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June 18, 2007

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New Brunswick Securities Commission

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

Dear Sir/Madam:

Re: Proposed National Instrument 31-103 – *Registration Requirements*
Response to Request for Comment

Aveiro Investment Corp. ("Aveiro") is an Alberta based reporting issuer engaged in commercial real estate investment in western Canada. Aveiro has relied upon the prospectus and registration exemptions contained in National Instrument 45-106 – *Prospectus and Registration Exemptions* ("NI 45-106") to raise capital.

The purpose of this letter is to comment on the proposed creation of a category of "exempt market dealer" and the corresponding "Fit and Proper Requirements" and "Conduct Rules" in connection therewith (collectively the "Proposed Exempt Market Dealer Rules") in proposed National Instrument 31-103 – *Registration Requirements* ("Proposed NI 31-103").

Summary

The Proposed Exempt Market Dealer Rules will significantly restrict access to capital and increase the cost of capital for small and mid sized private and reporting issuers in Alberta and British Columbia without any enhancement of investor protection.

The capital raising exemptions currently found in NI 45-106 were originally designed by the Alberta Securities Commission (the "ASC") and the British Columbia Securities Commission (the "BCSC") in 2002 and introduced in Alberta and British Columbia in Multilateral Instrument 45-103 – *Capital Raising Exemptions* ("MI 45-103") to create greater access to capital for small and mid sized issuers because of concerns that the rules governing exempt market financings were previously too restrictive and the cost of raising money too high. Implicit in this is the acknowledgement that Canada's capital markets are a regulated oligopoly and that by increasing competition and access to capital, issuers' cost of capital would be reduced and access to capital increased, thereby enhancing the opportunity for investor return and investment choice.

The innovative new prospectus and registration exemptions created by the ASC and BCSC in MI 45-103 have proven successful in their goal of increasing access to capital and reducing the cost while ensuring investor protection. So successful, in fact, that the exemptions have been adopted, generally without material change, by every securities regulator in Canada with the exception of the Ontario Securities Commission.

The Proposed Exempt Market Dealer Rules will not increase investor protection, but will increase issuers' cost of capital raised in the exempt market thereby making Alberta and British Columbia based issuers less competitive and reducing the return on capital (and by implication the investment returns) of Alberta and British Columbia resident investors who invest through the exempt market.

Accordingly, I would submit that the Proposed Exempt Market Dealer Rules in Proposed NI 31-103 should not be adopted because they do not advance either of the key elements of the role of securities regulation (being fundamentally (i) the efficient operation of the capital markets; and (ii) investor protection) and, in fact, will significantly reduce or eliminate many of the benefits enjoyed by issuers and investors since the introduction of MI 45-103 and NI 45-106 without any corresponding increase in investor protection.

Background

The ASC and the BCSC were the leaders in developing expanded capital raising exemptions now found in NI-45-106. In their 2002 annual report the Chair of the Alberta Securities Commission commented in connection with the predecessor instrument to NI 45-106, MI 45-103:

> In response to industry concerns that the rules governing exempt market financings are too restrictive and the cost of raising money is too high, the ASC initiated a project that would enhance the ability to raise capital in the exempt market. The ASC invited the BC Securities Commission to participate in the project in order to harmonize the exemptions between the

> two jurisdictions, making it easier to raise money in the two provinces. As a result of this initiative, the ASC adopted Multilateral Instrument 45-103 *Capital Raising Exemptions* in March 2002. MI 45-103 provides four new and expanded capital raising exemptions from the prospectus requirements. MI 45-103 will make it easier and less expensive for issuers, particularly small and medium-sized issuers, to raise capital in Alberta and BC, without compromising investor protection. The ASC intends to review this instrument after one year in order to assess its impact on the exempt market.

The innovation created by MI 45-103 was the creation of prospectus and registration exemptions (collectively the "Expanded Capital Raising Exemptions") which allowed investors that met certain sophistication or financial robustness tests (referred to in MI 45-103 and NI 45-106 as "accredited investors" or "eligible investors") the personal autonomy to purchase securities without the need for the involvement of a registrant. In the case of eligible investors, the issuer is required to provide certain disclosure and statutory or contractual rights of action to the investor.

