



February 29, 2012

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

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Dear Sirs and Madams:

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

About Exempt Market Consultants (“EMC”)

EMC is a firm dedicated to assisting organizations involved in the selling of exempt market securities by structuring RRSP eligible investment offerings for presentation to the investing public.

It is because of our role that we have established a considerable number of relationships with Exempt Market Dealers and product manufacturers across the country, and it is through those relationships we have acquired certain awareness to the effects of this proposed review. Understandably the exempt market space encompasses many different product types, and while the comments below are my own, they do reflect perceptions from conversations from many such entities.

Consultation questions

(Please note that I have only answered those questions applicable to my intent.)

1. What is the appropriate basis for the minimum amount exemption and the AI exemption?

Let us first assume that the rationale for the minimum amount (“MA”) exemption, as well as the AI exemption, is really a way of simplifying the determination of proper suitability of the specific investor. Thus if it is “suitability”, rather than a specific exemption, that is in question for review as a result of the recent global financial crisis, I would like to then focus first on the objective versus the appropriate exemption.

Regulations have significantly changed across the country since the AI & MA exemption implementation, along with its subsequent updates in the 1980’s. More specifically, and keeping in mind our objective of suitability, was the adoption of National Instrument 31-103 (“NI 31-103”). Under sections 13.2 and 13.3, the focus would appear to be directly in-line with the objective of this review, as well as the above assumption.

*“NI 31-103, 13.2 – Know your Client, Paragraph 2 – A registrant must take reasonable steps to (a) establish the identity of a client and, if the registrant has cause for concern, make reasonable inquiries as to the reputation of the client (c) ensure that it has sufficient information regarding all of the following to enable it to meet its obligations under section 13.3 ... (i) the client’s investment needs and objectives; (ii) **the client’s financial circumstance**; (iii) the client’s risk tolerance ...”*

“NI 31-103, 13.3 – Suitability, Paragraph 1 – A registrant must take reasonable steps to ensure that, before it makes a recommendation to or accept an instruction from a client to buy or sell a security, or makes a purchase or sale of a security for a client’s managed account, the purchase or sale is suitable for the client.”

It is fair to say that there is a certain level of sophistication for a large number of investors who currently rely on these exemptions, although it is not for 100% of them. It is therefore not accurate to assume that an investor’s financial resources, educational background, work experience, or investment experience should form the basis of an assumption of eligibility to make an investment under any circumstance.

At a recent roundtable consultation at the OSC, one of its panel members made a comment that if the AI & MA exemption was a “good idea” when last updated, it should still be considered a “good idea”. This, in part, is archaic in its rationale, mostly with reference to the above noted points found within NI 31-103, but as well to National Instrument 45-106 (“NI 45-106”). Were they not adopted, the point potentially would have been valid, as it has been in other global jurisdictions.

To this end, there appears to be a common misconception of the presumed safety of investments sold via prospectus versus those sold by alternate exemptions. An individual who is not an accredited investor in a prospectus offering may easily suffer the same consequences of an investment relying on prospectus exemptions (due to events such as a global financial crisis). There are arguments about liquidity which is a

valid point, and as such, suitability again needs to be the focus, as well as accountability to the registrant performing the transaction. Another point is that prospectus offerings are deemed safer as they must be filed with its applicable regulator (and subsequently vetted). When looking at an Offering Memorandum (“OM”) exemption however, and as per NI 45-106, issuers would then be required to provide certain disclosures that too must be filed with its applicable regulator per NI 45-106, Part 2, Division 1, Section 2.9 (17), certifying that the disclosure does NOT contain any misrepresentations as mandated in NI 45-106, Part 2, Division 1, Section 2.9 (8)

“NI 45-106, Part 2: Prospectus Exemptions, Division 1: Capital Raising Exemptions, Section 2.9 (8) An offering memorandum delivered under this section must contain a certificate that states the following: This offering memorandum does not contain a misrepresentation. (17) The issuer must file a copy of an offering memorandum delivered under this section and any update of a previously filed offering memorandum with the securities regulatory authority on or before the 10th day after the distribution under the offering memorandum or update of the offering memorandum.”

I acknowledge that unlike the prospectus offerings, OM’s are not vetted, however were the above point to be relied upon honestly, while under the scrutiny of each applicable regulator, the increased level of disclosure could afford the added security as well as the opportunity to identify risk, per the objective of regulators.

A compromise then, to the certain “stakeholders” who endorse an adjustment to the MA and AI exemptions, could be the implementation of an OM exemption in Ontario. It has been adopted by the majority of Canadian provinces as it opens access to millions of investors who would otherwise not have the ability to invest in this type of product due to their limited means. **We are taught that by definition, increased diversification naturally decreases an investor’s investment risk. As such, would it not be considered further diversification for an investor to invest a portion of his portfolio in exempt product? To further this point, would it not then increase an investor’s risk by denying them access to such diversification?**

Rules are in place to address concerns on behalf of the investor, and of course should one of the rules be compromised, the applicable regulatory body responds accordingly with enforcement. It has been of great notice to many, to witness the positive effect of NI 31-103 and subsequently the reduction of those who previously took advantage.

- 2. Does the involvement in the distribution of a registrant who has an obligation to recommend only suitable investments to the purchaser address any concerns?** Absolutely. The registrant is already required to “Know your Product”, as well assess proper suitability via “Know your Client”, and with the addition of proper disclosure to the client, eliminate the need to even consider adjusting the MA & AI exemptions. This in itself would aid in providing a fair marketplace within the capital markets that allows the majority of Canadians (rather the small percentage as seen in Ontario) access to further diversification.

In addition to this, as the rules are in place to determine the appropriate suitability of a client, at some point the registrant, and subsequently the dealer are held accountable in circumstances where the investor’s suitability has been taken advantage of.

- 3. Do you have comments on the issues described in background #3?** Simply that ALL investors should have the right to participate in the exempt market, regardless of their perceived sophistication.

As a small add on to this, I agree completely as well with then the need to ensure an investor's ability to withstand such financial loss (which falls into suitability). One could then argue to impose a "Maximum Amount" allowance prior to that investor requiring a specific "status" exemption in order to invest. For example, propose then to allow an investor the opportunity to invest up to \$10,000 without having to meet requirements as defined in both the AI and MA exemptions.

- 5. Do you agree with maintaining the minimum amount exemption in its current form?** I DO NOT agree in increasing it to adjust to inflation, as the original reasons for its last increase should no longer be applicable with the adoption of NI 45-106 and NI 31-103. The MA exemption should be repealed based on the reasons provided above, and to aid with disclosure, I strongly endorse an OM exemption within Ontario so as to maintain a level of unity with the majority of provinces who have it already in place.
- 8. If we changed the \$150,000 threshold what would the impact be on capital raising?** Notably, a large number of the "small" percentage that has \$150,000 to invest should already be categorized as an accredited investor. This said, and should this be raised alongside the AI asset thresholds, there would be significant impact in provinces such as Ontario, as the already small pool of investors allowed to invest would grow even smaller.
- 14. Should the minimum amount exemption be repealed?** YES. Based on comments above, I endorse the removal of the MA exemption, and the adoption of the OM exemption across Canada.
- 17. Do you have comments on the issues described above?** Please refer to comment for question #3.

Thank you for taking the time to read my comments. I appreciate the CSA taking the consideration of industry professionals in the exempt space.

I am happy to discuss the contents of my letter concerning this review at any time.

Sincerely,

Nancy Bacon
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