May 6, 2014

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The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8

Re: CSA Proposed Amendments Relating to the Offering Memorandum Exemption

Dear Madams:

I appreciate the opportunity to provide input into the proposed amendments in National Instrument ('NI') 45-106.

Background:

Ken Engler is the President and a Director of Stable MIC Management II Inc. ('Stable'). Stable is registered with the Alberta Securities Commission as an Investment Fund Manager, Restricted Portfolio Manager and Exempt Market Dealer. Stable has been very proactive since the NI 31-103 regime has come into place and has expended a great deal of professional time, money and business resources to ensure compliance with this new regulatory regime.

Overview:

Stable was shocked and extremely disappointed that the severe investment limits proposed in NI 45-106 are even being considered by regulators at this time. Both the industry and the regulatory bodies are still learning together about the implementation mechanics and long term benefits of NI 31-103 on the exempt market industry. The draconian investment limits proposed in NI 45-106 appear to make the whole NI 31-103 exercise moot while that new regulatory program is still in its infancy.

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To implement dramatic, arbitrary investor restrictions on our industry before the long term benefits of NI 31-103 can been seen, quantified and studied shows a level of disrespect to the immense amount of work done by the industry participants, their professional advisors and the quality securities commission employees who have worked so hard over the past three years on NI 31-103 implementation.

I have attached further technical comments regarding this matter to this letter.

If you would like further elaboration on my comments, please feel free to contact me at kenengler@shaw.ca.

Regards,

Kenneth D. Engler, CA
President
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CC:

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Technical Points

1. **Investor Protection Mechanisms already in place**

- In the case where the trade involves a registered Dealing Representative, who is supervised by a registered Exempt Market Dealer, placing any limits on how much can be invested undermines the very principals of KYC, KYP, and suitability obligations which are "cornerstones of (the CSA's) investor protection regime" put in place under NI 31-103.[1]

- A large enough "filter" already exists to ensure investors are adequately protected:

    - Trade is conducted through a Dealing Representative (registered with a provincial securities regulator) with the "cornerstones of (the CSA's) investor protection regime" being KYC, KYP, and suitability obligations in place under NI 31-103.[2]
    - If client and DR agree on a "suitable" transaction, then the trade goes to a regulatory approved Chief Compliance Officer (CCO) to ensure they agree with the suitability of the trade
    - Assuming the CCO approves the trade and the issuer closes on investor funds, the trade proceeds and a record of this trade is filed with regulators.
    - If regulators do not agree with the trade's suitability, they have varying enforcement options available depending on the regularity and severity of the transgressions.
    - This additional limit gives the perception that $30,000 is an acceptable loss for investors and places a stigma on our products.

2. **Diversification Issues**

- "Diversification is an important factor to consider when assessing suitability of investments" yet these proposed annual contribution limits will not allow for proper diversification for many clients.[3]
    - Given the ongoing costs of an investor, many issuers in the exempt market will only accept subscriptions of $25,000 or more. Assuming exempt market product is suitable, how could a Dealing Representative diversify a client's exempt market portfolio if they were capped to dealing with $30,000 contribution room a year?
    - The proposed contribution amounts limit the flexibility needed to build a holistic portfolio based on investor suitability.
    - If regulators are concerned with proper diversification, particularly in regards to those "few issuer groups raising the majority of the funds under the OM Exemption (with their) 'in-house' exempt market dealers" perhaps suitability practices should be looked into closer.[4]

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[1] CSA Staff Notice 31-336 *Guidance for Portfolio Managers, Exempt market Dealers and Other Registrants on the Know-Your -Client, Know-Your-Product and Suitability Obligations*. January 9, 2014. P 1.
[2] CSA Staff Notice 31-336 *Guidance for Portfolio Managers, Exempt market Dealers and Other Registrants on the Know-Your -Client, Know-Your-Product and Suitability Obligations*. January 9, 2014. P 1.
[3] CSA Staff Notice 31-336 *Guidance for Portfolio Managers, Exempt market Dealers and Other Registrants on the Know-Your -Client, Know-Your-Product and Suitability Obligations*. January 9, 2014. P 14.
[4] *Multilateral CSA Notice of Publication and Request for Comment Proposed Amendments to National Instrument 45-106 Prospectus and Registrant Exemptions Relating to the Offering Memorandum Exemption and in Alberta, New Brunswick and Saskatchewan, Reports of Exempt Distribution*. March 20, 2014. Annex B. p 1-3.

