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VIA EMAIL

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Dear Sir or Madam:

Re: CSA Staff Consultation Note 45-401 – *Review of Minimum Amount and Accredited Investor Exemptions.*

Walton Capital Management Inc. (“WCMI”) welcomes the opportunity to comment on CSA Staff Consultation Note 45-401 – *Review of Minimum Amount and Accredited Investor Exemptions*. WCMI has been registered as an Exempt Market Dealer (“EMD”) (and formerly a Limited Market Dealer (“LMD”)) since 2007. WCMI is now registered in all 10 provinces with over 55 registered dealing representatives. WCMI is an affiliate of Walton International Group Inc. (“Walton”), a manufacturer of exempt securities, and trades only in securities promoted by Walton and its affiliates. WCMI’s ongoing goal, led by its Ultimate Designated Person and Chief Compliance Officer, is to embrace best practices and ensure that its operations are compliant with current laws.

The exempt market plays an important role in capital-raising in Canada. The Alberta exempt market relies on prospectus exemptions to raise capital and has become increasingly important for both investors and issuers. Alberta-based issuers in the exempt market (778) raised approximately \$11.6 billion between April 2010 and December 2010.¹ Of this total, Alberta-

¹ The Alberta Capital Market: A Comparative Overview. May 2011. Alberta Securities Commission. www.albertasecurities.com/news/ASCPublications/6116/ACM2011.pdf. “The Alberta Capital Market”.

based investors contributed approximately \$3.2 billion (28%), while non-Alberta investors contributed the remaining \$8.4 billion.² This important industry must be supported and maintained, and the creation of unnecessary barriers to entry should be avoided.

WCMI and Walton believe that restricting the use of the Accredited Investor (“AI”) exemption and Minimum Amount (“MA”) exemption would reduce the universe of investors and the availability of capital to issuers, with no corresponding increase in investor protection. We do not support the elimination of or an increase in the financial thresholds for the AI or MA exemptions. As an alternative, we propose the adoption of an Offering Memorandum (“OM”) exemption in Ontario to provide a harmonized disclosure-based prospectus exemption across Canada. Disclosure, combined with the benefits of registration reform, would enhance investor protection while, at the same time, permitting committed issuers to appropriately raise capital.

In this letter, we will discuss WCMI’s use of the AI, MA, and OM exemptions and present statistical information that reflects our own experiences. We will also discuss some of the issues that the CSA has raised in a more general sense, as they apply to the AI and MA exemptions. To conclude, we will review the benefits of harmonization and the OM exemption.

I. WCMI’s use of NI 45-106 exemptions

The AI exemption is an important exemption for WCMI. Since 2007, over 95% of our total trades in Ontario, which account for over 95% of Ontario sales, were made under the AI exemption. This percentage has remained relatively consistent in Ontario for the period from 2007 to 2011. The AI exemption is used to a lesser extent outside Ontario, as WCMI relies primarily on the OM exemption in the other nine provinces.

WCMI infrequently uses the MA exemption to complete trades. Since 2007, when WCMI became registered as an LMD in Ontario, less than 1% of our trades, which accounted for less than 1% of sales, were completed under this exemption.

One reason WCMI has a low number of sales under the MA exemption is that an investment of \$150,000 or more, in many cases, is not suitable for an investor who is not an AI. WCMI’s registered dealing representatives are required to assess suitability of investments for all clients. In general, an investment that is in excess of \$150,000 would only be suitable for a corporation or an individual that would meet the AI or Permitted Client definitions.

The percentage of trades and sales WCMI completed under the OM exemption has increased as WCMI rolled out its sales operations across all provinces. In 2011, Ontario sales represented 36% of total sales in Canada and 98% of Ontario sales relied on the AI exemption. During that year, 90% of trades outside Ontario, which accounted for 84% of total sales, were made using the OM exemption.

By the end of 2011, WCMI was registered in all Canadian provinces. During this first year of trading as a national EMD, 30% of WCMI’s total national trades, which accounted for 45% of total sales, were made under the AI exemption. The corresponding figures for national trades

² The Alberta Capital Market. Data compiled through filings received and recorded by the ASC. Totals reflect only financings for which a report of exempt distribution is required.

using the OM exemption were 67% of trades, which in 2011 accounted for 54% of sales. WCMI expects the use of the OM exemption will increase further in 2012, as its operations in other provinces become more established.