The Enhanced Capital Raising Exemptions have proven to be exceptionally successful in balancing the efficient operation of the exempt capital markets with investor protection. Five years after the creation of the Expanded Capital Raising Exemptions innovated by the ASC and BCSC in MI 45-103, the Expanded Capital Raising Exemptions have been adopted, generally without any material change, by every securities regulator in the country other than the Ontario Securities Commission through the creation of NI 45-106.

Current Role of Exempt Market Intermediaries

Currently in Alberta and British Columbia, issuers can retain or employ intermediaries to solicit investment from accredited and eligible investors (and certain other investors in specific circumstances). The role played by these intermediaries is fundamentally different from that played by a traditional registered representative.

A registered representative acts for, is paid by, and owes certain duties to his investor client. Exempt market intermediaries work for, and are paid by, the issuer. The exempt market intermediaries do not act for, provide advice to, or generally have direct access to an investor's funds.

These exempt market intermediaries are not purporting to provide financial planning or other advice, but rather are making a specific investment opportunity available to an investor who qualifies to use the Expanded Capital Raising Exemptions. Unlike a registered representative who can recommend and execute the purchase or sale of all publicly listed securities to his or her client, an exempt market intermediary generally has only one investment opportunity available for an investor to consider. In many instances the relationship with an investor is only in connection with one transaction.

To my knowledge these intermediaries rarely have access to an investor's money. Rather the eligible investor writes a cheque, in trust, to a law firm, escrow agent or the issuer and it is held in trust for a mandated "cooling off" period to allow an investor to reconsider his or her investment decision.

Accordingly, requiring an intermediary to "know your client" would weaken the protections that are currently built into NI 45-106 because it would require the investor to divulge significant

personal information to an intermediary whose interests conflict with those of the investor. Currently, eligible investors who subscribe for securities using exemptions in the Expanded Capital Raising Exemptions acknowledges their awareness of the role the exempt market intermediary plays and the lack of paternalistic regulatory oversight with respect to the transaction by being required to sign a brutally blunt prescribed form of risk acknowledgement which has been drafted in bold letters and in very plain English, advising the investor, among other things, (i) that they are investing entirely at their own risk; (ii) that the person selling the securities is getting paid a commission (and the magnitude of the commission); (iii) that the exempt market intermediary has no duty to tell the investor whether the investment is suitable for them; and (iv) that the investor could lose all the money that they invest.

In no other commercial transaction is a purchaser required to tell the vendor (or his salesperson) his or her income or net worth in order to be permitted to purchase the product. One can only speculate as to the outcome if Canadians were required to provide income and net worth statements to a car salesperson in order to be permitted to purchase a new car. Everyday, thousands of Canadians make significant investment decisions to purchase cars, houses, personal property and other assets where they are personally accountable for the decision. The purpose of the Expanded Capital Raising Exemptions is to allow certain investors to be personally accountable for their investment decision where the investor passes certain sophistication or financial robustness tests. The risk acknowledgement form confirms an eligible investor's awareness of this personal accountability.

NI 45-106 is designed to allow an eligible investor to rely on the disclosure (including financial disclosure) of the issuer of the securities. Accordingly, the requirements for capital adequacy, bonding and financial statement disclosure of the exempt market intermediary will provide no additional protection to investors and will only increase the costs and administrative burdens of the intermediaries which in turn will be passed on to the issuers and their investors.

The eligible investor does, however, have the comfort of knowing that they have a statutory or contractual action for recission or damages against the issuer and against the directors, officers and promoters, personally, in the event of a misrepresentation in the disclosure document.

It is submitted that the design of the prospectus and registration exemption in section 2.9 of NI 45-106 available in Alberta and British Columbia (often referred to as the "Offering Memorandum Exemption") is particularly well designed and should be considered in greater detail by securities regulators as a model for the operation of the exempt market before proposing any reform to exempt market regulation. The Offering Memorandum Exemption provides for (i) the robust disclosure of material facts about the issuer and the securities; (ii) issuer liability and personal liability for directors, officers and promoters for extended periods in the event of a misrepresentation; and (iii) acknowledgement by an investor of their personal autonomy in making the investment decision and that the exempt market intermediary's interest are in conflict with theirs.

