



PROSPECTORS &
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OF CANADA

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April 2, 2013

Re: Considerations for new capital raising prospectus exemptions

As the voice of Canada's mineral exploration community, the Prospectors and Developers Association of Canada (PDAC) takes an active interest in the regulatory environments that shape the ability of our member companies to raise the risk capital they depend upon.

The ability to raise capital is one of the lifelines of our industry. At no time has this been made more evident than now and with respect to what our industry has experienced during the current economic downturn. This downturn has highlighted one of the fundamental weaknesses of the current prospectus regime, which is that an industry that is as capital intensive as the mining and exploration industry cannot survive if its capital lifeline is limited to less than 4% of the population: the accredited investor. Yet this is the reality of most of our junior exploration companies. The exploration and mining industry needs and must have broader access to capital that can be raised in a cost efficient manner.

Our members thrive on access to a healthy capital market but under the current exempt market regime in Ontario, exploration and mining companies are forced to focus the majority of their financing efforts on an elite group of investors, the accredited investors. The result is that majority of Ontario investors are denied access to the exempt market securities offered by our industry.

Many of the securities offered by our members also come with tax advantages, such as flow-through securities, or security enhancements, such as warrants or discounts to current market



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prices. Most Ontario investors are denied access to these benefits because their annual income or total wealth accumulation does not meet the threshold criteria set out in the accredited investor definition.

The complexity of securities regulation and the cost of raising capital continues to be an issue that threatens the Canadian mineral exploration and development industry. Accordingly, the PDAC supports regulatory changes that will provide its members with greater access to the capital markets.

The PDAC has reviewed OSC staff consultation paper 45-710 (the “OSC Paper”) and has some general comments as outlined in this letter. Detailed responses to the discussion questions can be found in Annex One.

As an overarching comment, the PDAC strongly encourages the OSC to harmonize the Ontario prospectus exemptions with the prospectus exemptions available in the rest of Canada. Unfortunately, because the OSC did not harmonize its prospectus exemptions with the rest of Canada in 2005, many Ontario investors have been denied the opportunity to participate in exempt market offerings. More importantly, many Ontario issuers have opted to restrict their offerings to the Ontario-only exemptions, thereby limiting their options for raising capital.

The PDAC supports the OSC’s initiative with respect to implementing a “Crowdfunding” exemption in Ontario and encourages other CSA members to also adopt this exemption. We also encourage the OSC to harmonize its proposed OM exemption with the OM exemptions that currently exist in the rest of Canada. We encourage the OSC not to create a third “Ontario model” version of the OM exemption, as this will only add more confusion for investors, increase costs to issuers and increase compliance issues for the industry as a whole.

The PDAC supports the OSC’s goal of investor protection as well as any initiative that provides greater equality for investors with respect to access to exempt market securities and appreciates the opportunity to comment on these issues, on behalf of its membership.



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Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ross Gallinger". The signature is fluid and cursive, with a small superscripted "r" at the end.

Ross Gallinger
Executive Director
Prospectors and Developers Association of Canada

Cc:
Brian Prill (Barrister and Solicitor, BLP Law Professional Corporation)
Barbara Hendrickson (Co-Chair, PDAC Securities Committee)
Bruce McLeod (Co-Chair, PDAC Securities Committee)



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ANNEX ONE: DETAILED RESPONSES TO QUESTIONS RAISED IN OSC DISCUSSION PAPER 45-710

1. INTRODUCTION

Background

Major changes to the exempt market regime in Canada were last made in 2005 with the introduction of National Instrument 45-106 *Prospectus and Registration Exemptions* (“**NI 45-106**”). NI 45-106 contains two key capital raising prospectus exemptions, the “minimum amount investment” exemption and the “accredited investor” exemption. These exemptions were available in some jurisdictions prior to 2005, but were harmonized nationally in NI 45-106. At that time, the Ontario Securities Commission (the “**OSC**”) chose not to adopt an offering memorandum (“**OM**”) exemption, unlike all other Canadian jurisdictions. Further, the OSC adopted a more limited version of the family, friends, and business associates exemption available elsewhere.

