

Feedback re: OSC Staff Consultation Paper 45-710

Provided by:

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5.2 Exploration of Crowdfunding

Part I

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

Yes. A major inhabitant for growth in micro- to small-businesses is access to capital. Allowing crowdfunding for SME would be particularly useful for two reasons:

- (a) There are many business sectors which have difficulty obtaining capital because they do not fit into the traditional incubator profiles, and are thus unappealing to large institutional, venture capital or angel investors. This could be either because they are not in a high growth industry or do not have the potential investors returns required by such investors.
- (b) Undercapitalized small businesses often have difficulty in obtaining bank financing, and allowing crowdfunding may be useful for strengthening one's balance sheet to obtained additional bank financing, ultimately reducing their overall weighed average cost of capital.

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

Yes. It is important that we look at broadening the exempt market to include additional investors as wealth is not a great proxy for investor sophistication. This will provide additional investment opportunities for investors who can further tailor their investment portfolio based on their own personal preferences.

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

There are a number of potential motivating factors such as:

- (a) The opportunity to invest in micro- and small-businesses in their own community.
- (b) The ability to further refine one's investment portfolio based on other factors, such as location, small business sector, and social/environmental factors.
- (c) The desire to invest in social or environmental business not large enough to be part of the listed market.
- (d) The ability to invest in culture and the arts on a micro level, such as individual projects.

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

I believe that with appropriate reporting, investor protection concerns can be addressed through:

- (a) The implementation of ongoing disclosure, such as annual financial statements and some form of simplified MD&A.
- (b) Financial statements that are at least reviewed by an independent licensed public accounting firm.
- (c) Financial information should also be reviewed to ensure the proceeds were indeed used as intended, this could be done through a special engagement in situations where the total offering is of a minimum size, given that there would be some cost to it.
- (d) Possible background checks and ensure that individuals convicted of a felony cannot certify management information (this may or may not be practical however).

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

Requiring reviewed financial statements will reduce the risk for businesses which are already operating. For new start-ups, background checks of management, and other information should be notarized to ensure its authenticity.

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

Yes, if we are going to allow crowdfunding, we need to ensure that there is some form of exit strategy available for investors, otherwise many investors may never see a return on their investment. This may also discourage many investors from using crowdfunding in the first place.

One solution for this may be allow funding portals to both sell the initial securities of the SME and also provide an aftermarket for the purchase and sale of the issues shares. An alternate solution may be to allow approved businesses or portals to operate an exchange-type business, much like a crowdfunding security exchange. Such businesses should not be allowed to buy and sell securities, but to charge a reasonable fee for the facilitation of such transactions.

In conjunction with the implementation of ongoing disclosures, there would be at least as much information available to subsequent investors as there was to the initial investors. Such businesses should also be required to make available any and all information as supplied by management of the SME so that subsequent investors have access to it.

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

One concern with having a large number of security holders is the election of the board of directors and having sufficient votes to approve by-laws, amendments and other items that require shareholder approval.

This could be addressed by reducing the quorum required to conduct certain shareholder business and by allowing AGMs and shareholder votes to be conducted electronically.

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?*

The issue with a trial or limited basis is that we cannot necessarily know in advance which industry sectors would most benefit from it. If a sector that is chosen that is not a good fit for crowdfunding, its “failure” could be projected across the entire SME market, which means we could be missing out on a great opportunity for other sectors.

With a time-limited basis, there could be a rush of crowdfunding applicants who may not be ready, or appropriate, for crowdfunding try and get in before the deadline. It will take time for the crowdfunding model to fully develop and SMEs will need appropriate time to develop crowdfunding approaches that make sense for them, yet still protect investors.

Using a specified portal might work initially, however it could also move SMEs to the OM model, which would then restrict the potential number of investors. As long as funding portals are licensed and meet all of the OSC’s guidelines/restrictions, the number of funding portals should not necessarily be limited.

Part II

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

Yes there should be a limit. As crowdfunding initiatives are often project-based or for micro- to small-businesses, and given that they are highly risky, there should be a reasonable limit under this exemption. I believe that \$1,000,000 in any 12 month period would be more than sufficient given the nature of crowdfunding and individual investment limits.

Additionally, by limiting the total amount raised by an SME, it would also reduce the overall losses sustained by crowdfunding investors as a whole, and would ensure that crowdfunders-at-large can sustain the loss of the investment.

10. *Should issuers be required to spend proceeds raised in Canada?*

Yes. Perhaps either more than half or substantially all (>90%) should be spent in Canada. Just as the small business deduction is designed to create jobs in Canada, requiring that SMEs spend substantially all of the proceeds in Canada will contribute to the Canadian economy and have spin-off benefits. This will also ensure we do not encourage capital flight out of Canada.

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

Given that most crowdfunding investors would not be high wealth Canadians, it is important to put a limit on the type of investment to ensure that the investor can withstand the loss. Tying the limit to Canadian individual or household income would ensure that the limit remains appropriate as the economy and income either grow or contract. A limit of 5% of individual

median income on individual investments would ensure that an appropriate level is established based on the number of people in each tax bracket, rather than using an average, which is distorted by extremely high or low individual income levels of a small group of investors.

