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March 8, 2013

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

Via Email: jstevenson@osc.gov.on.ca

Attn: John Stevenson

Dear Sir:

RE: OSC Staff Consultation Paper 45-710

Compliance Support Services is a legal and regulatory compliance consulting firm offering compliance services and advice to market participants in all registration categories, including exempt market dealers. **Compliance Support Services** has the benefit of both regulatory and industry experience bringing arguably, a highly balanced perspective to the issues in this consultation process. We are grateful for the opportunity to comment on this important initiative.

1. Offering Memorandum

The consultation paper offers a model of an OM exemption and asks specific questions in relation to that model.

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

As stated in our February 2012 comment letter, we feel it is critical that an OM exemption, or something very much like it, be introduced in Ontario. Again, the reason for that is the current restriction on access to capital for Ontario issuers and fair access (along with other Canadians) to alternative investment options for Ontarians. We also feel there would be profoundly positive economic outcomes overall with the softening of current restrictions.

- **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. In our view there is no rational reason for placing monetary limits on this exemption – not on investors and not on issuers. We also feel that crowdfunding is an utterly different creature than this prospectus exemption, serves different purposes and targets different tranches of the Ontario investing public. The concept idea offered for an OM exemption blurs the two in a confusing and unhelpful way. If a limit of $2500 is placed on a single investment, the time and effort expended on developing it will have been wasted as the exemption will never be used. No business will expend the time, effort and money to comply with such rigorous requirements for $2500. Also, the $1.5M cap should have no bearing on this proposal. The purpose of the cap in the crowdfunding concept is to limit potential investor overall loss because there are other risks involved. Here, with all the extra safeguards (OM, Registrant, Types of Securities – as set out below), the cap makes no policy sense.

We feel the Alberta model of the OM exemption is the most sensible iteration of where Ontario should be headed. Unlike BC, Alberta requires investors who want to invest more than $10,000 to demonstrate a certain level of financial comfort which usually, though not always, correlates to a certain level of investment comfort. There is also a great deal to be said for harmonizing requirements, both from a simplification standpoint and to be fair to Ontario investors.

If the concern in Ontario is that this model does not afford appropriate protection we would argue:

- Part 5 of 45-501 could be modified to require the delivery of an OM in all cases and to continue to afford the same protections as a prospectus, including right of withdrawal. That would be an extra protection measure over and above our western counterparts;
- The requirements could be expanded to require additional delivery of a plain language risk disclosure. It is our view that this is most effectively understood when delivered separately from the OM;
- The types of securities that can be offered under this exemption could be restricted to the more simple or straightforward, though it is difficult to appreciate why Limited Partnership Units or more conservative hedge funds would be excluded. It would require more research and a clearer understanding of available products in the exempt market, but the benefit to the economy would be greater if the restrictions were limited to only those that are absolutely necessary.
- A scaled form of financial disclosure by the issuer, similar to the US JOBS Act requirements could be required.

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

No. See answer below re registrant involvement.

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

Yes, disclosure should be mandated. Disclosure is one of the key methods of improving investor protection under this exemption. However, apart from the prospectus "protections" of s. 130 of the SA, the otherwise onerous (and largely ineffective – because they are unread) requirements of prospectus disclosure should be avoided. The Client Relationship Model disclosure initiatives should be studied to guide us on appropriate length, complexity and content of meaningful disclosure.

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

Yes, registrants should be involved as we are of the view that the proposed protections (i.e. crowdfunding-like limits and restrictions) are inappropriate for this exemption. Exempt Market Dealers and their Dealing Representatives and any superior categories of registration should be permitted to provide advice under this exemption.

First, we feel that if the exemption is limited to issuers distributing securities of their own issue, it narrows the scope of the exemption so profoundly as to negate most of the economic benefit. We advocate its availability to Exempt Market registrants and others for a number of reasons.

It's important to acknowledge that the EMD category of registration has only received the level of regulatory scrutiny and been subject to enhanced and clearer requirements since the advent of NI 31-103. As with any new regulatory initiative, full understanding and compliance takes time. We feel it is not surprising that recent EMD reviews by staff have uncovered deficiencies in this category. However, that does not correlate to the inability of these registrants to correct deficiencies and equip themselves to provide advice under this exemption going forward. The health of the markets depends on a balanced and remediative approach to regulation in this area and on encouraging rather than stifling competition among all levels of market intermediaries. Investor protection is best achieved by supporting intermediaries who are otherwise capable, solvent and who demonstrate integrity, to get to where they need to be.

Also, it goes without saying that the wider the distribution network available to issuers, the greater the access to capital and the greater availability of alternative investment opportunities to the Ontario investing public.

