



**Prospectors and Developers Association of Canada**  
**l'Association canadienne des prospecteurs et entrepreneurs**

Mr. Gordon Smith  
British Columbia Securities Commission  
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February 29, 2012

**Re: PDAC comments on the CSA STAFF CONSULTATION NOTE 45-401: *REVIEW OF MINIMUM AMOUNT AND ACCREDITED INVESTOR EXEMPTIONS (PUBLIC CONSULTATION)***

Dear Mr. Smith,

Please find attached the CSA Staff Consultation Note 45-401 with comments offered by members of our PDAC Securities Committee. We hope that you and the CSA staff will find these to be of assistance.

Should you have any questions about the attached comments, please do not hesitate to contact our office.

Sincerely,

Philip Bousquet  
Senior Program Director, PDAC

Copy:

Canadian Securities Administrators

## REVIEW OF MINIMUM AMOUNT AND ACCREDITED INVESTOR EXEMPTIONS

### Consultation Note 45-401

#### 1. Introduction

##### **Purpose of consultation**

Staff of the Canadian Securities Administrators (CSA) are reviewing the \$150,000 minimum amount prospectus exemption (minimum amount exemption) and the accredited investor prospectus exemption (AI exemption) contained in National Instrument 45-106 *Prospectus and Registration Exemptions* (NI 45-106).

We are consulting with stakeholders, including investors, issuers, dealers, and legal and other advisors. This consultation note provides background information and sets out consultation questions for input from stakeholders.

At the conclusion of the review, CSA staff may recommend either retaining the exemptions in their current form or may propose changes.

##### **Reason for review**

The global financial crisis and recent international regulatory developments have raised questions about the use of the minimum amount exemption and the AI exemption.

The CSA is engaging in this consultation to identify any issues that stakeholders may have about the use of the exemptions and to obtain information that will assist in deciding whether changes are necessary or appropriate.

##### **Framework for review**

In deciding whether changes to the minimum amount exemption and the AI exemption are necessary or appropriate, and if so, in developing recommendations for changes, we will be governed by our regulatory mandate of:

- protecting investors from unfair, improper or fraudulent practices, and
- fostering fair and efficient capital markets, and confidence in those markets.

We will also be guided by the principles that

- regulatory initiatives must effectively address the risks to investors and markets that are identified, and
- the benefits of any regulatory initiative must be proportionate to its cost to industry and the restrictions it imposes on market participants.

### **Proposals regarding securitized products**

On April 1, 2011, the CSA published for comment a proposed new regulatory regime for certain securitized products in a Notice of Proposed National Instrument 41-103 *Supplementary Prospectus Disclosure Requirements for Securitized Products* (NI 41-103 Notice). Among other things, the CSA has proposed amendments to NI 45-106 to create a new regulatory regime for the distribution of securitized products on a prospectus-exempt basis. The new regulatory regime would narrow the class of investors who can buy securitized products on a prospectus-exempt basis, and require issuers of securitized products to provide disclosure at the time of distribution, as well as on an ongoing basis. The NI 41-103 Notice seeks comment on a number of aspects of the proposal, including whether there are any existing registration categories or registration exemptions that should be modified or made unavailable for the distribution and resale of securitized products in the exempt market.

While the NI 41-103 Notice is focused on the distribution of securitized products in the exempt market, we will consider the comments we received in response to that notice as part of our general review of the minimum amount exemption and the AI exemption. We believe it is important that our assessment of those exemptions be informed by the CSA's proposals concerning securitized products and the comments of stakeholders with respect to those proposals.

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## **2. Principles underlying the minimum amount exemption and the AI exemption**

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The minimum amount exemption and the AI exemption have been premised on an investor having one or more of:

- a certain level of sophistication,
- the ability to withstand financial loss,
- the financial resources to obtain expert advice, and
- the incentive to carefully evaluate the investment given its size.