On November 10, 2011, the Canadian Securities Administrators (“**CSA**”) published CSA Staff Consultation Note 45-401 *Review of Minimum Amount and Accredited Investor Exemptions* (the “**Consultation Note**”). The Consultation Note focused on the minimum amount investment and accredited investor exemptions and asked questions designed to elicit feedback on whether those exemptions continue to be appropriate for Canadian markets. The CSA conducted its consultation to identify issues that stakeholders may have about the use of the exemptions and to obtain information that would assist CSA members in deciding whether changes to those exemptions were necessary or appropriate.

A wide range of views were expressed in both the written comment letters and in the consultation sessions. One theme that emerged from the OSC consultation sessions was the desirability of providing greater access to the exempt market for issuers and a more democratic approach by the OSC with respect to granting investors broader access to exempt market securities. Another view that was frequently expressed was the desirability of the OSC to harmonize its prospectus exemptions with the rest of the CSA jurisdictions.

Given the feedback received during the OSC’s consultation process, the OSC decided to expand the focus of their review to consider whether there is potential to foster greater access by start-ups and small and medium sized enterprises (“**SMEs**”) to capital markets while maintaining appropriate investor protection. In this respect, the OSC noted that Ontario does



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not have all of the prospectus exemptions (such as the OM exemption) available in the rest of the country.

2. OSC MANDATE AND GUIDING PRINCIPLES

The OSC has stated that their policy review must take into account the OSC's dual mandate of:

- providing protection to investors from unfair, improper or fraudulent practices, and
- fostering fair and efficient capital markets and confidence in capital markets.

The stated objectives of the OSC policy review are to consider how to best regulate the exempt market in a manner that:

- enhances its role in raising capital for businesses, particularly SMEs,
- provides retail investors with greater access to investment opportunities without compromising investor protection, and
- better aligns the interests of issuers and investors.

The OSC has stated in the OSC Paper that they will also be guided by the principle that business and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized.

In carrying out the OSC's policy review, the OSC has further stated that it is important that the OSC consider the exempt market as a whole and the range of prospectus exemptions available in that market.

3. PROSPECTUS EXEMPTIONS BASED ON RELATIONSHIP TO ISSUER

Consultation questions

(a) Is the 50 security holder limit under the private issuer exemption too restrictive? If so, what limit would be appropriate? Please explain.

The PDAC's view is that the current private issuer exemption is too restrictive in that it is only available if other exemptions under securities law are available (accredited investors; friends and family etc.) and therefore does not meaningfully add to issuer's options for



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raising capital. Raising the limit on the number of security holders will not impact its usefulness. **A reversion to the section 72 private company exemption which leaves the discretion to the issuer to determine who is “not a member of the public” is preferable.**

(b) Should the OSC consider re-introducing the closely held issuer exemption in addition, or as an alternative, to the private issuer exemption? If yes, should the conditions be changed?

While the closely held issuer exemption had a number of issues, the currently private issuer exemption is of limited use and therefore **another exemption in addition to the private issuer exemption would be helpful.**

(c) Should the OSC consider adopting a family exemption that allows for securities to be issued to an unlimited number of family members of the directors, executive officers, or control persons of the issuer or its affiliates? Please explain.

Yes. Issuers and residents in Ontario are unfairly prejudiced with respect to access to exempt market securities because of the lack of harmonization of the “friends, family, and business associates” exemption. For example, Ontario-based close personal friends and close business associates of an Ontario director are denied access to certain exempt market securities, whereas close friends and business associates of the same director that reside anywhere else in Canada are not denied access to these same securities. **The OSC should harmonize its “founder, control person and family” exemption with the “friends, family and business associates” exemption that is available in the rest of Canada.**

4. CROWDFUNDING

The OSC’s Crowdfunding proposal provides issuers with an exemption from the prospectus requirement for offerings that range up to \$1.5 million in any 12 month period. There is a \$2,500 investment cap per investor per offering and a \$10,000 total investment cap per investor per calendar year.

