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March 8, 2013

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

Dear Sirs/Mesdames:

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

I write in response to the Ontario Securities Commission (“OSC”) Staff Consultation Paper 45-710 – Considerations for New Capital Raising Prospectus Exemptions (the “**Consultation Paper**”), published for comment on December 14, 2012.

I am a lawyer at SkyLaw LLP, a boutique corporate and securities law firm. My clients include public and private companies, small start-ups, investment funds and dealers/advisers. As such, the Consultation Paper is of great interest to my clients and me, and I welcome the opportunity to submit comments on some of the issues and questions raised in the Consultation Paper.

Specifically, I would like to address some of the questions raised by the OSC in the Consultation Paper with respect to the proposed crowdfunding and OM exemptions.

In general, I agree with the crowdfunding framework proposed in the Consultation Paper, particularly with respect to limiting the amount each investor may invest and ongoing disclosure requirements. I also agree that all crowdfunding portals should be registered and should play a gatekeeper function. However, I would also like to make a few suggestions and comments on the proposed framework, which I believe may enhance the protection of investor interests without sacrificing the efficiency of the crowdfunding model. I also believe that an OM exemption would be beneficial to SMEs in Ontario, particularly if a crowdfunding exemption is to be introduced.

In that regard, I would like to specifically address the following questions raised in the Consultation Paper:

Crowdfunding

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

2. Can investor protection concerns associated with crowdfunding be addressed and, if so, how?
3. What measures, if any, would be the most effective at reducing the risk of potential abuse and fraud?
4. Are there concerns with retail investors making investments that are illiquid with very limited options for monetizing their investments?
5. Are there concerns with SMEs that are not reporting issuers having a large number of security holders?

OM Exemption

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

Crowdfunding

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

A crowdfunding exemption would be useful for SMEs in raising capital. SMEs, in particular start-ups, are vital to the health and continuing growth of the Canadian economy, yet many of them are unable to access capital efficiently and cost-effectively under the current regime.

With the advent of technology, SMEs can efficiently and cost-effectively access capital through a crowdfunding over the internet. If properly done, it would allow investors who would otherwise be barred from participating in the capital markets to safely invest in and to take ownership stakes in business enterprises and ideas that they like.

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

Investor protection concerns in the context of crowdfunding are real and should not be trivialized. However, crowdfunding can only succeed if the process is efficient and cost-effective.

In order to protect investors without sacrificing efficiency, “simplicity is key”. Other successful crowdfunding models such as “Kickstarter” do well because it offers simplicity in one key area: the investment product itself. Using the Pebble Watch campaign on Kickstarter as an example, when investors put their \$100 into the campaign, they know exactly what they can expect to get and when (e.g., if the campaign and development of the product is successful, they will get “one Jet Black Pebble Watch”).

In the context of securities crowdfunding, simplicity is also key. Simplicity also serves to address many of the investor protection concerns raised in the Consultation Paper.

With that in mind, I offer some comments and suggestions regarding the framework proposed in the Consultation Paper as follows:

- a. **Type of Security:** Given that crowdfunding will be available to all members of the public, regulators should account for the fact that there will be a wide spectrum of investment knowledge among participating investors. For that reason, the Consultation Paper proposes to limit availability of the exemption to certain types of non-complex securities and specifically excludes derivatives and securitized products.

I agree with the OSC's overall approach but propose that the OSC should take a step further by prescribing only one type of security that may be offered under the crowdfunding exemption, with simple, standardized terms for all issuers and all offerings.

More specifically, I propose that the OSC prescribe, by regulation, one single class of "Crowdfunder Shares" that may be issued under the crowdfunding exemption; the Crowdfunder Shares will be non-voting and will have standard terms and conditions and formulas dealing with IPO, liquidation and other events.

The terms of the Crowdfunder Shares should also be structured to confer unique status to the Crowdfunders viz. other shareholders such that their rights and interests are clearly delineated and protected. In doing so, the OSC can effectively create a special class of crowdfunding shareholders viz. other investors and offer direct statutory protection of their interests through the prescribed share terms. For example, the Crowdfunder Shares can be structured such that a massive dilution event would automatically trigger a redemption of the Crowdfunder Shares at a prescribed capped percentage rate and the crowdfunders would get their money back with, hopefully, some positive return on investment.

Similar to the Pebble Watch campaign described above, limiting the crowdfunding exemption to one single type of security with simple, standardized terms and conditions would help ensure that even the most inexperienced investor would be able to understand what they are investing in.

To carry the concept further, this class of Crowdfunder Shares should be available only to crowdfunders through a crowdfunding distribution and not to other investors such as angels or VCs outside of the crowdfunding channels.

If the exemption is limited to one single type of security with simple, standardized terms and conditions, much of the disclosure regarding "financing facts" can also be standardized, which will help reduce the cost to the issuer in preparing the information statement. This will also allow the issuer to devote more resources toward the disclosure of "issuer facts" and other pertinent information.

For most SMEs, including start-ups, inclusion of a prescribed class of Crowdfunder Shares can be done either at incorporation or via an amendment of Articles. The associated costs are not prohibitive. For companies that already have or are contemplating complex capital structures, they would either self-select themselves out of eligibility for failing to accommodate the terms of the Crowdfunder Shares, or they would simply structure their capital around the Crowdfunder Share class.