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### Consultation questions

1. What is the appropriate basis for the minimum amount exemption and the AI exemption? For example, should these exemptions be premised on an investor's:

- financial resources (ability to withstand financial loss or obtain expert advice),

**Comment: the CSA should consider developing new categories of accredited investors based on financial resources in addition to the current categories**

- access to financial and other key information about the issuer,

**Comment: the CSA should consider developing new categories of accredited investors based on this factor in addition to the current categories**

- educational background,

**Comment: the CSA should consider developing new categories of accredited investors based on this factor in addition to the current categories**

- work experience,

**Comment: the CSA should consider developing new categories of accredited investors based on this factor in addition to the current categories**

- investment experience, or

**Comment: the CSA should consider developing new categories of accredited investors based on this factor in addition to the current categories**

- other criteria?

**Comment: None at this time**

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?

**Comment: No need for a dealer to be involved in exempt trades as this increases the costs to the issuer and does not measurably improve the protection of investors.**

### **3. Minimum amount exemption**

#### **Background**

The terms of the current minimum amount exemption, a background discussion of the exemption, and a summary of comparable exemptions under the exempt market regimes in foreign jurisdictions are included at Appendix A.

#### **Issues involving the minimum amount exemption**

- **No assurance of sophistication.** The size of investment alone does not assure investor sophistication or access to information, particularly where the minimum amount exemption is used to sell novel or complex products without any accompanying disclosure. At most, the size of the investment is an indicator only of the investor's ability to withstand financial loss.
- **Current threshold for the minimum investment.** The current \$150,000 threshold for the minimum amount exemption was set in 1987 and has not been changed or adjusted for inflation since. The \$150,000 threshold is equivalent to over \$265,000 in 2011 dollars.<sup>{1}</sup> Some stakeholders have suggested that the \$150,000 threshold is too low and allows unsophisticated, retail investors to participate in the exempt market. Conversely, if the threshold is increased, the exemption may not be available to investors who do not need the protections provided by a prospectus offering.
- **Impact of a minimum amount concept on investment decisions.** An exemption based on a minimum amount invested may cause an investor to invest more than business or investment considerations may dictate solely to meet the threshold; for example, by investing \$150,000 when it may have made more sense to invest only \$50,000. Similarly, a higher minimum threshold may cause an investor to make a single investment of \$150,000 or more when a staged investment in smaller increments may better protect the investor's interests.
- **Use of the exemption to raise capital.** The minimum amount exemption is widely used by issuers to raise capital in some jurisdictions. If the investment threshold was increased or the minimum investment exemption was repealed, this could affect capital raising, especially by small and medium sized enterprises.

**Comment: agree; this would negatively affect capital raising.**

### **Consultation questions**

3. Do you have comments on the issues described above?

**Comment: Since 1987, the level of disclosure and the associated costs to the issuer of maintaining this level of disclosure have increased significantly. As such, we do not think there should be an increased disclosure for trades in the exempt markets. PDAC supports uniformity of rules across Canada and urges the CSA to adopt common prospectus exemptions across Canada including the offering memorandum exemption under section 2.9 of 45-106 which is not in effect in Ontario.**

4. Are there other issues you may have with the minimum amount exemption?

**Comment: None at this time**

### **Potential options regarding the minimum amount exemption**

Depending on the results of this consultation process, we may propose:

(1) retaining the minimum amount exemption in its current form,

(2) adjusting the \$150,000 threshold,

**Comment: \$150,000 threshold: this is suitable as an exemption. Currently most times this exemption is used the investor is also an accredited investor and we do not believe that increased disclosure is required for the accredited investor exemption nor this exemption.**

(3) limiting the use of the exemption to certain investors, such as institutional investors and not individuals,

(4) using alternative qualification criteria,

(5) imposing other investment limitations, or

(6) repealing the exemption.

### **Consultation questions**

#### **(a) Maintain the status quo**

5. Do you agree with maintaining the minimum amount exemption in its current form?

**Comment: yes**

**(b) Adjust the \$150,000 threshold**

6. How much should the minimum investment threshold be increased? Would your answer to this question change depending on whether:

- any disclosure is provided to investors, including risk factor disclosure?