2. Crowdfunding

The crowdfunding concept represents the greatest departure from traditional thinking in this space. Stakeholders generally agree that to work, portal service providers must face minimal regulatory burden or the numbers simply would not justify the risk. Also, apart from cautions and disclosures, "investor protection" measures would include capping investable amounts and imposing certain minimum standards on issuers to require some level of accountability to investors.

The question has been posed whether crowdfunding would be useful for issuers, especially SMEs, in raising capital. The answer in our view is, only if the investor protection and regulatory safeguards don't render the model unworkable.

The first determination that needs to be made is whether the overriding policy issue is investor protection or economic stimulus. There is no doubt that internet investing through a portal raises the level of risk of fraud, though experiences in other jurisdictions seem to indicate that is less of a concern than one would imagine. There is also the issue of historical failure rates of startups and the prospect of total loss. The question is, can the responsibility for fraud avoidance and total loss awareness be equitably spread among investors, portals and issuers such that the economic benefit outweighs the investor protection concern? We must not forget that these startups are providing jobs, buying

equipment and intellectual property, feeding into the financial health of communities, even if only temporarily. That is a very important consideration in favour of finding a way to make this work.

In terms of the motivation of an investor, it seems this method has typically been used for community-based enterprises and small startups. While return on investment is obviously important, many investors in such a scenario are investing in their neighbour, their relative or friend or in a business they believe in. Profit may be secondary in such cases.

The paper also asks specifically whether investor protection concerns can be adequately addressed. The restrictions proposed we feel are largely appropriate. In particular:

a) Limiting the amount that can be invested. The $2500 cap, ($10,000 total per year) in our view, almost singlehandedly solves the investor protection problem. There are arguably very few people who would be involved in investments at all who could not recover from a total loss of $2500 and those who could not, would hopefully be filtered out at the education/disclosure stage (see b) below).
b) Providing clear and plain disclosure of the risks, including lack of liquidity, historical failure rates of startups, lack of regulatory oversight, possibility of total loss to investors etc. is a must. This could be supplemented by a short investor education component that must be completed – online - before the investment can be made;
c) Requiring the investment total to reach a specified target before the money is passed to the issuer. This allows the market to determine whether the concept is viable and a pre-determined critical level of funding to increase the chances of success of the enterprise. The target total though, should be from all sources and exemptions where appropriate, not just from funds raised through crowdfunding;
d) Prescribing minimum evidence of an acceptable level of planning and projection from issuers and the format that should take in order to support the business concept;
e) Prescribing a minimum and thorough method and format of investor record-keeping for both portals and issuers.

It is difficult to understand the purpose of the restriction on issuer advertising. While issuers ought to be forbidden to mislead, as with any other securities participant, the freedom to advertise is key to achieving "critical mass" of investors and therefore improving odds of success. Marketing is a key component of any sound business plan. Regulating it away has far more downs than ups.

It is also very difficult to envision how this concept can succeed if the thinking is to require portals to adhere to the regulatory standards currently applicable to other dealer or adviser categories. The margins will simply not support the regulatory cost of that setup. Nor, in our view, does the level of investor risk warrant it.

Portals should be registered because, as the consultation paper states, portals will be "in the business of trading" in securities within the meaning of the Securities Act. However, there should be a distinct "firm" category created to address the unique features of this model and it should:

a) be prescriptive enough to make their duties clear;
b) offer through regulation, precise guidance on for example, the content of the investor education component of the portal, the minimum requirements portals must demand of issuers and the expectations regarding risk disclosure;

c) have registration and ongoing reporting duties that are tailored to its limited role.

In other words, as part of the overall continuum of responsibility in protecting investors, regulators should take more than the usual share of the work here by providing nearly "cookie cutter" requirements that are based on sound principles.

It may be useful for a trial portal to be launched through a government-funded service with a finite number of issuers for a limited period (2 years?). This would permit operational issues and gaps to be tracked and identified providing sound data for the development of more lasting and suitable regulatory parameters.

3. Exemption Based on Investment Knowledge

We strongly support this exemption in its current form. It is sensible and long overdue.

4. Summary

Overall, we continue to feel that while investor protection is an important factor in the design of regulation, it is not possible to regulate against investor loss. And it's at the risk of healthy markets that we increasingly restrict investment and over-burden intermediaries in an effort to do just that. Our role is to inform and educate investors as plainly and clearly as possible, to make issuers and registrants reasonably accountable, and to let free market activity rule the day.

Thank you for the opportunity to comment.

Yours Truly,

S. A. McManus

Stephanie A. McManus LL. B.
Compliance Support Services

cc. National Exempt Market Association