Just as complex securities themselves are deemed not to be suitable for crowdfunding as noted in the Consultation Paper, it would not be unreasonable to also exclude companies with complex capital structures from being able to use crowdfunding.

- b. **Capped Number of Offerings:** I do not agree that the size of an offering should be limited because it is not immediately clear as to how it enhances investor protection, particularly where there are already investment limits in place for each investor. Moreover, any prescribed offering size would be arbitrary given the different capital requirements between issuers. Also, there is inherent market tension limiting the size of what an offer can be. If an issuer wants to raise \$100 million, it will require 40,000 investors each investing the maximum of \$2,500 in order for it to succeed. There must be something that an issuer is doing right if 40,000 people believe in it sufficiently to each want to invest the maximum amount.

The OSC should instead consider limiting the number of times an issuer may use the exemption within a period of time (e.g. maximum 3 rounds in a 5 year period, only 1 round is permitted in any given 12-month period and must wait 3 years after the third round).

This is based on the theory that after 3 rounds of crowdfunding, if the enterprise is a viable one, and if the capital-raising and subsequent deployment of the capital were done properly, there should have been enough time and opportunity for the enterprise to grow to a stage where it can afford the traditional capital-raising methods. If not, the issuer should not be allowed to use crowdfunding again until a “recovery period” has passed. I believe this restriction will help limit abuse by issuers of the exemption and will incentivize the issuer to take each crowdfunding round seriously.

- c. **Registered Portal as Gatekeeper:** Mandating the use of a registered portal is critical to the success of crowdfunding and will also reduce the risk of potential abuse and fraud. These portals should play a “gatekeeper function” and at the very least be subject to the same requirements that investment dealers are subject to, except with respect to “know-your-client” requirements which will be impractical to enforce in a crowdfunding context.

I agree with the OSC’s proposal regarding crowdfunding portals and would add that, if the OSC considers limiting the type of security offerable under the crowdfunding exemption to one single standardized class of “Crowdfunder Shares”, costs associated with “know-your-product” requirements would correspondingly be reduced.

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

For reasons described above, I believe that using standardized Crowdfunder Shares, limiting the number of times an issuer may use the exemption within a period of time and mandating the use of a registered portal would help reduce the risk of abuse by issuers of the exemption.

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

Concerns regarding illiquidity and limited monetizing options are overstated in the context of crowdfunding. I agree that full disclosure regarding the nature of these investments should be made at the time of distribution such that the investors are made fully aware of the illiquid nature of the investment. However, drawing upon the experience of successful crowdfunding platforms such as “Kickstarter”, I believe investors who participate in crowdfunding are interested more in owning a piece of an enterprise or business that they like or believe in rather than immediate financial rewards. In fact, I believe that the illiquid nature and limited availability of monetizing options can be viewed positively in that they minimize short-term speculation and helps to better align incentives in the longer-term as between the issuer and its shareholders.

In addition, through the prescription of standardized Crowdfunder Shares, the OSC can build specific provisions into those share terms dealing with liquidity events and redemption/exit rights.

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

If the OSC implements the ongoing disclosure requirements as proposed in the Consultation Paper, I do not see any concerns with SMEs that are not reporting issuers having a large number of security holders.

Regarding potential practical difficulties faced by an issuer in “managing” a large number of shareholders, the portal can help by playing a role similar to that of a transfer agent by keeping track of investors and their shareholdings.

Also, use of standardized Crowdfunder Shares can address some of these concerns in that the procedures relating to the management of Crowdfunder Shareholders can be structured in a standardized way that would allow for the streamlining and potential automation of such procedures, all of which could be performed through the registered portal.

OM Exemption

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

An OM Exemption should be adopted in Ontario, particularly if a crowdfunding exemption is introduced.

In view of the fact that an issuer would be precluded from using the private-issuer exemption after going through crowdfunding, it would be impractical for the issuer to be limited to only the accredited investor and minimum amount exemptions after having gone through crowdfunding without some middle ground to bridge the gap. I believe that the introduction of an OM Exemption would bridge that gap. However, the OM Exemption should be less restrictive than as proposed in the Consultation Paper and should more closely mirror the exemptions available in BC or Alberta.

Summary

The OSC should be applauded for taking the initiative to consider implementing a crowdfunding exemption and an OM exemption. As discussed above, the availability of a crowdfunding exemption and an OM exemption can really help SMEs in a tremendous way but the key to success is simplicity.

As noted above, simplicity facilitates understanding by the investor of the investment, minimizes the chances of fraud and abuse, and offers streamlining and automation potential to reduce costs. To that end, the OSC should consider prescribing one single class of “Crowdfunder Shares” with standardized terms and conditions for use in crowdfunding as described above.

Yours Sincerely,

(signed) Michael M. Lee

Michael M. Lee

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The comments and suggestions contained in this letter are the personal opinions of the author only and does not reflect the views of SkyLaw LLP, its other partners, counsel or employees. For more information, please contact Michael M. Lee at: michael.lee@skylaw.ca (email) or (416) 759-5299 (telephone).