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**Re: Considerations for new capital raising prospectus exemptions**

Toronto Business Development Center ("TBDC") is one of the many Canadian business incubators that are responsible for providing training and business coaching for Canadian entrepreneurs engaged in small to medium business enterprises ("SMEs"). To date, TBDC has helped more than 4500 businesses through the various programs it has offered. As such TBDC, its clients, and its graduates have a direct interest in the regulatory environment that affects the ability of SMEs to raise money on the capital markets.

Our clients and graduates are dependent on healthy capital markets to provide the capital required to develop their product lines or business ideas. At no time has this been made more evident than what SMEs are experiencing in the current capital markets. Access to early stage capital can be crucial to the ultimate success or failure of an SME and the current private issuer exemption does not provide a broad enough prospectus exemption for many SMEs. This situation is compounded by the need of SMEs to raise mezzanine capital in the \$1.5M to \$3.0M range. Because of the lack of an offering memorandum exemption in Ontario, Ontario SMEs are essentially restricted to looking for high net worth individuals to fund their business development. These investors make up less than 4% of the investor population of Ontario, which inhibits the ability of SMEs to access the broader investor community. In addition, most Ontario investors are denied access to early stage investment in SMEs because their annual income or total wealth accumulation does not meet the threshold criteria set out in the accredited investor definition.

TBDC supports regulatory changes that will provide its clients and other SMEs with greater access to the capital markets. TBDC has reviewed OSC staff consultation paper 45-710 (the "OSC Paper") and has some general comments as outlined in this letter.

TBDC 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 of the OM exemption as this will only add more confusion for investors, increased costs to issuers and increased compliance issues for the industry as a whole.

As an overarching comment, the Toronto Business Development Centre strongly encourages the OSC to harmonize the Ontario prospectus exemptions with the prospectus exemptions available in the rest of Canada. TBDC 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.

TBDC appreciates the opportunity to comment on these issues, on behalf of its clients and graduates.

Respectfully submitted,



Ed Hobbs  
President  
Toronto Business Development Center

Cc:

Brian Prill (Barrister and Solicitor, BLP Law Professional Corporation)  
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# CONSIDERATIONS FOR NEW CAPITAL RAISING PROSPECTUS EXEMPTIONS

## OSC STAFF CONSULTATION PAPER 45-710 (the “OSC PAPER”)

### 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 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. The Toronto Business Development Centre**

Toronto Business Development Centre ("TBDC") was established in 1990 with the support of the city of Toronto and the Province of Ontario. TBDC is an independent non-profit, non-government organization dedicated to nurturing the growth of new and emerging businesses. TBDC is recognized at home and internationally for achievements in the field of business incubation. Over the past twenty plus years, TBDC has helped more than 4500 businesses through its various programs.

Toronto Business Development Centre provides help in all phases of business creation and growth through the following business incubation activities:

- Business Incubation
- Business Seminars
- Education Programs
  - Ontario Self-Employment Benefit (OSEB)
  - Ontario Works Self-Employment Development (OWSED)
  - BIZ Futures
  - Summer Company
  - Canadian Youth Business Foundation (CYBF)

TBDC currently has two locations in in the Greater Toronto Area, one in the downtown Toronto core at 1 Yonge Street and the other in Etobicoke at 105 Judge Road.

### **General Comments**

We have reviewed the OSC Paper and TBDC supports any regulatory changes that will provide SMEs with greater access to the capital markets as well as providing investors with



greater access to this important segment of the Canadian market. TBDC supports the OSC's initiative with respect to implementing a Crowdfunding exemption in Ontario and encourages other CSA members to also adopt this exemption.

#### **4. Prospectus exemptions based on relationships with the issuer**

##### **Consultation questions**

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

Yes. SMEs require a broader access to capital than what is offered under the private issuer exemption. While there are a number of categories of investor that an SME can reach under this exemption, in many instances and except for the accredited investor category, the capital requirements of an SME exceed what the other investor categories in the private issuer exemption can provide. Once an SME has exhausted the capital resources of its close relations under the private issuer exemption, the SME is primarily limited to marketing its securities to a select group of investors, the accredited investor, which only represents 4% of the Canadian investor population. The implementation of the proposed Crowdfunding exemption and a harmonized OM exemption would provide additional exemptions that an SME could access once they exceeded the current private issuer threshold of 50 security holders.