II. Comments on CSA Staff Consultation Note 45-401 Review

The CSA review of the MA and AI exemptions has been tied to the global financial crisis. The CSA also notes that this review is being done in conjunction with proposed National Instrument 41-103, which also relates to the global financial crisis. However, the products that are most closely associated with the global financial crisis were not sold by exempt market dealers. Rather, these products were sold almost exclusively by investment dealers.

There has been anecdotal information about the impact of the global financial crisis. Some issuers apparently experienced difficulty raising capital due to the lack of credit available from traditional lenders. In addition, investors were reported to be nervous and a number of stock and bond issues were postponed due to the mood of the market. Interestingly, the average investment size for WCMI decreased by 5% in 2008 and by 39% in 2009, both as compared to 2007³.

No assurance of sophistication

WCMI agrees with the CSA and with the SEC that the size of investment, alone, does not guarantee investor sophistication or access to information. Nor for that matter does an individual's income or assets. The unfortunate effect of these artificial thresholds is to bar certain investors from participating in particular areas of the capital markets, regardless of the complexity or risk of the investment.

Indexing to inflation

WCMI does not support increasing or amending the MA or AI thresholds for any reason, including indexing the thresholds to inflation. Consumer price indices tend to be irrelevant because the MA and AI exemption thresholds are tied to income and net worth, not the cost of consumer goods. Obviously, the effect of indexing would be to reduce the number of investors who would qualify under these exemptions. However, the impact of indexing will be more significant when it is coupled with the Canadian demographic of an aging "baby boomer" population that will be retiring and living on a fixed income. Ultimately, indexing the thresholds might not only significantly decrease investors who would qualify for the AI exemption, but also might force individuals into making higher and potentially over-concentrated and unsuitable investments by relying on the MA exemption.

Regulation of dealers

An examination of the MA and AI prospectus exemptions must be made in the context of the applicable regulatory landscape. In the case of EMDs, that environment changed significantly with the introduction of registration reform in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, which was introduced in Canada in 2009. The CSA recognized that the first level of investor protection is the regulation of dealers. The Canadian regulatory framework exceeds the standards of the International

³ During this time frame, all WCMI sales were made in Ontario, primarily under the AI exemption.

Organization of Securities Commissions (IOSCO)⁴ for the regulation of dealers in the capital markets. The IOSCO principles include:

- registration standards for dealers based upon a demonstration of appropriate knowledge, resources, skill and integrity;
- ongoing capital and other prudent requirements reflecting the risks that dealers undertake; and
- compliance with standards for internal organization and operational conduct that aim to protect the interests of clients and ensure proper management of risk.

The dealer and its registrants must meet Know Your Client (“KYC”) requirements, ascertain that the investor meets the eligibility requirements for a prospectus exemption and ensure that the investment is suitable for the investor. Dealers and registrants are also required to meet Know Your Product (“KYP”) requirements under NI 31-103 and to conduct a reasonable investigation of the security, the issuer and the issuer’s representations about it.

Investment eligibility and suitability

A dealer’s obligation to establish client eligibility is one of several investor protection requirements established by the CSA. However, the dealer’s obligation to ascertain whether a client is an AI can be one of the more challenging requirements to satisfy. Although the dealer must make inquiries and appropriate investigations, the dealer must essentially rely on the client’s truthfulness, since the dealer’s ability to make independent inquiries is limited by privacy legislation.

When regulators conduct compliance reviews, the regulator will sometimes verify whether a client is an AI through a telephone call or interview. If the client misrepresented their financial situation to a dealer in order to meet the AI definition, but provided truthful information to the regulator, there are no consequences for the client because Canada’s securities commissions do not regulate investors. However, there may be consequences to the dealer, despite having made necessary inquiries and assessing information with suitable skepticism. Even when no wrongdoing is established, this situation can be very costly to dealers in terms of reputation, client relationships, time and money, including the cost of hiring legal counsel and advisors. It can also be costly and time-consuming for regulators.

We have been advised that investors providing inaccurate information about their AI status may be a particular problem in Ontario, where the OM exemption is not available. That problem becomes a problem for the dealer, but not necessarily because of any malfeasance by the dealer. There may be cases where a client, seeking potentially higher yields or more investment diversity may misrepresent their financial information to a dealer in order to participate in the exempt market. An increase in the AI financial thresholds is not likely to remedy this problem, and is more likely to exacerbate it. Nor is it appropriate or practical to enlist other professionals, like lawyers and accountants, to ‘certify’ a client’s income or net worth.

