March 8, 2013

John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
Email: jstevenson@osc.gov.on.ca

Dear Sirs/Mesdames:

Re: OSC Exempt Market Review – OSC Staff Consultation Paper 45-710 – Considerations for New Capital Raising Prospectus Exemptions ("CP 45-710")

The Canadian Advocacy Council[1] for Canadian CFA Institute[2] Societies (the CAC) appreciates the opportunity to comment on CP 45-710.

The CAC wishes to respond to the following specific consultation questions:

Current Regulatory Approaches

- *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 is not necessary to introduce another exemption that is based on the purchaser's relationship with an issuer; the private issuer exemption, together with the family exemption referenced below, would be sufficient. We believe it is important that to the extent possible the capital raising exemptions be harmonized across all Canadian jurisdictions. Harmonizing

[1]The CAC represents the 13,000 Canadian members of CFA Institute and its 12 Member Societies across Canada. The CAC membership includes portfolio managers, analysts and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. See the CAC's website at http://www.cfasociety.org/cac. Our Code of Ethics and Standards of Professional Conduct can be found at http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx.

[2] CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 113,000 members in 140 countries and territories, including 102,000 CFA charterholders, and 137 member societies. For more information, visit http://www.cfainstitute.org/.

the exemptions would simplify the capital raising process for issuers, and would help issuers and prospective investors more easily confirm eligibility for participation in an exempt offering that occurs in more than one jurisdiction.

- *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, in order to harmonize the exemption across jurisdictions. To clarify, we believe Ontario should adopt the exemption in Section 2.5(1) of NI 45-106, which would also permit issuers to issue securities to certain close personal friends. Family members and close personal friends are an important financing source for many small businesses. The OSC, as well as the other CSA members, should provide additional guidance and explanation (more than what is currently contained in 45-106CP) with respect to the meaning of "close personal friend".

To the extent an issuer does provide an informational document to prospective subscribers in connection with a distribution of securities under a different prospectus exemption, the issuer should make that document available to persons purchasing under the family exemption as well, so they are not at an informational disadvantage. We are not suggesting that a disclosure document be required as a condition of the family exemption, but that family members or others relying on a similar exemption based on the relationship with the issuer should simply be required to receive the same degree of information about the issuer that is made available to other investors. We recognize this is not currently a requirement in any jurisdiction and would recommend that it be considered in all CSA jurisdictions. If such a document constituted an "offering memorandum" under the *Securities Act* (Ontario), it would have the result of providing investors with statutory rights in the event of a misrepresentation. To the extent the CSA were to examine harmonizing the prospectus exemptions, consideration could also be given to harmonizing the definition of an "offering memorandum" and the statutory rights of action for misrepresentation in all jurisdictions.

Considerations for Crowdfunding Exemption

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

As a general note, we wish to stress the importance of harmonizing the prospectus exemptions across all Canadian jurisdictions. We believe it would be helpful to both issuers and investors, prior to introducing a radically new type of exemption such as crowdfunding, to first harmonize the existing exemptions and then determine, after an appropriate period of time has passed, whether a new prospectus exemption is still required. If after such period of time (no less than 12 months) staff were to decide to proceed, the crowdfunding exemption should only go forward if the same terms were to be imposed in the other CSA jurisdictions. As the exemption would only be available for a purchaser to buy small amounts of securities, and there are a number of conditions to the use of the exemption, it would not be

economically feasible for issuers to raise capital based on this exemption if the terms were different in various jurisdictions.

While an addition of a crowdfunding exemption may ultimately prove to be useful for SMEs, it would be difficult to determine its efficiency until the exemption is in place and has been monitored for a few years. At first glance crowdfunding appears to be inconsistent with many principles and procedures used in the current securities regime in Canada, but given the growing popularity of this idea in the U.S., it will likely become popular in Canada as well, including for distribution of securities, and thus must be addressed by the regulators.

We have a number of investor protection concerns with respect to the use of crowdfunding that will require strict monitoring and enforcement of the conditions of the exemption. Unlike other exemptions which are based on the relationship between the issuer and the purchaser or the purchaser's ability to withstand losses, the crowdfunding exemption by its nature involves the issuance of securities to a large, unlimited group of potentially unsophisticated purchasers with no relationship to the issuers. While we are concerned with the risk of fraud that may be facilitated by the anonymity of an internet portal, there are other considerations no less grave that are likely to arise through the use of this exemption and will be very hard to mitigate within the crowdfunding framework.