**Comment: no additional disclosure is necessary**

- the purchaser is an individual, instead of an institutional investor?
- the security is novel or complex?
- the issuer of the security is a reporting issuer?
- a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?

**Comment: The threshold should not be increased and the above factors have no impact on our answer**

7. Should the \$150,000 threshold be periodically indexed to inflation?

**Comment: no**

8. If we changed the \$150,000 threshold what would the impact be on capital raising?

**Comment: if the threshold were increased, this would negatively impact capital raising**

**(c) Limit the use of the exemption by individuals**

9. Should individuals be able to acquire securities under the minimum amount exemption? Would your answer to this question change depending on whether:

- any disclosure is provided to investors, including risk factor disclosure?
- the security is novel or complex?
- the issuer of the security is a reporting issuer?
- a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?

**Comment: an individual should be able to acquire securities under this exemption and the above factors do not impact our response**

10. If individuals are able to acquire securities under the minimum amount exemption, should there be any limitations?

**Comment: Individuals should be entitled to invest under the minimum amount exemption**

11. If we limited the use of the exemption to persons who are not individuals, what would the impact be on capital raising?

**Comment: the impact would be negative**

**(d) Use alternative qualification criteria or impose other limitations**

12. Are there alternative qualification criteria for the minimum amount exemption?

**Comment: Only if introduces as additional categories of accredited investors. Please also see question 1 above**

13. Are there other limitations that should be imposed on the use of the minimum amount exemption?

**Comment: No**

**(e) Repeal the exemption**

14. Should the minimum amount exemption be repealed? Would your answer to this question change depending on whether:

- any disclosure is provided to investors, including risk factor disclosure?
- the purchaser is an individual, instead of an institutional investor?
- the security is novel or complex?
- the issuer of the security is a reporting issuer?
- a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?

**Comment: It should not be repealed and the above factors have no impact on our position.**

15. If the minimum amount exemption was repealed:

**Comment: The minimum amount exemption should not be repealed. Please also see above**

- would that materially affect issuers' ability to raise capital?

**Comment: this would materially affect capital raising**



- is the AI exemption (in its current or modified form) an adequate alternative to the minimum amount exemption?

**Comment: Both the AI exemption and the minimum exemption should be retained in its current form. Please also see above.**

#### **(f) Other options**

16. Are there other options for modifying the minimum amount exemption that we should consider?

**Comments: None at this time**

#### **4. AI exemption**

##### **Background**

The terms of the current AI exemption, a background discussion of the exemption, and a summary of comparable exemptions under the exempt market regimes in foreign jurisdictions are included at Appendix B.

##### **Issues involving the AI exemption**

- **Current thresholds for income and assets.** The thresholds for individuals to qualify as accredited investors were originally set by the Securities and Exchange Commission (SEC) in 1982, and subsequently adopted by the CSA in the early 2000s. The thresholds have not been changed or adjusted for inflation since. Some stakeholders submit that these thresholds are too low by today's standards. The current threshold for an individual's income is \$200,000; in 2011 dollars, the threshold would be over \$443,000 based on 1982 dollars (the year of SEC adoption) or \$245,000 based on 2001 dollars (the year the Ontario Securities Commission first adopted the exemption).<sup>{2}</sup> As with the minimum amount exemption, some say these thresholds are too low and allow unsophisticated, retail investors to participate in the exempt market, yet an increase in the thresholds may exclude investors who do not need the protections provided by a prospectus offering.
- **Qualification criteria.** Some stakeholders have suggested that income and asset thresholds are not adequate proxies for sophistication. Individuals may have significant wealth, but may lack investment or other experience that enables them to make an investment decision without the protections afforded by a prospectus offering.
- **Use of the exemption to raise capital.** The AI exemption is widely used by issuers to raise capital. If the exemption was changed or repealed, this could affect capital raising, especially for small and medium sized enterprises.

- **Compliance with qualification criteria.** Regulators have concerns that some individuals purchasing securities under the AI exemption are not, in fact, accredited investors.

