



Northern Securities Inc.

Submission to the Ontario Securities Commission

May 7, 2001

Northern Securities

Northern Securities Inc. ("Northern Securities" or "Northern") is a Toronto-based full service brokerage firm that is a member of the Investment Dealers Association, a Participating Organization with the Toronto Stock Exchange and a member of the Canadian Venture Exchange.

Northern caters to the needs of small cap companies in Canada. Northern raises capital in the traditional manner and on the Internet through its online public offering site and its online private placement site.

Cherished Principles

Northern's mission is to create a high quality investment bank in Canada and the United States that is focused on serving small cap companies.

Northern is the only investment bank in Canada that has a traditional full service business as well as an online trading website, online public offering website and private placement site. Its online business is designed as a separate distribution system, in addition to the traditional distribution route using full service brokers, for the raising of capital by small cap companies.

Small cap companies have suffered tremendously in Canada because of the hardships imposed by the private placement rules. There is a need for simplicity and ease of use for capital raising by small cap companies.

For investors, there has been a substantial denial of opportunity to invest in small cap companies. Again this is due to the private placement system that has been in place for many years.

At the same time Northern recognizes the greater risks involved in small cap investments. There is a need to protect the investor by ensuring the investor has the financial means to take a risk and that the risk taken is minimal given the investor's current financial means.

Northern believes that the following is the key balance required:

- ❑ creating more efficiency in the capital markets for small cap companies in raising capital,
- ❑ enabling more Canadian investors to participate in small cap investments, and
- ❑ protecting Canadian investors from taking undue risk relative to their current financial means.

Northern believes that this balance of efficiency, opportunity and protection is missing from the Proposed Rule 45-501 (“Proposed Rule”).

Key Principle of Protection

Our key principle of protection is to ensure that the investor is not hurt if the investor loses the full amount of his or her investment. This is a principle deeply ingrained in securities law and respected by the Commission and the courts. The only issue is how to quantitatively measure the downside risk that an investor should be allowed to take.

Right now the Proposed Rule requires an investor to have \$1.0 million in financial assets or to have annual income of \$200,000 (or \$300,000 including the investor’s spousal income) to participate in a private placement.

Northern believes that a minimum of \$1.0 million in financial assets in Canada is too high a threshold. Northern also believes that \$200,000 annual income may not by itself be enough to qualify a person as a qualified investor.

We suggest that the level of financial assets be \$200,000 but that the investor is limited to investing a maximum of 20% of his financial assets in a private placement.

We do appreciate the step taken in the Proposed Rule that spouses are to be treated as an "investing unit" and that either spouse may qualify as an accredited investor if both spouses taken together meet the financial asset or net income tests. This is a positive step. However more needs to be done.

We need to lower the \$1.0 million threshold test for financial assets.

Use of a Brokerage Firm

Under the Proposed Rule companies cannot use a brokerage firm in raising \$3.0 million for closely held companies from up to 35 non-qualified investors. This is a serious disadvantage and competitive impediment.

There is no sensible reason to prohibit a brokerage firm from helping a closely held company in a financing.

A brokerage firm should be allowed to raise capital on the Internet for an issuer if a password-protected website is in place to pre-qualify qualified investors. Let's open up the capital markets but in a proper, measured and careful way.

Under the Proposed Rule, a brokerage firm can act as an agent on a closely held issuer financing involving accredited investors but not in the same financing involving non-accredited investors. This will be impossible from a practical point of view.

The brokerage firm will be involved in due diligence, in preparing the disclosure statement, and in every respect providing advice to the closely held issuer. At the start of a proposed financing, the issuer and brokerage firm will generally not know how much if any of the offering will be placed with accredited investors or non-accredited investors or both. It will be impossible to segregate the involvement of the brokerage firm as between accredited investors and non-accredited investors. Furthermore, if an offering ends up being placed with non-accredited investors, why should not the agent be compensated when it has been involved in all aspects of the offering including advice, due diligence and preparation of offering material.

In some closely held issuer financings, the brokerage firm is exactly the party that should be involved that needs to provide an independent assessment of the issuer's plans for investors who are relatives. Love money can be blind to the investment merits of any financing and a brokerage firm could and should provide the independent judgment.

Northern is unsure of exactly the extent of the prohibition against brokerage firms, particularly given the following as stated in the commentary in the Proposed Rule:

"The exemption does not expressly prohibit participation by market intermediaries. However, an important investor protection aspect of the exemption is the effective exclusion of market intermediaries. The exemption is intended to encourage capital raising from investors with some relation to the issuer. The exemption is not intended to facilitate general solicitations to unsophisticated investors through networks of market intermediaries. The Commission is of the view that permitting such general solicitations would be contrary to its investor protection mandate under the Act."

Northern requests that the Commission make the extent of the prohibition clear. Again Northern suggests that there be no prohibition, partly because we believe there should be an onus on brokerage firms to be sure that investors including family members are aware of the risks involved in the specific investment and that the risks are acceptable relative to the specific investor's financial means. With non-family investors or outside investors, there is a better opportunity for judgment that is unbiased.

Closely Held Issuer

Northern has come to the conclusion that the closely held issuer concept is outdated and should be dropped.

The ability to raise up to \$3 million from 35 non-accredited investors is limited to closely-held issuers which is an exceedingly restrictive limitation because of the following:

- ❑ there is to be no general solicitation
- ❑ selling or promotional expenses are not permitted
- ❑ no brokerage firm can be involved in the offering
- ❑ the net of investors is to be designed to be limited to friends and associates of the issuer's principals.

The Commission states that the "35 unaccredited investor" limit in the proposed closely-held issuer exemption "represents a balance between: (a) facilitating small companies' access to capital; and (b) limiting the potential risk assumed by unsophisticated investors."

The Commission also states that the closely held issuer exemption is "designed to be used by companies to raise investment capital from people and entities known by the issuer's principals and not through broad solicitations of potential investors."

There are many non-public companies that are not closely held issuers that need to raise capital by private placement. There are also many public companies that need to raise capital by private placement. All of these companies cannot raise \$3 million from a maximum of 35 investors. Their only recourse is to investors that are accredited, namely, for individual investors those persons who have \$1.0 million in financial assets or have annual income of at least \$200,000 in annual income. This is a very limited class of investors.

Northern therefore sees a very large gap between closely held issuer financings and other small cap or small business financings. This gap is too large. The closely held issuer financing is almost a seed financing. There are many stages of financing following a seed financing. It is unfortunate that these subsequent stage financings are limited to access to accredited investors, persons with at least \$1.0 million in financial assets or \$200,000 in annual income.

Northern believes that the ability to raise \$3.0 million from up to 35 non-accredited investors should be available for all issuers. If this is too large a step, Northern suggests that perhaps public companies under a certain market value be given the opportunity to rely on this valuable \$3 million exemption.

The key point we are trying to make is that there is too much of a gap between allowing any 35 investors (irrespective of financial means) to invest in a closely held issuer and allowing only investors with \$1.0 million in financial assets or \$200,000 in annual income to invest in any other private placement.

We have many suggestions which we would be happy to review with the Commission.

Northern Securities Inc.