Additionally, a limit of 15% of individual median income for all investments within a calendar year would ensure that investors would be able to sustain the loss even if significantly all of their investments went bad.

12. *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?*

Reviewed financial statements and a simplified MD&A should be included, along with what the proceeds are going to be used for. A simplified MD&A could take the place of a business plan where the company is already in business. For new start-ups, some form of streamlined business plan should be required to ensure critical information is included, as business plans take on a variety of formats and can be inconsistent in the information they provide.

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

Yes, given the investment's illiquid nature, ongoing disclosure should be required. This should consist of annual financial statements (at least reviewed) and a simplified MD&A.

14. *Should the issuer be required to provide audited financial statements to investors at the time of 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?*

Yes, the SME should be required to provide audited financial statements for investment proceeds greater than \$500,000. Where the proceeds are less than \$500,000, the SME should be required to provide reviewed financial statements. The threshold is appropriate as a review can be done for amounts less than that.

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

I do not see anti-dilution protection as being a significant concern as all crowdfunding investors will likely hold a very small proportion of the shares. Anti-dilution concerns could be addressed by allowing pre-emptive rights, which will ensure that existing security holders would be able to acquire additional shares if desired.

Tag-along rights would be more important as they could provide a much-needed out for individual investors, given the illiquid nature of the market.

16. *Should we allow investment through a funding portal? If so:*

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

The funding portal should be required to make available all information required, as submitted by management, to potential investors. Funding portals should be designed to facilitate crowdfunding transactions, however they should not be providing any advice regarding any security they are facilitating.

The funding portal should also be required to make sure that each SME they are listing has provided all of the required information as outlined by the OSC. The funding portal should also be required to identify and flag any SME that has not met some or all of the initial and ongoing disclosure requirements.

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

No comment regarding this item at this time.

17. *Should a registrant other than a funding portal be involved in this type of distribution? If so, what category of registrant? Should additional obligations be imposed on the registrant?*

Given the nature of oversight that a funding portal may need to provide over their listed investments, it may not be appropriate for registrants to be involved in the initial distribution of the securities. If every distributor had to assume all of the obligations noted in the previous questions, it would be impractical to implement. Centralizing the oversight among licensed portal should promote compliance and reduce redundancy.

5.3 Exploration of an OM Prospectus Exemption

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

Yes—if compliance can be reasonable assured.

If crowdfunding was restricted to funding portals, then it would make sense to allow for an OM exemption for securities that could be distributed everywhere else. The issue that comes up is of oversight. If there is no funding portal equivalent for oversight, it could be even more difficult to ensure compliance than it already is in the exempt market.

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.*

Yes, there should be limits similar to that of the crowdfunding exemption. There should be no additional limit given the potential compliance issues.

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

The investor should have all information that is available under the crowdfunding exemption be made available to them under the OM exemption. This may or may not warrant additional advice from an advisor, so while helpful, may not be necessary depending on the investor.

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

Yes, there should be mandatory disclosure similar to that under the crowdfunding exemption.

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

Yes, there should be the involvement of some form of registrant in order to ensure compliance. The registrant would not be required to provide advice, only to facilitate the transaction and ensure compliance.

6.2 Exploration of a prospectus exemption based on investment knowledge

I do not believe that this exemption will be of great impact based on the relatively small number of people who might qualify. A crowdfunding or OM exemption would be far more impactful for most Canadians. I will refrain from commenting on this exemption as I do not believe it will be overly useful.

7.2 Electronic Filing

I believe that electronic filing should be mandatory. The implementation of crowdfunding and/or an OM exemption could lead to a significant increase the number of filings to the OSC. By mandating electronic filing, the OSC will have the data in a format that is consistent and comparable. Additionally, it would free up some of the OSC's resources and also reduce the risk of human error.

Given that all businesses use computers, it would not be an impediment to electronic filing. Furthermore, if a business is raising up to \$1,000,000 in funds, it would not be unreasonable to require electronic filing of the required forms as long as they are browser-friendly.

CRA already requires the electronic filing of corporate tax returns and other forms, so it would not be unreasonable for the OSC to expect the same.

7.3 Additional information required

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

No concerns noted regarding the additional information. This information will be useful in determining which industries are benefiting from either the crowdfunding or OM exemptions and identify potential practice or compliance issues.

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

With respect to the investor, identifying their income bracket would be useful, however it is unlikely that most investors would feel comfortable disclosing such information.

Additionally, obtaining both of the issuer's and investor's addresses, or at least postal code, will highlight where most crowdfunding or OM activity is occurring.

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

Yes, investment funds should be required to report more frequently given the volume of transactions they will be dealing with. Also, it would allow for better oversight and information about what is happening with SMEs under the crowdfunding and OM exemptions.

8.1 Implications for broadening access to the exempt market

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

In terms of providing better access to capital for SMEs and providing additional investment opportunities for the general population, I believe both the crowdfunding and OM exemptions could be the most effective method.

If these were implemented, I do not foresee any other exemptions being required at this time.