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December 4, 2000

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 800, Box 55
Toronto, Ontario M5H 3S8

Dear Sir:

Re: Proposed OSC Rule 45-501 – Exempt Distributions (Revised)

The Canadian Bankers Association (CBA) appreciates this opportunity to provide you with our comments on the third draft of proposed OSC Rule 45-501 – Exempt Distributions (Revised), Companion Policy 45-501CP (Revised) and related forms. As you review our comments, please bear in mind that our members endorse the views presented in this submission as both intermediaries and as reporting issuers.

General Comments

The CBA welcomes this initiative to revamp the exempt market in order to make it easier for small and medium-sized enterprises ("SMEs") to raise capital. However, as we stated in our September 19, 1995 response to the Report of the OSC Task Force on Small Business Financing (the "Report"), we are of the view that a major restructuring of the securities regime should not be undertaken by a single provincial regulator. The establishment of divergent rules in different jurisdictions promises to increase the complexity of the legal and regulatory framework for raising capital in Canada, and highlights the need for a single national regulator.

Specific Comments

Pooled Funds in Trust Company Managed Accounts

We welcome the proposed exemption of trades made to accounts managed by portfolio advisers registered in Ontario that will result from the application of the proposed Accredited Investor exemption. However, we are disappointed that the proposed exemption does not include pooled fund investments in accounts that are managed by trust companies.

The definition of "accredited investor" in the proposed Rule effectively makes the accredited investor exemption unavailable for pooled funds investments in fully managed accounts, where such accounts are managed by trust companies on behalf of individuals who do not themselves qualify as accredited investors.

The law as it now stands permits trust companies to invest in pooled funds for fully managed accounts on behalf of investors for whom the trust companies determine the investments to be appropriate, since the trust companies are deemed to be acting as principal when trading on such clients' behalf. We would submit that this is consistent with the public interest, in that trust companies are regulated under provincial or federal legislation, have considerable experience and a long history of prudent and expert portfolio management, and are subject to a high standard of care in the management of discretionary accounts.

This proposed change to the status quo would deny many individuals access to pooled funds investments and sophisticated portfolio management that offer attractive returns. The change does not appear to be necessary as a matter of investor protection. We are not aware of any history of problems that would justify restricting the exemption as proposed. Such a curtailment also could work to limit competitive forces that are working to extend "high end" portfolio management services to reasonably affluent individuals who do not quite qualify as accredited investors.

Mutual Funds as Accredited Investors – Disclosure Requirements

The definition of "accredited investor" in the proposed Rule requires in clause (v) that, to be eligible as an accredited investor, a mutual fund must disclose in its prospectus (i) that the fund may purchase securities in reliance upon the exemption in section 2.3; and must also disclose (ii) any restrictions on the fund's ability to rely upon that exemption.

These disclosure requirements should be reconsidered. Disclosure concerning exempt distributions will clutter up the mutual fund prospectus, is not likely to be read by investors and if read is not likely to be particularly meaningful to them.

Many or even most mutual funds will invest in private placements, but specific disclosure of small holdings will not always be appropriate in the context of a large mutual fund. A $1 million private placement investment by a $1 billion mutual fund might not warrant disclosure. Perhaps disclosure requirements should be triggered only where a mutual fund acquires exempt securities that amount to more than a designated amount, such as 3% of fund assets.

Would the qualifications to the definition in clause (v) require an issuer that proposes to trade a private placement to a mutual fund, to first satisfy itself that the mutual fund prospectus contains appropriate disclosure?

We also would submit that it would be more appropriate for disclosure requirements concerning investment by mutual funds in exempt distributions to be set out in a rule relating to mutual funds, rather than as a definition of "accredited investor" in a rule governing exempt distributions.

Accredited Investor Exemption

Subject to the comments set out below, we support the proposed Accredited Investor exemption. In our view, this exemption will facilitate investment in SMEs by qualified investors, and will be more flexible than the $150,000 exemption alone. By not limiting investors to a minimum investment amount, this exemption will make it possible for qualified investors to invest, in amounts less than $150,000, in U.S. IPOs and other public offerings that could previously only be sold in Canada by private placement.

(a) Financial Assets Test too narrow

In our view, the financial assets test set out in clause (m) of the definition of "accredited investor" and the definition of "financial assets" are too narrow, and should be modified to accommodate individuals who possess substantial assets other than cash, securities and evidence of deposit. For example, an individual who has $2 million of equity in real property but does not meet the test as currently proposed, or who has in the aggregate assets including real property and chattels worth at least $2 million, should be able to qualify as an accredited investor. If substantial wealth is acceptable as a proxy for financial sophistication and risk-tolerance, individuals whose assets are more varied than cash, securities and deposits should not be excluded from the accredited investor category for reasons of administrative convenience.

(b) Net Income Test should be more flexible

In our view, the net income tests in clause (n) of the definition of "accredited investor" should be revised to include individuals whose average net income over a period has exceeded $200,000 or whose average joint net income has exceeded $300,000, even if those levels have not been reached in each year. It should be possible to qualify an individual whose aggregate income over a three year period exceeds $600,000, even if it exceeds $200,000 in only one of those years.

Closely-held Issuer and Family Member exemptions

The closely-held issuer exemption and the family member exemption will make it possible for SMEs to raise capital more quickly and at less cost. However, we note that the closely-held issuer exemption, which arguably would, in conjunction with the family member exemption, replace the private issuer exemption, the seed capital exemption and the government incentive securities exemption, is not likely to raise much capital: an SME would have to raise an average of $86,000 from 35 investors who do not qualify as Accredited Investors, in order to raise $3 million and make full use of the exemption.

The closely-held issuer exemption may reduce investor protection by excluding the involvement of market intermediaries who would assess suitability. It remains to be seen whether the benefits will justify the reduction in investor protection.

"Common enterprise"

Clause 2.1(a) of the proposed Rule, which provides that the calculation of the $3 million limit for the closely held issuer exemption will include aggregate proceeds received by any other issuer engaged in common enterprise with the issuer. It would be helpful if the Rule were to include a definition of "common enterprise".

Elimination of the Seed Capital and Government Incentive Securities Exemptions

The elimination of the seed capital and government incentive securities exemptions may leave some gaps. In particular, some small issuers that have relied upon the seed capital and government incentive security exemptions to market flow-through share offerings, will not be able to rely on the closely-held issuer exemption.

Elimination of the $150,000 Exemption

We do not agree that it is necessary to eliminate the $150,000 exemption. That exemption in Ontario, and other investment-threshold exemptions in other jurisdictions in Canada that set thresholds of $97,000 and even $25,000 – have been accepted as appropriate measures of sophistication and risk-tolerance. As well, it is not at all clear that an income-based accredited investor exemption that permits exempt investments in small amounts necessarily affords a better test of sophistication and risk tolerance than does a test that is based on the ability to make a single large investment. An investment threshold exemption – whether at the $150,000 level or a lesser amount - would not be incompatible with the proposed accredited investor and closely-held investor exemptions, and could be retained as one of a number of exemptions that serve to protect investors and facilitate investment.

We would be pleased to answer any questions that you may have about our comments.

Yours truly,

WL/DI