#### **5. 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.

TBDC supports the OSC's initiative to implement a Crowdfunding prospectus exemption to: (i) allow SMEs broader access to the Ontario capital market and (ii) provide retail investors with additional opportunities to invest in early stage companies. With respect to the proposal under the OSC's Crowdfunding exemption we provide the following comments:

The ability to raise capital is fundamental to the survival of the SME market place. The implementation of a Crowdfunding exemption would provide SMEs with access to a segment of the capital markets that is currently closed to them, the retail investor, and we encourage the OSC to adopt this exemption. However, the Crowdfunding cap of \$1.5 million does not help SMEs bridge the gap between a start-up financing of up to \$1.5 million and the mezzanine financing levels from \$1.5 million to \$5 million, which tends to be the lower threshold financing level for many venture capital funds. SMEs require a regulatory regime that provides a broader access to capital markets than that provided by the proposed Crowdfunding exemption, which is one of the reasons we also encourage the OSC to adopt the OM exemption as set out in our comments in that section.

TBDC supports the OSC's goal of investor protection as well as those initiatives that provide greater opportunity for investors to invest in early stage companies. However, with respect to the proposed Crowdfunding exemption, the individual investment and the total annual



caps do not adequately take into consideration the investor relations burden that an SME will have to undertake to handle the large shareholder base that a Crowdfunding offering could generate.

In addition, the Crowdfunding exemption should grant investors the right to make their own investment decisions based on their own personal risk tolerances and investment strategies. TBDC applauds the OSC's decision to set the Canadian maximum individual investment amount at \$2,500. 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 may have higher risk tolerances and be more willing to support local SMEs at a higher investment level.

With respect to an audited financial statement requirement for offerings over \$500,000, the cost of preparing audited financial statements will impose a significant financial burden on SMEs that may make it prohibitive for SMEs to use the Crowdfunding exemption, which would essentially defeat the one of the goals of the OSC, which is to make this exemption an efficient and cost effective method for SMEs to access the retail capital markets. However, TBDC supports the idea of CEO and CFO certification of management prepared financial statements as this will provide investors with financial disclosure with respect to a SMEs operations and provide the investor with the additional comfort of having statutory rights for damages or rescission in the event of any misrepresentation. We note that CEO and CFO certification of interim financial statements is already considered adequate investor protection with respect to venture issuers and we recommend that the OSC harmonize this standard with the Crowdfunding exemption.

With respect to providing annual financial statements or statements with respect to the use of funds, we recommend that SMEs be allowed to post required material/disclosure information on their web-sites, along with any required CEO and CFO certifications. SMEs should not be burdened with the additional distribution costs associated with mailing disclosure documents to investors, especially when SMEs are still in their formative or start-up years. One of the objectives of implementing a Crowdfunding exemption should be to provide SMEs an efficient, cost effective means of accessing the capital markets. Ongoing disclosure can be accomplished through the use of postings on the SME's website. Conversely, if the Crowdfunding disclosure requirements required SMEs to mail financial statements or other disclosure documents directly to investors, the additional costs incurred essentially redistribute the investors' money from the development of the SME's business, which is the original investment objective, and force the SME to use the investors' funds to cover the cost of regulatory compliance. This would appear to defeat part of the purpose of implementing a Crowdfunding exemption, which is to stimulate the growth of the SME market place.

With respect to conducting a due diligence review of an SME prior to a Crowdfunding portal taking the SME offering to the market place we note that, as an incubator, TBDC does a thorough review of our client's business plan as well as undertaking a background search with respect to all of the SME's officers and directors. TBDC does this to ensure that the SMEs we take into our incubation program have a viable business opportunity and a better than average chance of success after they have completed our program. We submit that Crowdfunding portals should be required to hold SMEs that they bring to the capital markets to a similar standard of



review. We also submit that Crowdfunding portals should be required to certify that they have undertaken this review of the SME prior to offering the SMEs securities through its portal.

