5. What educational qualifications should be met? Should we broaden the relevant educational qualifications?

Again. Use the services of an Human Resource professional to get the definition right but it should encompass educational qualifications that encompass research to analysis to decision making at the graduate level.

6. Are there other proxies for sophistication that we should consider?

No comment.

### **Page 38 – Consultation Questions – Advice Exemption**

Should we consider a new prospectus exemption that is based on advice provided by a registrant?

**No. From my experience with large and small investors, no.**

**No comment on the following.**

If so:

1. Do you agree with limiting this exemption to a situation where the registrant has a fiduciary duty to act in the best interests of the client?
2. Do you agree that this type of exemption should be limited to certain types of registrants (e.g., investment dealers) or should this exemption be available for another type of registrant (e.g., an EMD)?
3. Should this type of exemption be available for registrants that sell securities of “related issuers” or “connected issuers” (which would raise conflict of interest concerns, as explained in National Instrument 33- 105 *Underwriting Conflicts* and Part 13 of NI 31- 103)? If so, would this be consistent with the registrant being subject to a fiduciary duty to the client?
4. Would exempting the issuer from a disclosure obligation have implications for a registrant's ability to conduct a meaningful KYP and suitability review?
5. Do you agree that a registrant should be required to have an ongoing relationship with the client?
6. Should there be any restrictions on the type of security that could be purchased? For example, should this exemption be available for purchases of securities of investment funds and/or complex products (including securitized products and derivatives)?
7. Should the existing managed account exemption described above be expanded in Ontario to permit purchases of securities of investment funds?

**No to all listed above.**

### **Page 40 – Consultation Questions – Electronic Filing**

1. Are there any concerns with mandating use of the E- form?

No. The faster the better. Again it makes the securities industry utilization of new technologies ubiquitous. Eventually even SEDI will be a sleek process unlike now.

### **Page 41 – Consultation Questions – Additional information Required**

1. Are there any concerns with requiring this additional information in the report? Please explain.

No. The Staff at the OSC should table what information they want to see (all of it) and get feedback rather than this method of fishing.

2. Are there other types of information that we should require in the report?

No. Clearly this report is not intended for future uses as it refers to OM as well as accredited investors only as well only one exemption. I am asking myself why ? Not the point of looking at capital formation for SSMEs which is the focus of this consultation.

3. Should we require more frequent reporting for investment funds? If not, why not?



No. Will result in less money going to the fundholders.

**Page 42 – Consultation Questions – Broadened Access to Exempt Market**

1. Are there prospectus exemptions, in addition to the concept ideas discussed in this paper, that we should consider? Please elaborate.

In an effort to marry investor protection with capital formation and full disclosure, an exemption can be created along the lines of a shelf registration where the OM is a webpage or portal per SSME (or other private issuers – similar to SEDAR) which is covered by the usual liability and suitability concerns. This page would be a defacto SRO where the biggest cost is background checks and maintenance of continuous disclosure. All of the usual exemptions would apply for raising capital. The key is continuous disclosure.

Just a thought.