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Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut

RE: PROPOSED CHANGES RESULTING FROM THE REGISTERED REFORM PROJECT

In October of 2005, the rules surrounding raising funds via an Offering Memorandum ("OM") changed. It was clear at that time that the lawmakers of Canada wanted to make it easier for businessmen and promoters to raise money and also wanted to better protect the investing public. As a result of these changes, there were new advantages for the business owner and/or promoter: They could now advertise, pay agents a sales commission, and were no longer restricted to 50

investors for each project. For the public's protection, lawmakers restricted how much the unsophisticated person could invest to $10,000 per project (in certain provinces).

In addition, each investor was required to sign a very simple and understandable document (placed next to the word **WARNING** listed in large and bold font) that stated:

- **I am investing entirely at my own risk.**
- **The person selling me these securities has no duty to tell me whether this investment is suitable for me.**
- **I could lose all the money I invest.**
- **The person selling me these securities is being paid $X for selling them to me.**

The OM investor was further protected by a statutory extension on the investor's remedies in the event of a misrepresentation going from 180 days to a 3 year window. Investors were allowed to sue any promoter or director that had signed the OM.

Clearly the message these changes sent to business was "we've heard you and we want to give you a better set of laws to work with". The law makers were successful. **A renaissance in private equity raising has occurred and the changes in law have been extremely successful.**

Keeping the above in mind, it is with some surprise that the securities regulators almost simultaneously (with the introduction of the new rules) started working on new reforms they would like to pass that seem to be contrary to the spirit of the October 2005 legislation. After reviewing the current proposals made by the securities regulators, one cannot help but think that the regulators have missed the message the law makers had sent to the business and investment community. The lawmakers wanted business to have access to capital without the previous restrictions, break the monopoly the Investment Dealers Association ("IDA") had in raising capital, and provide greater protection to the investing public.The new proposals contemplate that if you are "in the business" of dealing with OM's, then you will soon be required to follow these new rules, among others:

- Your firm would become a specialty dealer
- You would be required to have $50,000 to $200,000 for working capital.
- All of your sales representatives will have to pass the Canadian Securities Course.
- Require those investing under an OM to complete Know Your Client forms.

Let us examine these proposed rules. Firstly, if you were in the business of dealing in securities you would have to be registered. Conveniently, this major change is without the benefit of a clear definition of what constitutes being in "the business" of dealing in securities. This ambiguous

definition is of great concern to those who make their living trying to abide by the laws. At exactly what time does one need a specialty dealer license?

I recently raised some money using the OM exemption in order to purchase some Alberta real estate. Included in the purchase was an area of mutual interest with my partner. As a result of that area of mutual interest, a second piece of land subsequently became available. Seeing an opportunity for myself and my investors, I started a new company and funded the purchase using the OM exemption. Subsequently, a third piece of land became available. When do we need to become a specialty dealer? And if so, how much time would that take? As well, with the proposed changes, I would not be able to retain the people who had helped raise the initial money because they have not passed the Canadian Securities Course. My business opportunity, and those of the investment community would suffer because presumably I wouldn't proceed to participate in the third parcel of land for fear of "being in the business".

Secondly, let's examine the proposed requirement that each specialty dealer have $200,000 of free working capital. Why? The specialty dealer should not be holding any cash. If the specialty dealer is in the business of raising money for issuers using the OM exemption, why should there be a capital requirement? The specialty dealer is not who gets sued, it's the promoter. The specialty dealer does not sign the OM, the promoter does. The specialty dealer would not take in the subscription cash, the issuer would. Again, the question has to be asked…why the need for the working capital?

If the commissions are worried about the investor's cash not getting to the Issuer, they should make it mandatory that the OM have a subscription agent that is either a trust company or a law firm. In any event, present law would prohibit a specialty dealer from holding cash in trust from the subscribers.

The only good reason I can see for $200,000 capital requirement is to artificially restrict entry into this business. Surely, if the law makers thought this was necessary, it would have been included in the revised statutes in October, 2005.