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3. **Lack of substantive evidence regarding 'investor complaints.'**

- "The ASC has received numerous complaints from investors that have invested significant amounts under the OM Exemption and incurred significant losses"[5]
    - However, the ASC has failed to truly quantify this statement by providing a breakdown of the underlying data for this vague statement which is the basis for their argument to "limit the risks associated with an investment by a retail investor in illiquid securities"[6]
    - There was no indication that these complaints were related to sales made by a registrant under NI 31-103
        - If they were, does the ASC have evidence of enforcement actions taken against these registrants?
        - The lack of press releases from the ASC regarding disciplinary actions taken against dealing representatives suggests that these complaints stem from the well documented losses that occurred before and were very much the basis for implementation of NI 31-103, an instrument that cost tax payers millions of dollars to create.
        - Accordingly there is no evidence that the post NI 31-103 exempt market, including the existing OM exemption parameters are not working.

4. **Encourages mechanical 'Tick Box' versus client focused behavior**

- Regulators indicate that a "mechanical 'tick box' approach is not sufficient" for constructing an investor portfolio yet that is the very approach they are taking here[7]
    - For example, how can regulators apply the same thresholds to an investor with an income of $75,000 and an investor with more than double that income (e.g. $199,999)?
    - How can an arbitrary contribution room be imposed on everyone base on income and net worth without knowledge of the investor's sophistication, time limes and risk tolerance?

5. **Annual contribution room not pragmatic**

- What happens when an existing "retail" exempt market investor has a successful exit where the proceeds exceed $30,000? How will this contribution room be managed?
    - Are regulators prepared to subsequently restrict them to investing $30,000 (which may be less than the principal they originally invested) in order "to limit the risks associated with an investment by (them) in illiquid securities" after they just had success with an investment of that very nature?[8]

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[5] *Multilateral CSA Notice of Publication and Request for Comment Proposed Amendments to National Instrument 45-106 Prospectus and Registrant Exemptions Relating to the Offering Memorandum Exemption and in Alberta, New Brunswick and Saskatchewan, Reports of Exempt Distribution.* March 20, 2014. Annex B. p 2.

[6] *Multilateral CSA Notice of Publication and Request for Comment Proposed Amendments to National Instrument 45-106 Prospectus and Registrant Exemptions Relating to the Offering Memorandum Exemption and in Alberta, New Brunswick and Saskatchewan, Reports of Exempt Distribution.* March 20, 2014. P. 3.

[7] CSA Staff Notice 31-336 *Guidance for Portfolio Managers, Exempt market Dealers and Other Registrants on the Know-Your -Client, Know-Your-Product and Suitability Obligations.* January 9, 2014. P 9.

[8] *Multilateral CSA Notice of Publication and Request for Comment Proposed Amendments to National Instrument 45-106 Prospectus and Registrant Exemptions Relating to the Offering Memorandum Exemption and in Alberta, New Brunswick and Saskatchewan, Reports of Exempt Distribution.* March 20, 2014. P. 3.

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- Dealing Representatives would have a transactional focus with the contribution limits as opposed to the client focus of the suitability process.
- Who would track and take action when investors have exceeded their annual contribution limits? EMDs or individual DRs would have no current means to ensure with 100% accuracy if the client has staying within the contribution limit over the last 12 month period.
- Regulators would force investors back into the public markets they fled to the exempt market from when they are trading at an all-time high?

6. **Increases costs and risks**

- The OM Exemption, which is generally used by Exempt Market Dealers and their Dealing Representatives is "designed to facilitate early stage and small business financing" yet the costs associated with the current EMD regulatory regime, coupled with regulators attitudes that losses are unacceptable make funding riskier small business very problematic in its current form. Adding these arbitrary contribution limits would even further reduce financing for new enterprises as;

  - Eligible investors wanting to take "suitable" SME investment risks would be capped at investing $30,000 per annum.
  - Those that do not qualify for Eligible Investor status wanting to take these "suitable" SME investment risks would be capped at investing $10,000 per annum.
  - Many existing Dealing Representatives, particularly those who are long term client focused, would leave the industry due to having their ability to earn a living "capped" given the time, complexity, and liability involved with working in the exempt market
  - EMDs would have additional costs of dual (conflicting) compliance regimes of suitability on one hand and contribution limits on the other.
  - EMDs would be less willing to undertake fundraising efforts for enterprises that have a risk of undercapitalization as their ability to raise funds would be inhibited.

7. **Is the Change within the Securities Commission's scope of Powers?**

- The policy may not withstand a court challenge. It is unclear whether the securities regulators have the authority to dictate caps on the amount of funds investors are able to put into a particular asset type. Such a policy may in fact be unconstitutional, as it takes away investor rights. In addition, setting limits on a particular product category could be considered giving investment advice, which is not in the mandate or powers of the Securities Commissions.[9] Should there be a court challenge of this limit, and should the regulators lose, it would further erode and undermine public confidence in the securities regulators.

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[9] *Multilateral CSA Notice of Publication and Request for Comment Proposed Amendments to National Instrument 45-106 Prospectus and Registrant Exemptions Relating to the Offering Memorandum Exemption and in Alberta, New Brunswick and Saskatchewan, Reports of Exempt Distribution.* March 20, 2014. P. 3.

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