



March 8, 2013

John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
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Dear Commission Members,

RE: OSC Exempt Market Review - Comments on OSC Staff Consultation Paper 45-710

We are pleased to provide the attached comments from MaRS Discovery District ("MaRS") on OSC Staff Consultation Paper 45-710. Our comments focus on the proposed crowdfunding exemption and related questions.

We appreciate the opportunity to participate in the consultation process and would be pleased to address any questions you may have regarding our submission.

Yours truly,

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Background

MaRS is a large-scale innovation centre located in Toronto and networked across Ontario, focused on building Canada's next generation of growth companies. MaRS works closely with entrepreneurs to grow and scale their ventures into global market leaders in the healthcare, information technology, cleantech and social innovation sectors, providing them with education, market intelligence and mentoring, as well as access to critical talent, customer and capital networks.

During 2011, 110 advisors, including full-time MaRS staff and volunteers, served a client base of 1,054 startup ventures in the above sectors. In 2011 alone, MaRS' venture clients created 1,500 new jobs, generated \$146 million in revenue and raised \$277 million in capital. From 2006-2011, 13,000 meetings, events and conferences were held at the MaRS Centre, with more than 500,000 attendees from the innovation and technology ecosystem.

On February 26, 2013, MaRS held a stakeholder event, attended by staff from the Ontario Securities Commission (OSC), where we gathered feedback from entrepreneurs and investors in the MaRS network. Our submission reflects the comments made by the MaRS community.

Funding and innovation gap

The funding gap for Canadian technology companies is well documented. According to the Canadian Venture Capital Association ("CVCA") report on 2012 activity, the number of Canadian innovative companies that received VC financing was 395, up slightly from 393 companies during the prior year. The average amount of capital raised by these firms was also consistent year over year at \$3.7 million and no progress was made on closing the gap between Canada and the United States on deal capitalization. The current gap, consistent with 2011 and 2010 results, has Canadian companies raising only 44% of the venture capital amounts raised by their U.S. counterparts.

The National Angel Capital Organization's report for 2011 indicated that registered angel groups invested in 134 companies during 2011 with an average investment amount of \$614,000 per company and, based on OECD estimates of the visible Canadian angel community, they estimated that 1,500 growth companies received investment from angel investors during 2011.

According to Industry Canada, in December 2011 there were 1.1 million Canadian businesses with employee payroll accounts. For these employer businesses, 99.7% were classified as small and medium-sized businesses of less than 500 employees ("SMEs"). Based on the above statistics, SMEs that raise venture capital and attract angel investment represent only 0.17% of the total SME population, so a large opportunity exists to improve access to capital for the remaining 99.83%.

Most of the discussions on crowdfunding have focused on improving access to capital, but we also believe that fostering the crowdfunding ecosystem could serve to stimulate and accelerate innovation by exposing more Canadians to local innovators and their businesses – raising awareness, inspiring others, catalyzing local support for great Canadian ideas, exposing existing Canadian companies to new local innovations and drawing new talent (women, immigrants) into the innovation mainstream. In addition to raising more capital for more Canadian businesses, a progressive and vibrant crowdfunding regime will also make Canada more attractive to innovators and their businesses from other jurisdictions – strengthening our ability to compete in the fast-moving global innovation economy.

Summary recommendation

We believe that the OSC has an opportunity to apply technology advances from the Internet and from the changing investor behaviours that result from the growth and acceptance of social networks to improve the capital-raising process for Canadian SMEs. We encourage the OSC to:

- 1) Move forward to implement an Ontario crowdfunding exemption quickly.** The exemption will provide an opportunity to fill the current funding gap faced by SMEs in the Ontario market and also provide access to early-stage investment opportunities for Ontario investors. By moving fast, the OSC can help ensure that the crowdfunding vacuum is not filled by non-Canadian crowdfunding portals, which are outside of the OSC's power to effectively regulate. We see growing evidence that U.S.-based portals are approaching early-stage companies in Ontario with the aim of drawing them to relocate to the U.S. to take advantage of their services and improve their access to capital.
- 2) Create a crowdfunding exemption that is complementary to existing exemptions – permitting issuers to simultaneously use different prospectus exemptions when raising capital.** By allowing investment portals, the OSC has the opportunity to not just increase the number of potential SME and investor participants in the exempt market through non-accredited investor crowdfunding, but also to dramatically improve the efficiency of connecting accredited investors to SME investment opportunities. In early-stage financing transactions, multiple prospectus exemptions are often used together, and we believe that the concurrent use of crowdfunding and accredited investor exemptions (and possibly other exemptions, such as the proposed Offering Memorandum exemption) will enable SMEs to maximize the size of their financing rounds.
- 3) There is a strong need to strike a good balance between portal efficiency and investor protection against fraud.** Given that a portal may have a very limited role in the capital-raising process, the OSC should ensure that the regulations match the activities that the portal is performing. If the portal is not providing advice to investors on the suitability of investments and/or is not active in the exchange of cash between investors and the issuers, then the portal should only be subject to a light regulatory framework to validate the management and board of the issuer against key risks associated with fraud. If there is heavy regulation, this financing option will be too expensive for SMEs to consider and portals will be unable to build a viable business model.
- 4) Work toward one set of national crowdfunding regulations.** Work with securities regulators in other provinces to create one set of national crowdfunding regulations for use by Canadian companies (issuers) and investors in order to create the scale necessary for equity crowdfunding platforms and SMEs to thrive.

Crowdfunding exemption

Q1. Would a crowdfunding exemption be useful for issuers, particularly SMEs, in raising capital?

1. YES. Our advisory experience with many entrepreneurs seeking funding for their early-stage ventures is that there is a limited supply of risk capital for technology companies in Canada and that capital can be difficult to access, particularly for entrepreneurs who are new to, or inexperienced in, the local startup community. We believe that crowdfunding can address at least part of the early-stage funding gap that is well documented in Canada.

Crowdfunding can potentially provide the necessary funding to young startup companies from a range of technology subsectors and to smaller companies with low capital needs. Crowdfunding platforms may particularly benefit industry sectors that face unique challenges with accessing capital, such as the medical technology or social innovation fields. Crowdfunding portals have the potential to energize financing in these sectors by educating a wider audience of potential investors about the opportunities in these fields, as well as providing greater exposure for the companies and entrepreneurs operating them.

The proceeds from an online crowdfunding round should enable these types of companies to achieve product development and/or customer acquisition milestones that will position them to either attract more significant levels of investment, or become cash-flow-positive based on their revenues.

Q2. Have we recognized the potential benefits of this exemption for investors?

2. YES. We believe that democratizing the opportunity for all investors to participate in early-stage company investments through the exempt market is a key benefit of the proposed exemption.

We would also like to underline the importance of making the capital-raising process more efficient and less expensive, which ultimately benefits issuers and all of their shareholders (both accredited and non-accredited investors). The current methods of fundraising for startup companies generally do not leverage the Internet and social media, largely because of existing securities regulatory constraints. It should also come as no surprise that these methods are also very inefficient. Founders need to rely on their contacts and informal networks to identify potential investors, and then spend months or longer “pitching” their business plans to these investors. This process can be very time-consuming and distracting for founders during a critical time for establishing the viability of their technology or product and gaining traction with early customers. The process has also become significantly slower and more challenging in recent years for a number of reasons: the number of active venture capital funds has declined; existing funds have had less capital available for new investments due to their own challenges with fundraising; and the economic crisis forced fund managers to spend time and capital on struggling investees in their existing portfolios rather than making new investments.