For example there is a possibility that management of an issuer choosing to raise money through a crowdfunding site will not have adequate experience and qualifications to be running a business. These individuals have already been rejected by banks and other traditional lenders for these and other reasons, and possibly utilized all available capital from friends and family or had financing declined by them as well. They may not have the necessary financial background to prepare the requisite financial statements and provide the financial information expected of a business raising money from the public. While the proposed requirements for registered portals and the caps on investment are important safeguards, they may not be sufficient to help protect investors with low financial literacy or ensure businesses are able to provide adequate financial disclosure on an ongoing basis. We believe it is important to consider the additional safeguards set out in our responses below in order to help further mitigate these substantial risks to the investing public prior to the implementation of a crowdfunding exemption.

While the market will ultimately decide if the crowdfunding exemption (if implemented) is useful, given the necessity of dealers or other service providers maintaining a registered portal and the associated costs that are likely to fall on the issuers using such services, as well as the cost of financial reporting, small issuers may struggle to raise capital through crowdfunding in an economical manner.

- *Have we recognized the potential benefits of this exemption for investors?*

Yes. In particular, CP 45-710 addresses the primary benefit to investors of permitting them access to start up businesses.

- *What would motivate an investor to make an investment through crowdfunding?*

Some of the rational reasons may be that investors would be trying to gain access to investments at a lower cost than through traditional channels. Another reason may be that while there is a greater risk involved (and the investor has determined they can withstand the risk), there may also be a potential for greater investment returns as compared with other investment products currently available in the market. The investment could also be made relatively quickly and efficiently. Some of the irrational reasons may result from misunderstanding the nature of an investment and its risks, not fully appreciating the illiquidity of the investment or lack of available disclosure, or being influenced by advertising and media.

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

All the proposed restrictions on the exemption set out in CP 45-710 would help address investor protection concerns. We believe the proposed limit on the amount of investment that could be made by each purchaser will be of assistance. While we agree that a specified dollar limit would be easier to monitor and apply than a limit based on a percentage of an investor's net worth (excluding their primary residence), such a limit could be feasible if self-certified. Regulation and close monitoring of the crowdfunding portals would be paramount, as they would play a major role in investor protection, given the relatively small and powerless position of each individual crowdfunding investor in relation to the issuer. We propose a number of measures in our responses below and we believe if all of these suggestions were implemented it would help mitigate investor protection concerns associated with crowdfunding.

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

It will be very important for the securities regulatory authorities to monitor the registered portals and the issuers utilizing the crowd funding exemption. Timely and effective enforcement will be key to mitigating the risk of abuse and fraud, particularly with respect to the required financial reporting. The consequences of not providing the requisite reporting should be made clear to the portals, the issuers and investors. It may be necessary to consider new elements of enforcement to help ensure that issuers provide the requisite financial information to investors, including potentially requiring senior management of the issuer to post collateral. In addition, it could be useful if issuers were required to post a notarized or other certified summary of their tax returns.

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

The illiquid nature of the investments is a concern with a potential crowdfunding exemption; however the risk is no greater than for other illiquid investments available for purchase today. This concern can be mitigated with the restriction on the amount of money each purchaser can invest using this exemption.

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

Issuers, particularly start-up companies, will require assistance to monitor and communicate with their security holders. The registered portals could potentially be required to provide registry and transfer agent type functions to assist issuers in this regard. Issuers might also require assistance with investor relations functions.

- *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?*

The CAC does not believe it would be beneficial to introduce the exemption for a particular industry sector or through any one particular portal. It will be important, however, to monitor the use of the exemption closely for the first three to five years after implementation for signs of misuse. The length of time the exemption is initially available should be reasonable so that issuers (particularly start-ups) will have the necessary time to try to generate returns. The portals should also be monitored to determine if they have sufficient capacity to properly evaluate issuers.

Issuer restrictions

- *Should there be a limit on the amount of capital that can be raised under this exemption? If so, what should the limit be?*

A limit of $1.5-$3 million should be sufficient for issuers to raise startup capital while still offering some investor protection.

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

Issuers should not be required to spend the proceeds raised in Canada. Such a limit would be too difficult to monitor and could raise extra-territorial jurisdictional issues.

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?*

  Yes, the proposed limits of $2,500 per investment and $10,000 per year are reasonable. Additional consideration could be given to extending the individual investment limit to a limit per household (i.e. a limit on family members in the same residence) to help ensure that a family unit does not collectively invest a sizable portion of their net worth or assets under this exemption.

- *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?*

  We believe information on the issuer's business plan, the officers, directors, key employees and/or principals behind the company (including those who have access to the capital raised) and use of proceeds is important for the information statement. However, the document must remain streamlined and not begin to resemble an offering memorandum, which is expensive and time consuming to prepare.

  The risk acknowledgement statement should not only emphasize the illiquidity of the investment (for private issuers) but the lack of continuous disclosure materials.

