PORTFOLIO AUDIT

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RE: INTRODUCTION OF PROPOSED PROSPECTUS EXEMPTIONS AND
PROPOSED REPORTS OF EXEMPT DISTRIBUTION IN ONTARIO
Supplement to the OSC Bulletin, March 20, 2014 Volume 37, Issue 12 (Supp-3) (2014), 37 OSCB

To whom it may concern;

I have founded a company called Portfolio Audit. We audit the investment processes of individual investors, who are most often represented by licensed advisers. During the course of our work, we frequently come across investments that are high risk, opaque, costly, illiquid, and generally very dangerous to the individual investor. Most of these investments were recommended by a licensed adviser and come with a prospectus or an offering memorandum.

Even with these safeguards, many individual investors hold excessive quantities of these high risk investments, such as hedge funds or inversed leveraged products, not knowing the impact the losses from these investments would have on their retirement or other objectives.

There are no shortage of these high risk investments available for investors. I fail to see why Equity Crowdfunding [the wild, wild west of fundraising] is needed or desirable for the regular small investor given the wide access to existing high risk investments.

As someone who makes a living dealing with the fall out of high risk investments, I'm sure Equity Crowdfunding will keep me very busy well into the future, although it is not something I desire.

Following are some of my general thoughts on Equity Crowdfunding and the impact to the regular small investor.

Self-selection

I fear that ventures seeking capital will be self-selecting resulting in the lowest quality ventures seeking capital through these portals. Those startup businesses with a strong business plan and maybe a good track record will have access to regular sources of venture capital. Those riskier ventures, shall I say of the sort rejected on dragons den, will turn to Equity Crowdfunding. But why should this surprise us, when people are raising funds for their business on reality shows it is not much of a stretch to fund your money from a kick starter. From the regular investors view point, they will likely be selecting from mostly low quality offerings, and the investor will have little ability to select the good quality capital seekers from the chaff. The risk of selecting an investment with a high risk of failure will be great, and normal in this market.

Due Diligence

Normally when investing in small companies, due diligence is performed. Years ago I was the senior officer with a startup that was going to get a round of funding from Reuters for $30,000,000. I was in charge of the due diligence effort for the company. The team of auditors left no stone unturned and it took about 45 days to complete. New ventures need at least some level of due diligence. Who is protecting investor's money here? We have mom and pop investing their life savings and who is doing the due diligence for them? No one I would guess or at least not an impartial party. It's basically a roll of the dice with your personal savings.

Cash Flow Management

Which brings up an interesting point. Most large investors understand that when investing in high risk venture capital, you can expect to lose all of your money on many investments with a few winners paying off. Cash management is critical in any high risk gambling, whether that is poker, futures, or venture capital. How on earth is the regular investor with maybe $60,000 in savings going to be able to diversify their Equity Crowdfunding investments sufficiently to ensure they are not knocked out of the game before they can get a winner? Pure luck I suppose. In the meantime they have just lost a sizable portion of their investable assets which they could ill afford to lose.

Disclosure and Oversight

We are already having difficulties with disclosure of risk in all of its various forms. Most clients do not understand the many risk they can be exposed to in a moderately risky investment and the necessary documents to protect investors are mandated by the regulators. If the documents are not up to snuff, the regulators will force their correction.

But as I understand it, the portal will be responsible for oversight of not only documentation but the businesses coming to the portal to raise money? So if I understand it, the organization what will be paid by having 'action' on its portal are the very people who are supposed to be protecting the retail investors putting up the money that ultimately pays the portal's salaries and profits? Well at least there's no conflict of interest there.

Asset Allocation

And what of the investor who actually buys these illiquid high risk investments. Perhaps an investor could end up with a portfolio with t-bills, bonds, blue chip stocks, a few etfs, and some black box that is impossible to get your money out of or truly quantify the risk. This portfolio does not represent a sensible portfolio for most investors. It seems to me that Equity Crowdfunding is most lucrative for the entrepreneur and the portal.

Will highly ethical individuals be selling in the best interest of clients?

And who will be pushing these 'investments'? I have enough concerns with the manner in which our regulated investments are sold to investors. There are countless unscrupulous hawkers of investments out there who I'm sure at this moment are salivating with the prospects of Equity Crowdfunding. Will commissions be paid to representatives marketing these unwashed securities?

Will investors know how to quantify risk?

Experienced investors have difficulties understanding the risks associated with startups, inexperienced investors will easily be caught up in the hype and over invest putting themselves at risk. There are risk associated with these investments that regular investors will not understand, and could include: liquidity risk, business risk, conflict of interest risk, counterparty risk, credit risk, earnings surprise risk, foreign exchange risk, lack of insurance risk, low rated or unrated debt obligation risk, market risk, net asset value risk, newly established and smaller capitalization companies risk, valuation risk, unit or shareholder liability risk, fraud risk.

These are the types of risk normally associated with high risk investments. How will regular investors have a winning hand when the entrepreneurs and middlemen are holding the stacked deck by which the game is played? Which leads me to my last point.

Why?

Can someone please tell me why the average investors needs to be exposed to these kinds of risks? It smacks of putting a casino near a retirement community. I for one am against Equity Crowdfunding at this time. Perhaps the markets will mature in other countries. I would like Canada to wait and learn from the mistakes other countries make with their money, before we roll the dice on the retirements of average Canadians. If this goes forward, which it appears it will, I am predicting major disaster stories for regular investors. Who was watching out for those people? Reporters, sharpen your pens.

You may share my comments publicly and I welcome discussion on this matter.

Sincerely,

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