In our experience, founders are often unable to raise capital because they lack business networks. Young or inexperienced entrepreneurs and founders from groups outside the mainstream technology community, including women and new Canadians, are particularly disadvantaged. In urban centres like Toronto there are many new Canadians trying to establish new businesses. They do not have access to the networks of traditional angels and VC investors. In addition, we urgently need to make it easier for more women to engage in building growth companies in the knowledge economy sectors. It is extremely challenging for women entrepreneurs to raise capital from traditional angel networks or venture capital funds, since these networks include very few women as active investors. While we could not locate



Canadian data on this topic, we believe that the experience of Canadian women is similar to their U.S. counterparts. A recent study by the U.S. National Foundation of Business Owners and Wells Fargo & Company reported that while women owned 38% of U.S. businesses, just 2% of the venture capital invested in the U.S. goes to women-owned firms.

Innovation centres like MaRS, other economic development agencies, accelerators like our own JOLT program and angel networks can and do make the process of finding angel investors easier for startups, while being careful not to stray into activities that require registration. However, as investor behaviours shift and more efficient alternatives like AngelList and SecondMarket emerge in the U.S., it will become more difficult for organizations like MaRS to maintain investor interest in our client ventures by using current methods.

We view the equity crowdfunding initiative as having two steps:

- The first step is to enable the use of Internet “portals” to enable efficient capital-raising by SMEs from accredited investors. We believe that in embracing this approach, there is little risk and lots of opportunity to democratize, improve and better regulate the capital formation process in Ontario. We also believe that we need access to these tools to continue to serve our community of entrepreneurs at MaRS.
- The second step would be to extend the potential investor base for early-stage company financings in the exempt market by including non-accredited investors.

Q3. What would motivate an investor to make an investment through crowdfunding?

3. Some investors will be drawn to making startup investments through the crowdfunding exemption with the goal of “getting in on the ground floor” and achieving promising returns from these high-risk / high-potential deals. However, based on our experience, startup investors often have other objectives in mind, including:

- supporting friends, family or former colleagues;
- promoting businesses with a positive health, social or community impact;
- helping bring to market a desirable product or service in a field of interest; and/or
- participating in a recreational form of business networking, inspired by watching Dragons’ Den or Shark Tank.

As long as investors fully understand that there is a very real risk that they may lose their entire investment when investing in a startup company (issuer), we believe that this activity should be permitted.

At our stakeholder event, we received some interesting comments about the benefits for investors of investing in companies listed on crowdfunding portals. The ability for investors (or their advisors) to see a larger variety of early-stage investment opportunities that they wouldn’t be able to access elsewhere without significant effort was a key benefit. With this increased access, they felt more able to tailor investments to the investor’s personal values and/or strategic goals. Some stated that this could lead to much better alignment between a company and its investors. One participant suggested that by lowering transaction costs, portals will actually make it possible to have more diverse goals for investing. Finally, participants were highly motivated by the transparency of investing in opportunities posted online (e.g., AngelList) and stated that it provides good education for companies and investors on valuation and other terms of early-stage investments. Consolidating a group of companies onto a portal also enables investors to compare benchmark data on startup companies and to make better investment decisions.



Q4. Can the investor protection concerns associated with crowdfunding be addressed and, if so, how?

4. YES. We believe that the risks associated with crowdfunding can be addressed through the following measures, most of which were addressed in the OSC paper:

- Require all crowdfunding investors to sign a risk acknowledgement form about the investment – it should be a standard form that is brief/easy to understand and clearly indicate that investors bear the risk of losing all of their investment.
- Require non-accredited investors making crowdfunding investments to be subject to reasonable limits on the dollar amount they can invest. However, we feel strongly that these limits should NOT apply to accredited investors or other investors that fall under another investment exemption, even if they learn about the investment opportunity through a crowdfunding portal.
- Require that crowdfunding investments be made through a portal that is registered and that has the responsibility to ensure that:
 - the management of companies (issuers) have been vetted by the portal with respect to criminal background checks and bankruptcy;
 - companies (issuers) provide potential investors with an information statement that includes basic information about the share offering, the issuer's business, the funding portal (including its compensation for the transaction) and a description of the key risks for the business; and
 - investors are provided with a cooling-off period of two business days to withdraw from the investment.
- The OSC should encourage portals to use an escrow process for funds received from investors to facilitate a simultaneous closing date with all interested investors. If the company (issuer) fails to find sufficient investors for their offering, then any funds held in escrow would be returned to investors. Portals may also consider allowing companies (issuers) to determine and describe their use of proceeds for their total offering and, where applicable, specify a minimum first closing threshold amount that may enable them to move forward with a smaller number of interested investors in either a "first closing" or, ultimately, upon completion of a smaller offering, if no further investors come forward after a first closing date. Companies (issuers) that choose to post a first closing and total financing amount should also indicate a targeted first closing date. These practices would mirror best practices from non-equity crowdfunding websites, as well as "first closing" practices used by angels and other early-stage investors to ensure that the company (issuer) has sufficient funding to achieve the meaningful milestones described in the plans presented to potential investors, while also allowing companies (issuers) the flexibility to proceed sooner with a smaller financing amount should investors be willing to participate based on the first closing amount and associated plan. During our stakeholder event, entrepreneurs also expressed support for the escrow approach, as they also would like to ensure that their company receives the full amount of required funding to execute their business plan from portal investors who have made commitments online.

- One additional best practice from existing crowdfunding alternatives that the portals should also consider in implementation is the setting of an expiry date associated with a specific crowdfunding offer.

Q5. What measures, if any, would be the most effective at reducing the risk of potential abuse and fraud?

5. The most important measure is to establish and monitor a simple set of regulations for crowdfunding investments and the portals that facilitate these investments. Keeping it simple is really important, as stakeholders who establish portals may not currently be in the securities industry. For many years, “conventional” broker-dealers have not been active in the technology startup financing community and that will likely continue until such time as there is a sufficient volume of activity to attract their financial interest. We believe that many portals would likely put in place the measures, identified above in response to question 4, in order to protect investors and their reputations; however, there would be benefit to investors, portals and the OSC in standardizing the requirements and expectations.

Q6. Are there concerns with retail investors making investments that are illiquid with very limited options for monetizing their investments?

6. NO. Investors must understand that they are NOT making a crowdfunded investment with an expectation of either liquidity or the ability to monetize the investment. This should be made completely clear in the risk acknowledgement form.

Q7. Are there concerns with SMEs that are not reporting issuers having a large number of security holders?

7. YES. Issuers will need to be educated about the potential impediments to working with a large number of shareholders and to raising follow-on financing from angels and venture capital firms in this situation. However, we expect that many of the concerns can be addressed through well-drafted shareholder agreements and the use of voting trustees. We expect that portals would also provide technology solutions to help maintain the share register and capitalization table. Using portal platforms to help standardize these documents promises to significantly improve the haphazard record-keeping that is typical of most startups.

Q8. 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?

8. We don't believe that a trial period is necessary as Ontario has had the benefit of observing how crowdfunding has been adopted in other geographical markets, as discussed in the consultation paper. We also feel it is important that we not fall further behind other jurisdictions in developing innovative regulatory frameworks that grasp the reality of the Internet and widespread adoption of social media. Finally, we believe that implementation of a trial for a particular industry sector would be difficult to administer and may be unfair.

However, if the OSC is only willing to support a staged approach to introducing the exemption, we suggest minimal restrictions during a short trial period of 18-24 months, as this will encourage experimentation with different models to help inform the OSC on the final regulations.



We would also like to encourage the OSC to work with the other securities regulators across Canada to develop and implement a national framework for crowdfunding exemptions and portals. The Internet and social media technologies are global tools and crowdfunding platforms will be much more useful if they can attract companies (issuers) and investors across at least provincial borders.