If the existing exemptions create problems in Ontario, it may be because investors want a different type of protection. Given the importance of harmonization within the Canadian regulatory framework, it would be prudent for Ontario to consider adding a disclosure-based prospectus exemption that is not dependent on a client’s wealth or a minimum size of investment, consistent with the OM exemption already adopted by the other provinces.

⁴ We understand that the CSA participates in IOSCO through the membership of the OSC and the AMF.

III. The OM Exemption

The exempt market and risk

As noted by the CSA, any regulatory initiative must consider the mandate of the commissions and the impact of the regulatory initiative. The dual mandate of the commissions to protect investors and to foster fair and efficient capital markets means regulators must take a balanced approach in their initiatives. While the regulatory initiatives must effectively address the risk to investors, regulation should not be expected to remove risk from the capital markets. Instead, it should ensure that there is proper management of that risk. Further, the benefits of the risk management must be proportionate to the cost to the industry.

We submit that barring certain investors from participating in the exempt segment of the capital markets on the basis of financial thresholds is not risk management and places a significant regulatory burden on dealers. Instead, regulatory emphasis should be on ensuring that issuers provide accurate and truthful disclosure and that dealing representatives are qualified and satisfy their obligation to determine that an investment is suitable and appropriate for the investor. With these requirements, investors should be in a position to make an informed investment decision without artificial monetary barriers.

That does not mean investors will never lose money. Evidence shows that investors have lost money from all types of investments, including prospectus products, and that monetary loss and even fraud exist in the prospectus world. However, imposing high financial thresholds does not prevent investors from investing and taking risks and the MA and AI rules have little impact on whether investment decisions are informed and suitable.

Regulation of issuers

Based on the IOSCO principles, investors should be provided with the information necessary to make informed investment decisions. The principle of full, timely and accurate disclosure of current and reliable information material to investment decisions is directly related to the objectives of investor protection and fair, efficient and transparent markets. All Canadian provinces other than Ontario permit dealers to distribute prospectus-exempt securities, provided the issuer has prepared and filed with regulators an offering memorandum that contains certain prescribed information outlined in National Instrument 45-106 *Prospectus and Registration Exemptions*. This requirement does not eliminate the dealer's obligation to conduct due diligence on the issuer, to satisfy KYP, KYC and suitability obligations and to explain the features and risks of the product to the client. OM disclosure is an additional protective measure, not a substitute for other important safeguards.

This model allows investors the ability to make an informed investment decision based on full disclosure of information mandated by the CSA. It would also permit regulators to enhance disclosure requirements or mandate industry-specific disclosure, if they see fit. Moreover, regulators can take action against the issuer or the dealer if either fails to perform its duties.

Although filing and obtaining a receipt for a prospectus is another means of distributing securities, there are important distinctions. Prospectus sales require the support of investment dealers and generally take a significantly longer period of time to complete. Prospectus disclosure also creates financial barriers to market entry because the cost of a prospectus is so much greater: in the experience of Walton, a product manufacturer that has cleared a number of prospectuses, a prospectus offering can cost approximately five times as much as an OM offering.

Investment Concentration

Some concern has been expressed that the OM exemption encourages investors to make excessive investments. Registration reform, with EMDs being required to assess suitability, has mitigated this risk. In fact, our own empirical evidence demonstrates that investment size is proportionate to net worth. In 2011, WCMI used the OM exemption most frequently (67%), followed by the AI exemption (30%). In that calendar year, the average investment amount for those relying on an OM exemption was 44% of the average investment amount for those claiming an AI exemption. As noted above, concentration in a security, income and net worth are considerations in ensuring that an investment is suitable for an investor, as borne out by these statistics. In addition, WCMI has experienced no significant history of dissatisfaction or complaints by clients who purchased under either the OM or AI exemptions.

IV. Conclusion

WCMI believes that harmonization should be an important goal for all Canadian capital market participants. NI 31-103 has changed the distribution of exempt products by creating new registration standards that exceed international requirements and enhance investor protection. By extending the OM exemption to Ontario, clients would benefit from enhanced disclosure and securities regulators would be in a position to clearly focus on the behaviour of dealers and issuers.

Ultimately, we would like the MA and AI exemptions to remain intact and the OM exemption extended into Ontario. Changes to the MA and AI financial thresholds would have a negative impact on the exempt market, which is an important aspect of the Canadian capital markets, with no corresponding increase in investor protection. Instead, we support harmonization of existing prospectus exemptions across Canada.

WCMI would be happy to respond to any questions and would welcome a meeting to discuss this comment letter.

Yours very truly,
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