The PDAC supports the OSC’s initiative to implement a Crowdfunding prospectus exemption to: (i) allow SMEs and other issuers greater access to the capital markets and (ii) provide retail investors with additional opportunities to purchase exempt market securities.



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With respect to the proposal under the OSC's Crowdfunding exemption we provide the following comments:

A Crowdfunding exemption would permit more Ontario investors to participate in the sale of exempt market securities and take advantage of investment opportunities that are normally denied to them. The implementation of a Crowdfunding exemption would also provide some relief to our junior exploration market, and we encourage the OSC to adopt this exemption. **However, the Crowdfunding cap of \$1.5 million does not offer a full solution to the current funding gaps our industry is experiencing, which is why we also encourage the OSC to adopt the OM exemption in our comments below**

With respect to the proposed Crowdfunding exemption, the individual investment and the total annual caps do not adequately take into consideration an individual investor's financial situation. The principles behind caps such as the ones proposed ignore an individual investor's risk tolerance, investment objectives, or investment capacity. Furthermore, SMEs and other issuers will be forced to limit investor participation in their offerings in order to comply with these investment ceilings.

The PDAC supports the OSC's decision to set the Canadian maximum individual investment amount at \$2,500, which is \$500 higher than the US threshold. However, the **OSC should also include the percentage formulas used in the proposed US Crowdfunding exemption to take into consideration that investors with higher incomes or higher net worth have higher risk tolerances.**

The proposed caps prevent investors from diversifying their investments in SMEs to no more than four Crowdfunding offerings in any one calendar year. By mirroring the annual income caps proposed in the U.S., investors have a better opportunity to diversify their portfolio of SME securities and participate in a larger number of Crowdfunding opportunities based on higher income earning capacity or higher net worth.

Under the proposed Crowdfunding exemption, the requirement for audited financial statements defeats the purpose of providing an efficient and cost effective method of accessing the capital markets, especially for reporting issuers, which are already filing audited financial statements on SEDAR.

Crowdfunding disclosure for reporting issuers should be based on the filings that are available on SEDAR, which are already certified by the CEO and the CFO. Where an issuer is



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not a reporting issuer, CEO and CFO certification of management prepared financial statements should be sufficient, especially if the investor is given statutory rights for damages or rescission in the event of a misrepresentation. We note that CEO and CFO certification of interim financial statements for ventures issuers is already considered adequate investor protection and we recommend that the OSC harmonize this standard with the Crowdfunding exemption.

We recommend that non-reporting issuers should be allowed to post required disclosure material / information on their web-sites. SMEs should not be burdened with the additional distribution costs associated with mailing disclosure documents to these investors, especially when these entities are still in their formative or start-up years. With respect to concerns that the OSC may have regarding access to disclosure documents online, if Crowdfunding investors have the technical sophistication to participate in a financing through a Crowdfunding portal, then they should also have the technical sophistication to access an SME's disclosure documents on the SME's website.

PDAC does not support a proposal to restrict Crowdfunding portals to only certain categories of registered dealers or advisors. While we recognize that the registration as a portal may be a separate category of registration, existing registrants in all categories should also be eligible to register as a portal and assist SMEs or other issuers in accessing the capital markets.

With respect to anti-dilution protection, tag-along rights, pre-emptive rights, or security enhancements, such as flow-through shares and warrants, **issuers should be allowed to decide which protections, rights, or enhancements they may offer to Crowdfunding investors.** In a competitive capital market, many SMEs or other issuers will likely be inclined to include certain protections, rights, or security enhancements to attract investors to their offering. This in turn will allow all Ontario investors access to some of the protections, rights, or enhancements associated with exempt market securities that currently are only available to other investors.