Issuer restrictions

Q9. Should there be a limit on the amount of capital that can be raised under this exemption? If so, what should the limit be?

9. Our initial reaction, after reviewing the annual data we compiled on capital raised by MaRS client companies, was that the proposed \$1.5 million limit in any 12-month period, as described in the consultation paper, appears to be in the appropriate range. We believe it is critical to clarify that this limit would exclude amounts raised from accredited investors or from investors under other prospectus exemptions. An investment limit should NOT be placed on accredited investors simply because they learn of and/or complete an investment through a crowdfunding portal.

That said, during our stakeholder event, many participants struggled to understand the need for any limit at the company (issuer) level, assuming that there will be a tight \$10,000-per-year cap put on individual investors. Their rationale included: (i) the company cap may be low in relation to capital requirements in some technology sectors; (ii) having a cap may limit the success of equity crowdfunding as a viable alternative for companies (issuers) (i.e., would Kickstarter be as successful had Pebble not far exceeded its initial fundraising target?); and (iii) as companies (issuers) will be providing terms of investment, including how much ownership they are prepared to offer in exchange for their targeted investment amount, there will be a natural check and balance on the size of the round, as entrepreneurs will likely impose a cap to avoid significant ownership dilution.

Q10. Should issuers be required to spend the proceeds raised in Canada?

10. NO. Most Canadian companies operate in global markets and must source staff, products and services from other countries in order to be competitive. There are well-established incentives in Canada's tax system and in both federal and provincial grant programs to encourage companies to perform certain activities in Canada. It is more productive to focus on creating a positive growth environment for emerging companies in Canada than to impose operating restrictions. SMEs in particular need to be encouraged and supported to expand globally – their lack of capital is, in fact, a critical impediment to their growth in the current environment.

Investor protection measures

A11. Should there be limits on the amount that an investor can invest under this exemption? If so, what should the limits be?

11. We agree that there should be limits on the amount that an investor can invest under a crowdfunding exemption. However, these limits should ONLY apply to investors who ONLY qualify under the crowdfunding exemption. Accredited investors and investors who qualify under other exemptions should NOT be subject to the limits, even if their investment is completed through a portal and/or at the same time that the company (issuer) also raises funds under the crowdfunding exemption.



The limits proposed in the consultation paper of \$2,500 per investment and \$10,000 per year generally seem appropriate; however, some of our stakeholders felt that using a percentage of income may be more useful to enabling investments by those individuals currently making more than \$100,000 per year, but less than the current \$200,000 accredited investor limit. We also heard from others who felt that just an annual limit of \$10,000 was more appropriate, enabling investors to decide whether they want to invest in one or many opportunities per year. We believe that an absolute dollar limit is much easier for investors, portals and the OSC to administer, and preferable to limits based on net income or net worth that are proposed under the JOBS Act. There is some risk that crowdfunded investments will gravitate toward the \$2,500 limit, so it may be preferable for issuers/portals to post an investment range which also includes the minimum investment amount they permit (for example: \$500-\$2,500 per investor).

Q12. 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?

12. The issuer and portal should be required to ensure that investors receive an information statement at the time of sale. We would hope that the information statement be brief and not become a prospectus-like document, which would eliminate the attractiveness of this exemption. Our comments and suggestions follow:

- The content for the disclosure in the “crowdfunding concept idea” is appropriate.
- In terms of format, consider encouraging companies (issuers) to present information in PowerPoint slides. Portals should be encouraged to provide an investor slide deck outline and samples to educate issuers on the information required by investors to make an informed investment decision.
- Similarly, consider encouraging issuers to also use short video clips to present their information, describing their business and enabling investors to get a better sense of the company’s (issuer’s) management team.

Alternative presentations (e.g., slides or video clips) can and should still be certified by the CEO and directors of the issuer.

Q13. Should issuers that rely on this exemption be required to provide ongoing disclosure to investors? If so, what form should this disclosure take?