Lack of Need for Reform of Exempt Market in Alberta and British Columbia

No evidence has been put forward to indicate that there is a problem that is being solved by the Proposed Exempt Market Dealer Rules. A review of recent annual reports of the ASC and BCSC indicate that the number of complaints made to them (and not just complaints related to exempt market securities) have not materially increased since the introduction of NI 45-106.

In a working paper undertaken for the Commission des valeurs mobilières du Québec in 2005

entitled "Securities Regulation in Canada" by CIRANO, Jean-Marc Suret and Cécile Carpentier commented that:

> Most arguments put forward to support the idea of the inefficiency of securities regulation are not supported by regulatory and finance theory, and are generally based only on unsupported statements. The current debate in the field is a new illustration of the phenomenon which Lacasse (1995) describes: Canadian economic and regulatory policy decisions have more often than not been guided by myths put forward by pressure groups rather than by actual knowledge resulting from rigorous, independent research. It is disturbing to realize that some are considering reforming a system which has not been analyzed carefully, on the basis of assertions made primarily by pressure groups. As a result, it was necessary to provide the basic components for a structured analysis in order to respond to the proposals and assertions made with respect to securities regulation in Canada.

There is no evidence that the number of enforcement actions arising from exempt market transactions brought by the ASC or BCSC relative to the number of participants in the capital markets have increased since the introduction of MI 45-103. This would seem to indicate that the objective of making it easier and less expensive for small and medium sized issuers to raise capital has been achieved while adequately balancing the protection of investors.

The Canadian securities markets are a regulated oligopoly. An oligopoly is a market defined by a small number of sellers (known as oligopolists). In the case of Proposed NI 31-103, some might argue that the oligopolists are proposing changes to recently introduced regulation (NI 45-106) which has proven to be highly effective but which limits the basis of their oligopoly. The effect of Proposed 33-103 is to reverse the benefits which have been enjoyed by issuers and investors, in particular in western Canada, since the introduction of MI 45-103 and NI 45-106 with no clear empirical evidence to suggest that there is a harm which the Proposed Exempt Market Dealer Rules are attempting to address.

Provided that investor protection objectives have been met, securities regulation should move toward less regulation rather than more. There is a significant body of evidence developing to indicate, for instance, that the Sarbanes Oxley legislation adopted in the United States has significantly increased costs for issuers subject to the legislation with no corresponding benefit to investors. Issuers in the US markets have lost a cost of capital advantage which has been illustrated by foreign issuers choosing other markets to raise capital.

Given the rapid economic growth of the western Canadian provinces, the capital intensive nature of their economies and the need of issuers to have efficient access to capital, it is submitted that securities regulators in western Canada should provide significant weight to the objective of fostering the economic benefits of broad access to capital. In conclusion, it is submitted that the reforms contained in Proposed NI 31-103 relating to the Proposed Exempt Market Dealer Rules are not required because, among other things:

- There is no evidence to suggest that NI 45-106 is not working well for both investor and issuers and in fact has provided issuers with greater access to capital and investors with more opportunities to invest their capital with no corresponding investor protection issues;

- The existing issuer capital raising exemption provisions contained in sections 2.3, 2.9 and 2.10 of NI 45-106 have provided access to the capital markets for issuers and investment opportunities to investors which had not traditionally been available prior to the implementation of its predecessor in 2002;

- NI 45-106 provides adequate investor protection measures including, for eligible investors, rights of actions for damages, rights of rescission and personal liability of officers and directors of issuers in certain circumstances;

- The Proposed Exempt Market Dealer Rules add significant expense to the exempt market capital raising process which is ultimately passed onto investors in the form of a lower return on invested capital; and

- The increased costs and administrative burdens imposed by the Proposed Exempt Market Dealer Rules in connection with requirements for insurance, financial bonding and documentation of financial information on the purchaser of an investment do not provide any additional investor protection because in most cases the exempt market intermediary does not have any access to the investors funds. Rather investors can look to corporate and personal liability of the issuer and its directors, officers and promoters, respectively.