**Consultation questions**

17. Do you have comments on the issues described above?

**Comment: no**

18. Are there any other issues you may have with the AI exemption?

**Comment: PDAC has no issues**

**Potential options regarding the AI exemption**

Depending on the results of this consultation process, we may propose:

- (1) retaining the AI exemption in its current form,
- (2) adjusting the income and asset thresholds in the definition of accredited investor,
- (3) using alternative qualification criteria for individuals,
- (4) limiting the exemption to certain investors, such as institutional investors and not individuals, and
- (5) imposing other investment limitations.

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**Consultation questions**

**(a) Maintain the status quo**

19. Do you agree with retaining the AI exemption and the definition of "accredited investor" in their current form?

**Comment: yes**

**(b) Adjust income and asset thresholds in the definition of accredited investor**

**Comment: the thresholds remain valid given the increased costs and disclosure requirements; it is a burden to issuers when rules change frequently**

20. What should the income and asset thresholds be? Would your answer to this question change depending on whether:

- any disclosure is provided to investors, including risk factor disclosure?

**Comment: no**

- the security is novel or complex?

**Comment: no**

- the issuer of the security is a reporting issuer?

**Comment: no**

- a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?

**Comment: no**

21. Should the income and asset thresholds be periodically indexed to inflation?

**Comment: no**

22. If we changed the income and asset thresholds, what would the impact be on capital raising?

**Comment: a significant negative impact**

**(c) Use alternative qualification criteria for individuals**

Alternative qualification criteria for individual investors could be required such as:

- *investment experience* (for example, the investor has carried out transactions of a significant size in securities markets at a given frequency),
- *investment portfolio size* (for example, the investor's securities portfolio must exceed a specified amount),
- *work experience* (for example, the investor works or has worked in the financial sector in a professional position which requires knowledge of securities investment), and / or
- *education* (such as the investor has completed the Canadian Securities Course, achieved a CFA designation or has received an advanced degree in business or finance).

23. What qualification criteria should be used in the AI exemption for individual investors? Would your answer to this question change depending on whether:

- any disclosure is provided to investors, including risk factor disclosure?
- the security is novel or complex?

- the issuer of the security is a reporting issuer?
- a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?

**Comment: No qualification criteria should be used except as additional categories of accredited investors. The above criteria have no impact on our response.**

24. If we changed the qualification criteria, what would the impact be on capital raising?

**Comment: If you add additional categories then it will be easier to raise capital**

**(d) Limit the use of the exemption by individuals**

25. Should individuals be able to acquire securities under the AI exemption?

**Comment: yes**

Would your answer to this question change depending on whether:

- any disclosure is provided to investors, including risk factor disclosure?
- the security is novel or complex?
- the issuer of the security is a reporting issuer?
- a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?

**Comment: no**

**(e) Impose other investment limitations**

26. Should an investment limit be imposed on accredited investors who are individuals? If a limit is appropriate, what should the limit be? Would your answer to these questions change depending on whether:

**Comment: no**

- any disclosure is provided to investors, including risk factor disclosure?

**Comment: no**

- the security is novel or complex?

**Comment: no**

- the issuer of the security is a reporting issuer?

**Comment: no**

- a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?

**Comment: no**

27. If investment limitations for individuals were imposed, what would the impact be on capital raising?

**Comment: the impact would be very negative**

#### **(f) Compliance with qualification criteria**

An issue with the AI exemption is ensuring compliance with the qualification criteria. One way to improve compliance with the AI exemption would be to require an investor's accredited investor status to be certified by an independent third party, such as a lawyer or qualified accountant.

28. Should this be considered in a review of the AI exemption?

**Comment: no**

29. Do you agree with imposing such a requirement?

**Comment: no**

30. Are there alternatives that we should consider?

**Comment: Consider adding new categories based on education, experience (work related or investing)**

#### **(g) Other options**

31. Are there other options we should consider for revising the AI exemption or for substituting an alternative exemption?

**Comment: None at this time**

{1} Source for inflation adjustments: Bank of Canada Inflation Calculator (<http://www.bankofcanada.ca/rates/related/inflation-calculator/>)

{2} Ibid.