13. The ongoing disclosure described in the OSC’s concept idea seems reasonable and appropriate (i.e., providing investors with annual financial statements, and keeping books and records on securities issued, names of security holders and use of proceeds). It would be helpful to the process if the registered portals could assist companies (issuers) in publishing this data in an investor-only, password-protected area on their website or through electronic distribution to the company’s (issuer’s) investors.

Q14. 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?

14. NO. In most early-stage startup companies we see at MaRS, many shareholders are willing to waive the annual audit requirement in favour of their investment dollars being used toward product development or customer acquisition activities. This is also likely due to the fact that historical financial statements at the early stage of company development have little value in helping an investor determine

the future potential for a company. At the \$500,000 investment level, we believe it would be more appropriate to require that the company (issuer) provide a set of accountant-reviewed financial statements for the company's (issuer's) last financial year-end period. If the company (issuer) has not yet reached their first year-end, management-prepared financial statements as of the month-end date prior to the offering should be sufficient for investor purposes.

Q15. Should rights and protections, such as anti-dilution protection, tag-along rights and preemptive rights, be provided to shareholders?

15. NO. It should be up to the company (issuer) to choose whether they wish to offer some or all of these terms to prospective shareholders as part of the offering.

Funding portals and other registrants

Q16. Should we allow investments through a funding portal (similar to the funding portals contemplated by the crowdfunding exemption in the JOBS Act)?

16. YES. As an innovation centre, MaRS embraces the OSC's desire to explore innovative approaches and the use of emerging technologies to improve the capital-raising process for SMEs and their investors. This is particularly true given the advances being made in this area in the U.S., an adjacent market with an open-door policy for Canadian entrepreneurs. We have already seen significant evidence of Canadian companies and investors present in the emerging crowdfunding ecosystem in the U.S. and would expect this migration to increase as the U.S. Securities and Exchange Commission (SEC) implements rules and regulations for the JOBS Act. MaRS' mission includes enabling Canadian companies to achieve global success from a home base here in Canada. However, in order for these companies to be competitive, they need access to similar tools as those available to their American counterparts and other global players.

If so:

- **What obligations should a funding portal have?**

We believe it is important to adopt a regulation framework that would enable entry by stakeholders who are not currently active in the securities industry. Each portal must be able to establish its own community of companies (issuers) and investors, and reflect the investing culture of that community. This might be highly varied, from portals funding small owner-managed businesses in a city or town to a portal supporting highly disruptive technology startup companies in a specific sector. The regulations need to allow investors and issuers with aligned goals to co-exist and to ensure efficient capital-raising for all parties.

We expect that portals would do the following:

1. "Showcase" companies (issuers) and describe their funding requirements.
2. Perform bankruptcy and criminal checks of company (issuer) management and board to screen out potential fraud.
3. Create an investor database and administer investor access to the portal (e.g., through passwords).



4. Arrange for payment processing through a third-party payment processor.
5. Possibly establish standards for the companies (issuers) that can use the site, and for the disclosure that must be provided by those companies (in addition to any legally mandated disclosure).
6. Some portals may also establish chat rooms or other social networking platforms for issuers and investors to interact with one another.

It was interesting to note that during our stakeholder event, the concept of “social” proof or due diligence was discussed as a way to mitigate potential fraud and this could be applied by portals. For example, some closed community angel networks require that investors and companies (issuers) be referred and then validated through members of the closed community before being permitted to post company information for review by investors or also to review company (issuer) data for potential investment.

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

YES. Portals should be required to register in a new category of restricted dealer. Portals that register in this category should not be permitted to provide advice or to hold funds or securities. Based on this, registrants in this new restricted category should be exempted from proficiency and solvency requirements.

Q17. 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?

17. NO. We support the OSC’s concept idea from the paper and do not believe that this type of distribution requires involvement of any registrant beyond the funding portal.