With respect to anti-dilution protection, tag-along rights, pre-emptive rights, or security enhancements, such as warrants, SMEs should be allowed to decide which protections, rights, or enhancements they may offer to Crowdfunding investors. In a competitive capital market this will allow Ontario investors access to a growing segment of the Canadian economy while the same time providing investors with the additional protections, rights, or enhancements that these retail investors may not otherwise receive.

## **6. Offering Memorandum Prospectus Exemption**

The OM exemption already exist in two different models, a BC model, which has minimal restrictions and an Alberta model 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.

TBDC recommends that the OSC refrain from creating a third form of OM, which we believe would only increase the regulatory burden on SMEs that choose the OM exemption as a method of accessing Canadian capital markets. We encourage the OSC to work with the other CSA members to implement a harmonized OM exemption across Canada.

Adopting either the BC or the Alberta OM exemption across Canada will also provide SMEs with a harmonized OM regime that they can utilize to access to the entire Canadian capital market. The OM exemption would also serve as a method SMEs could bridge the financing for financings greater than \$1.5 million dollars, the Crowdfunding limit, and \$5 million, which is often the lower limit for mezzanine financings for venture capital firms. One of the advantages of a harmonized OM exemption is that there would be no cap on the total offering size as in the Crowdfunding exemption and there would be no need to market the offering through a Crowdfunding portal. SMEs could access the entire Canadian capital market directly or they can access the market through existing registrants. Moreover, they would not have to focus their financing efforts on a select group of qualified persons, the accredited investor, which only makes up 4% of the investor population in Canada. SMEs would then be able to offer all Canadians the investment opportunities that only a select few get to participate in. Therefore, we recommend the OSC focus its efforts on harmonizing the OM exemption amongst all CSA jurisdictions. If the OSC were to implement a harmonized OM exemption in Ontario it would also stimulate investor democracy by providing all Canadians with a means of investing in SMEs while at the same time providing investor protection through the OM disclosure requirements.

## **7. Prospectus exemption based on investment knowledge**

TBDC supports any initiative the OSC undertakes to improve access to the capital markets for SMEs. 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 we note that many of TBDC’s business incubation program clients have sophistication based on



a number of educational criteria. Assuming a financial education is a proxy for sophistication does not take into consideration the education and knowledge possessed by computer programmers, software developers, 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.

Limiting the sophistication criteria to only financial education denies our entrepreneurs the ability to invest in other SMEs that our entrepreneurs may understand and want to invest 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. Our clients have a broad range of educational proficiency, any one of which would enable them to determine if another SME has a viable business model that they should support. Moreover, with respect to establishing an education proxy for sophistication, TBDC 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.

#### **8. Prospectus exemption based on registrant advice**

In order to provide investors full access to the exempt securities market TBDC 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, provided such registrant has a regulatory obligation to fulfill the applicable “Know-Your-Client”, Know-Your-Product” and suitability analysis requirements with the investor. 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.

#### **9. Need for more data**

TBDC supports the initiatives of the OSC in collecting more data on the exempt market, the exemptions used, and the participants in the market place. TBDC 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.

#### **10. Conclusion**

TBDC supports all initiatives that provide SMEs with broader access to the capital markets and provide investors with a broader access to this growing segment of the market. We also support any initiative that will reduce the regulatory burden and associated costs for SMEs to bring their business opportunities to the market place. With respect to the OM exemption, we encourage the OSC to collaborate with its CSA partners in harmonizing the OM exemption and allow all investors a universal opportunity to have access to the business opportunities SMEs provide.



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The above comments are respectfully submitted by Toronto Business Development Centre on behalf of the many entrepreneurs that are a part of or have graduated from our programs.

We thank you for the opportunity to provide you with our comments on the proposed amendments. If you have any questions or concerns, we ask that you direct them to Toronto Business Development Centre, Attn: Brian Prill, Director.