5. OFFERING MEMORANDUM PROSPECTUS EXEMPTION

The OM exemption already exists under section 2.9 of NI 45-106 in two different formats, the BC format, which has minimal restrictions and the Alberta format which has restrictions with respect to: (i) maximum investment amounts of \$10,000 for "retail" investors or (ii) a requirement that "eligible investors" receive investment advice from an investment dealer prior to purchasing exempt market securities in excess of \$10,000.



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Rather than create a third format of OM in Ontario which is too restrictive as to be meaningful and create an even more fractured exempt market in Canada, **the OSC should implement one of the existing two models; BC or Alberta.** It would be counterproductive to the operation of fair and efficient capital markets if the OSC were to establish a third OM regime. If the OSC were to implement either the BC or the Alberta OM exemption in Ontario it would stimulate investor democracy by allowing all Canadians, including those in Ontario, with a means of accessing exempt market securities while at the same time providing investor protection.

The OSC has argued that the OM exemption is not being used by its target audience in other jurisdictions, and that it is a costly endeavour that produces complex documentation almost equivalent to a prospectus. The PDAC, by contrast, is of the opinion that an OM exemption would be useful to the mineral exploration industry.

Adopting the BC or the Alberta model will provide Ontarians with an exemption currently recognized across Canada. The OSC should not implement a third OM model and increase the confusion in the Ontario and Canadian capital markets with respect to the prospectus exemptions. The OSC should harmonize its prospectus regime with the rest of Canada and utilize their compliance reviews to enforce the investor protection rules that already exist.

6. PROSPECTUS EXEMPTION BASED ON INVESTMENT KNOWLEDGE

The PDAC supports any initiative the OSC undertakes to improve access to the capital markets. We note however, that the proposed educational requirements under the current concept proposal are primarily weighted towards those educational programs that contain a certain level of financial education. While a financial education is a valuable education to have, assuming a financial education is a proxy for sophistication does not take into consideration the education and knowledge possessed by geologists, lawyers, individuals possessing scientific or technical knowledge or other business professionals; any of which may be relevant for an investor in determining if an offering is something the investor desires to participate in.

If education is to be perceived to be a proxy for sophistication then it should apply to all higher education degrees, not just the three degrees enumerated in the OSC proposal. **With respect to establishing an education proxy for sophistication, the PDAC encourages the OSC to harmonize this exemption with all CSA jurisdictions.** It would be fundamentally unfair to designate someone to be a “sophisticated investor” in Ontario, only to see them lose that designation if they moved to another province. This would only serve to enhance the



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inequalities that currently exist with respect to security exemptions and access to exempt market securities in Canada.

7. PROSPECTUS EXEMPTION BASED ON REGISTRANT ADVICE

In order to provide investors full access to the exempt securities market **PDAC recommends that the OSC adopt this exemption.** However investment advice should not be limited to individuals registered in the category of portfolio manager or investment dealer. **All investors should have access to exempt market securities when they have sought and received investment advice from any registrant.** All investors should be given the right to choose who they trust as an investment advisor based on their relationship with that advisor, so long as that advisor has the requisite proficiency to understand and explain the product they are reviewing with the investor.

8. NEED FOR MORE DATA

The PDAC supports the initiatives of the OSC in collecting more data on the exempt market, the exemptions used, and the participants in the market place. The PDAC also supports the use of electronic filing of Form 45-106F1 reports and encourages the OSC to work with other CSA jurisdictions in reviewing the data from these reports and providing reports on this data to the capital markets.

9. CONCLUSION

The PDAC supports all initiatives that provide issuers with broader access to the capital markets and provide investors with a broader access to purchase exempt market securities. We also support any initiative that will reduce the regulatory burden and associated costs for issuers to bring exempt market securities to the market place. **We encourage the OSC to collaborate with its CSA partners in harmonizing the OM exemption and allowing Ontario investors the opportunity to have broader access to exempt market securities. We also encourage the OSC to work with all categories of registrants to improve compliance with the current regulatory rules and achieve investor protection.**