Response to Certain Questions in Request for Comments

Q1: What issues or concerns, if any, would your firm have with the proposed fit and proper and conduct requirements for exempt dealers? Please explain and provide examples where appropriate.

Please see my comments above generally on this matter.

Q2: The British Columbia Securities Commission seeks comments on the relative costs and benefits in British Columbia of harmonizing with other CSA jurisdictions to create an exempt market dealer category and in doing so, eliminating the registration exemptions for capital-raising transactions and the sale of those securities, referred to in some jurisdictions as "safe securities" (i.e. government guaranteed debt.)

I agree with the position of the British Columbia Securities Commission in the Request for Comment, and in particular that:

> British Columbia is considering not adopting this category because it is concerned that requiring registration of persons who are in the business of dealing in the exempt market will have a negative impact on the province's venture capital raising business. British Columbia is also not convinced that there is a market problem in this area in British Columbia that is address by the registration requirement.

In proceeding on this basis the BCSC is acknowledging that access to capital provides greater economic benefit than harmonization of legislation. It is submitted that given the highly diversified nature of Canadian capital markets, and in particular the significant number of junior issuers in western Canada that full harmonization of securities legislation is impractical and unwarranted.

Further, a significant argument can be made for the benefit of competitive regulation. In "Securities Regulation in Canada" (ibid), Suret and Carpentier argue:

> Competition in company law in the United States seems to have led to the emergence of relatively uniform laws in the various States, although certain authors have criticized this model. Competition has been lead by the State of Delaware, where more than half of American corporations are incorporated and which, between 1996 and 2000, incorporated 90.22% of new companies which chose a State other than their State of origin. This movement does not seem to be to the detriment of investors, as changes from the place of incorporation to Delaware seem to be perceived positively by the stock market. American specialists, such as Roberta Romano of Yale University, suggest that the competition prevailing in company law be applied to securities law. In the securities field, subject to constant changes, rapidity of adaptation to laws and regulations and quick detection of problems and tendencies is essential. The European system of mutual recognition allows a certain degree of competition which encourages innovation. This system does not lead to the disappearance of local authorities, which several countries are currently strengthening. It also allows the existence of differences which can take into consideration the distinctiveness of various countries. As with the European market, the Canadian securities market is diverse in terms of types of companies and provincial initiatives. Because of its regulatory structure, Canada has found itself over the years in a system of imperfect regulatory competition. The various jurisdictions can set up different rules, but issuers and intermediaries remain subject to the jurisdiction of the province where they operate or offer securities. Such a system encourages innovation. The creation of programs such as stock savings plans in Quebec, capital pools in Alberta and negotiated brokerage fees are examples of innovation begun in one province and copied in others.

I would respectfully submit that the ASC should follow the lead of the BCSC in taking this view regarding the efficacy of Proposed NI 33-103 in efficiently regulating the market for exempt securities in Alberta.

Q8: The Rule required dealers, advisers and fund managers to have Financial Institution Bonds. In cases where the owners of the firm also carry out the operations and registerable activity of the firm, usually in small firms, are these bonds prohibitively costly to obtain and will the bonds provide coverage if they are obtained in these situations?

Please see my comments above with respect to the proposed "Fit and Proper Requirements" of Proposed NI 33-103

Q9: We propose that some requirements of Division 1 not apply to clients that are accredited investors as defined in NI 45-106 Prospectus and Registration Exemptions. Is it appropriate to exclude this group, or any other group, of clients from the account opening requirements?

Please see my comments above generally on this matter. Additionally, to the extent that Proposed NI 33-103 is adopted in its current form, it is submitted that eligible investors (as defined in NI 45-106) should also be exempt from the account opening process.

Thank you for the opportunity to comment on Proposed NI 33-103. I trust you will find the foregoing to be in order, however, should you have any questions, please contact me directly at (403) 218-6509.

Yours very truly,

AVEIRO INVESTMENT CORP.

Per: 

John Mackay
Chairman

JM/ha

Encl.

cc: Bill Rice, Q.C. – Chair, Alberta Securities Commission
The Honourable, Lyle Oberg, Minister of Finance, Province of Alberta