December 11, 2000

Mr. John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, ON M5H 3S8

Dear Mr. Stevenson:

**Re: Proposed OSC Rule 45-501 ? Exempt Distributions**

Proposed OSC Rule 45-501 on Exempt Distributions (?the Proposed Rule?) effects widespread changes to the regulation of Ontario?s exempt market. It also introduces several new exemptions designed to replace, among others, the private company exemption, the private issuer exemption, the $150,000 exemption, the seed capital exemption and the government incentive security exemption currently in the *Securities Act* (Ontario) (?the Act?).

The purpose of the Proposed Rule as stated in the Notice is to facilitate the raising of capital by small and medium-sized issuers in Ontario. For the most part, Members of The Investment Funds Institute of Canada (?IFIC?) are pleased with proposed changes and consider them to be an improvement over the recommendations released last year in the Concept Paper ?*Revamping the Regulation of the Exempt Market*? ((1999) 22 OSCB 2835) (?the Concept Paper?). Nonetheless, our Members do have a few specific concerns with the proposed changes, which are briefly outlined below.

## PART 1 - DEFINITIONS

One of our Members? main concerns under the Concept Paper was the threshold an investor had to meet in order to qualify as an ?accredited investor?. This concern has been addressed in the Proposed Rule, which contemplates a significantly lower threshold of $1,000,000 (including cash, securities and bank deposits), as opposed to the previously proposed threshold of $2,500,000 set out in the Concept Paper. Nevertheless, the definition of an ?accredited investor? is still troublesome in the following respects:

?*Accredited Investor*? *- Subsection 1.1(m):*

Subsection 1.1(m) provides that an accredited investor means ?an individual who, either alone or with a spouse, beneficially owns financial assets having an aggregate net realizable value exceeding $1.0 million.? In our view, if an individual meets the asset test, then that individual should be able to invest either directly, or through his or her RRSP. We therefore suggest that this subsection be reworded as follows: ?an individual, ? *or an RRSP or RRIF established by an individual,* who, either alone or with a spouse, beneficially owns financial assets having an aggregate net realizable value exceeding $1.0 million.?

*Subsection 1.1(n):*

This subsection provides that ?an individual whose net income exceeded $200,000 in each of the two most recent years or whose joint net income with a spouse exceeded $300,000 in each of those years and who, in either case, has a reasonable expectation of exceeding the same net income level in the current year? meets the definition of an accredited investor. We recommend that similar wording be included here for the same reasons outlined in subsection 1.1(m), so that this subsection reads as follows: ?an individual ? *or an RRSP or RRIF established by an individual where net assets exceed $200,000.?*

*Subsection 1.1(v):*

We do not believe that disclosure is necessary under subsections (v)i and ii regarding reliance on the exemption in section 2.3 (the accredited investor exemption), since mutual funds are permitted by law to purchase illiquid securities. Funds are already required to disclose in their annual information form (Item 4 under NI81-101 F2) that they are subject to the investment restrictions and practices under NI81-102, which includes investment in illiquid securities. We note that similar disclosure has not been required for reliance on other prospectus exemptions. If such disclosure is required, then at a minimum, we suggest there be a transitional period given to mutual funds to include this disclosure in their prospectuses. If the rule becomes effective after the renewal of a mutual fund?s simplified prospectus and annual information form, the mutual fund in question should be able to include the disclosure in its next renewal rather than having to amend its simplified prospectus.

*Subsection 1.1(w):*

Our Members question the need for the restriction set out in subsection (w), that in order to qualify as an accredited investor, a managed account may only invest in securities directly and not in securities of a mutual fund or pooled fund. For accounts with discretionary management, the client?s assets are often held in pooled funds and mutual funds. In each case, it should be up to the portfolio manager to determine whether or not a pooled fund or mutual fund is an appropriate investment.

*?Financial Assets?*

Subsection 1.1 states that ?financial assets? means ?cash, securities, and any evidence of deposit that is not a security for purposes of the Act.? This definition is quite restrictive and, as currently drafted, would not include real estate or insurance contracts that have a realizable cash surrender value. Because of the narrow definition, many investors currently able to rely on the

$150,000 exemption would not be able to rely on the new accredited investor exemption. Clarification is also sought as to whether the term ?securities? in the above definition includes RRSP assets. We strongly urge the OSC to amend the definition of ?financial assets? to include real estate, insurance contracts and RRSP assets (if the latter is not already included under the term ?securities?).

## PART 4 ? OFFERING MEMORANDUM

Section 4.2 of the Proposed Rule stipulates that the exemptions from the prospectus requirements in section 2.1 (closely-held issuer), 2.3 (accredited investor) and 2.4 (family member) are not available for a trade where the seller delivers an offering memorandum to the prospective purchaser, unless the statutory right of action referred to in section 130.1 of the Act is described in the offering memorandum. While it made sense to require such disclosure under the previous regime where there was a contractual right of action, we believe that such disclosure is no longer necessary where there is a statutory right of action. Historically, requiring foreign issuers to include such disclosure in their offering memoranda has been highly impractical.

## Companion Policy 45-501CP

Our Members have concerns regarding the Commission?s intention to dispense with sprinkling orders granted pursuant to subsection 74(1) of the Act. Due to the restrictive definition of ?financial assets? in the Proposed Rule, some investors in our Members? existing pooled funds may not necessarily meet the new asset threshold. Accordingly, they strongly feel that they should be able to continue to rely on the sprinkling orders in respect of existing investors. We also assume that there is a typographical error in subsection 2.3 of the Companion Policy entitled ?Sunset of Pooled Fund Rulings?, which references section 2.1 (closely-held issuer exemption) of the Proposed Rule as providing the appropriate relief from the registration and prospectus requirements for trades in additional pooled fund interests to existing investors. We believe that section 2.3 (accredited investor exemption) is the correct section that should be referenced.

Thank you for providing IFIC with an opportunity to comment on the Proposed Rule. As requested, we are including an electronic copy of our submission on diskette. Should you have any questions, please do not hesitate to contact me or Lori Lalonde, IFIC?s Senior Counsel at (416) 363-2150, ext. 246 or by e-mail at llalonde@ific.ca.

Sincerely,

**The Investment Funds Institute of Canada**

John Mountain
Vice President, Regulation

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