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

  The proposed dissemination of annual financial statements is sufficient, but it would also be useful to investors and the regulators if the issuers were required to disclose information such as the name, business address, resume and photograph of each person with signing authority over the financial accounts of the issuer.

- *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?*

  We believe audited financial statements are in the best interest of investors, however we also recognize that the cost of providing regular audited financial statements for businesses raising small amounts of capital may be prohibitive. We do not have a view as to whether $500,000 is the appropriate threshold, but believe additional study and consultation is required in order to try to ensure investors can be protected in situations where unaudited statements are permitted. Consideration might be given to some of the other safeguards suggested in our responses relating to the crowdfunding exemption, including enhanced enforcement methods.

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

  While such rights would be an important protection to minority shareholders, such rights are usually granted in a shareholder agreement, and such an agreement is unlikely to be feasible for the crowdfunding exemption.

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?*

    We believe the use of portals for crowdfunding should be mandated rather than optional for issuers and such portals should be closely monitored by the securities regulatory authorities. A funding portal should be required to confirm the bona fides of the offerings and the principals behind the offeror, and fulfill anti-money laundering requirements. Portals should also be a repository of financial information and risk factors about the issuer, and should be used to help ensure issuers do not exceed the maximum amount they are permitted to raise through the exemption and that individual investors do not exceed the maximum amount they are permitted to invest. Portals could also be used to assist issuers to communicate with their shareholders.

    Consideration should be given to requiring portals to disclose their due diligence process and criteria for selection of issuers, as well as disclose information regarding the success of issuers that have raised money through the portal (and conversely, the number of issuers that have become insolvent).

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

    A new registration category might be required for funding portals. While their functions will be closest to that of an exempt market dealer, they will not engage in suitability determinations and will not have custody of funds, nor will they provide any discretionary advice to investors.

- *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, we do not believe another registrant is required to be involved in this type of distribution. Adding another layer of regulation would render this potential exemption too cumbersome and would become too expensive to administer. If the portals are owned by banks or other

large institutions, it will be important that they be required to institute ethical walls to ensure that other divisions do not have priority access to issuer information.

Considerations for OM Exemption

- *Should an OM exemption be adopted in Ontario? If so, why?*

An OM exemption should be adopted in Ontario in order to help harmonize the prospectus exemptions available in each Canadian jurisdiction.

- *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?*

Yes, there should be a monetary limit per issuer and per investor that is specific to this exemption that should be harmonized across all jurisdictions. We note, however, that the proposed offering memorandum exemption under discussion is quite different than the two types of offering memorandum exemptions currently available in the other Canadian jurisdictions. An offering memorandum is a very time consuming and expensive document to produce, and to the extent the disclosure requirements vary in different jurisdictions, the time and cost involved (including the cost as a percentage of the offering) increases considerably. Please see our response below with respect to our suggested required disclosure form. Provided that such form was required, we believe an aggregate limit of $10 million per issuer would be appropriate as investors would receive fulsome disclosure regarding the offering and the issuer.

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

No, a purchaser should not be required to receive investment advice from an adviser. As a result of the due diligence required on these types of investments, it will not be feasible or economical for advisers to review many of these offerings, particularly if the amount of the investment is limited to $2,500 per investment and $10,000 per investor in any one calendar year. To the extent additional disclosure is provided in an offering memorandum, as suggested in our response below, we believe that these monetary limits could be increased or eliminated for "eligible investors" as currently set out for certain provinces in the offering memorandum exemption in section 2.9 of NI 45-106.

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

We believe the same forms that are mandated in the other Canadian jurisdictions, Form 45-106F2 and Form 45-106F3, should form the basis of an offering memorandum exemption instead of a more limited disclosure document.

- *Should we require registrant involvement as a condition of this exemption? If so, what category of registration should be required?*

Please see our response regarding investment advisers above, which is equally applicable to a registered dealer.

Considerations for Prospectus Exemptions Based on Sophistication and Advice

General questions

- *Would this exemption be useful for issuers, particularly SMEs, in raising capital?*

It is unlikely that this exemption would be utilized often by issuers given the potential difficulty in identifying whether purchasers have satisfied the relevant work experience in the investment industry. In addition, as noted in CP 45-710, for investments in issuers in certain industries, it may in fact be experience in those industries (e.g. the medical industry for investments in a bio-technology issuer) that is more relevant than investment industry experience. There are a sufficient number of other prospectus exemptions available, particularly if the offering memorandum exemption were adopted in Ontario, such that this exemption would not be required.

We also reiterate the importance of harmonizing the prospectus exemptions across all Canadian jurisdictions, and to the extent staff were to proceed to consider this exemption, the exemption should only be implemented if the same terms were to be imposed in all CSA jurisdictions.

- *Are there sufficient investor protections built into this exemption?*

If the exemption were to be adopted, the proposed "term sheet" disclosure statement and risk acknowledgement form would be sufficient.