The third issue is the requirement that all sales representatives of a speciality dealer pass the Canadian Securities Course. While I am not opposed to learning for learning's sake, I fail to see how this particular recommendation has any merit. In Alberta, I believe that 90% of the funds raised using the OM exemption in 2006 involved real estate in some shape or form. I have a current copy of the Canadian Securities Course in which only 3 pages reference real estate. **How well would those 3 pages help the sales representative and subsequently the investor?** I cannot help but feel that the real reason behind this rule is to restrict competition to the IDA and MFDA rather than to protect the public. Why or how would passing this course help the public? Keep in mind, this proposal to license agents selling under NI 45-106 is contrary to the spirit of the law makers who did not want the public to think the sales agent is dealing with them in a knowledgeable or caring manner. Remember, the law makers wanted the purchaser to acknowledge that the salesman is not required to have any obligation as to the suitability of the investment.

The fourth issue brought forward is the Know Your Client (KYC) rule. It was proposed at a public forum held by the Alberta Securities Commission that each investor in an OM would be required to complete a KYC form or they wouldn't be able to purchase the security. This proposal is totally unworkable. Why would an investor who wants to purchase $10,000 of a real estate security want to give all of his/her financial information to the seller of the security and why would the seller want that information? **The purchaser is not looking for a financial planner and the seller does not want to be a financial planner. The seller is simply selling a product. Buy it or don't buy it. End of story.** If this proposal is put into law it will substantially eliminate the exempt market as investors will refuse to divulge, for good reason, their total financial status.

The other change to the rules that I would like to address is item NI-45-106 #2.3 - Accredited Investor Exemption. It is proposed that the accredited investor exemption would be eliminated unless used by a specialty dealer. This proposal, if enacted, robs the business community of a long standing efficient method of raising money. The net effect of this proposal would be to create a cash cow for specialty dealers and an additional cost to raising investment funds. Presidents of new companies would still have to find investors and then presumably the subscriptions would move through a specialty dealer for a fee. In the end, the president still gets his cash, the investor his investment and the associated risk, and the specialty dealer gets a commission. The specialty dealer gets the commission even though they provide no extra due diligence and don't find the money. This idea clearly stinks of IDA involvement. The IDA likes to encourage a rule book that lets someone else do all the work and they get the money (do junior IPO's ring a bell?) This is the same as the larger brokerage firms do today for small IPO's and CPC's. They require that the president go raise money and they get the commission and a new customer account.

When you take a close look at the individuals who are accredited investors, it is difficult to see why the regulators feel they need protection. The definition of "accredited investor" surely defines an individual that has the ability to make investment decisions without a specialty dealer or the securities regulators intervening or interfering.

To summarize my position with respect to the proposed changes regarding the registration reform project:

1. The laws and regulations with respect to offering memorandums were **properly changed in October, 2005**. They are serving the investing public and the business community very well. They do not need to be changed in any dramatic way.

2. The newly proposed changes are contrary to the spirit of the changes made by the law makers in October of 2005.

3. The new changes, if implemented, **will <u>not</u> improve investor safety**.

4. They are, if implemented, going to decrease competition in the capital raising markets.

It is interesting that the securities regulators started working on these new proposed changes at about the same time the new rules were set in action. Did they secretly plan to dilute the effect of the new changes? Why didn't they let the new rules have a chance to prove themselves before fixing them? With the ability of investors to launch class action law suites and with a new three year window to exercise these rights, the investors seem well protected and the promoters should be wary of their actions. It is hard to believe that the promoters of these new changes are not influenced by interests other than shareholder protection.

Current wisdom suggests that the pendulum has swung too far. Businessmen and women have had too many rules put to them in the most recent past. There is a concerted effort going on today by the US Congress to start to unwind some of the overkill in regulations. I sincerely hope you use this as an opportunity to start the pendulum going in the opposite direction in Canada.

I suggest that industry and the investing public would be better served with higher fee costs to support the cost of better enforcement rather than more rules.

Yours truly,

Rick Skauge
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