Questions on the specific terms of the concept idea

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

If the exemption were to be adopted, the CAC is of the view that both conditions are necessary. For some professional designations, specifically the CFA designation, there is already a requirement to have relevant work experience which is strictly interpreted and applied. In other circumstances, it is less obvious that a professional designation, such as an MBA, is sufficiently related to investment experience. For example, an MBA with a specialty in finance is quite different than an MBA with a specialty in marketing.

- *How should we define the relevant work experience criteria?*

The criteria applied should be the same as the experience requirements for registration as an advising representative. The work experience should be related directly to investment management or analysis of securities. Guidance can be drawn from CSA Staff Notice 31-332 – *Relevant Investment Management Experience for Advising Representatives and Associate Representatives of Portfolio Managers*.

- *Are there other proxies for sophistication that we should consider?*

No, if the exemption were adopted, the work experience and educational qualifications would be sufficient.

Exploration of a prospectus exemption based on registrant advice

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

  A new prospectus exemption that is based on advice provided by a registrant should be considered, but only if it is also being considered by the other CSA jurisdictions as well.

- *If so:*

  a. *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?*

     Yes. One of the standards for CFA charter holders is a duty of loyalty, prudence and care to their clients. The CAC also wishes to stress the importance of implementing a statutory fiduciary duty on all registrants providing advice.

  b. *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)?*

     Provided that all registrants are subject to a fiduciary duty, the exemption should be available for all registrants.

  c. *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?*

     The embedded conflict of interest that exists when dealers/advisers sell or recommend related party or proprietary products may result in the inability to

recommend such products where a fiduciary duty exists. However, that should not automatically preclude the availability of the exemption in every scenario.

The OSC could consider limiting the amount of money that can be raised by issuers in these circumstances.

d. *Would exempting the issuer from a disclosure obligation have implications for a registrant's ability to conduct a meaningful KYP and suitability review?*

The lack of prescribed disclosure with respect to the specific distribution is no different than with respect to the use of the managed account accredited investor exemption or any other exemption that does not require disclosure at the time of an investment, so there should be no added difficulty in meeting KYP and suitability review requirements for this new potential exemption.

e. *Do you agree that a registrant should be required to have an ongoing relationship with the client?*

Yes, we agree that the exemption should not be available for registrants that engage in "one-off" transactions on behalf of an issuer.

f. *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)?*

There should not be any restrictions on the type of security that could be purchased under this exemption. It is subjective and difficult to define a "complex product", and the nature of investment products is constantly evolving.

- *Should the existing managed account exemption described above be expanded in Ontario to permit purchases of securities of investment funds?*

Yes. There are frequently situations where a pooled fund would be an appropriate investment choice (particularly for various members of one family) but as a result of the limitations on the exemption, an adviser is required to open a segregated account which does not have the diversification and economies of scale of a pooled fund.

Need for additional exempt market data

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

We do not have any concerns with mandating the use of the E-form.

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

Any additional information required for the OSC to better understand the use of the prospectus exemptions should be balanced with privacy requirements on behalf of individual investors, as well as recognize that private issuers are not usually otherwise required to provide information on their operations to the securities regulators. For example, it is reasonable to identify the category of accredited investor under which an investor is purchasing securities, as it directly relates to the criteria for the exemption, but we do not see the utility of requiring an issuer to provide information such as an investor's current employment status and age. Similarly, asking for additional basic information about an issuer such as the number of years it has been in operation and information on its directors and officers is reasonable, and is relatively accessible from other sources. However, requiring information on private investment funds such as key service providers, assets under management, redemption activity, MER and performance information would appear to be unrelated to the criteria for reliance on any prospectus exemption and is not usually required to be disclosed elsewhere.

We do think the suggested additional information with respect to any registrant involved in a distribution would be useful, particularly to help determine the category of registration utilized and whether the issuer has identified the distribution as a related/connected distribution.

- *Are there other types of information that we should require in the report?*

No, the list for discussion in CP 45-710 is comprehensive.

- *Should we require more frequent reporting for investment funds? If not, why not?*

More frequent reporting for investment funds is not required. Many investment funds are in continuous distribution and it would be an unnecessary burden to prepare and file a report on a more frequent basis.

Implications for broadening access to the exempt market

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

We do not believe there are any additional prospectus exemptions that the OSC should consider. The existing prospectus exemptions, together with the proposed harmonized family member and offering memorandum exemptions, should provide SMEs with ample opportunities for fund raising while balancing investor protection considerations.

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at chair@cfaadvocacy.ca on this or any other issue in future.

(Signed) Ada Litvinov

Ada Litvinov, CFA
Chair, Canadian Advocacy Council