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BY EMAIL

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority (Saskatchewan)
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Yukon
Superintendent of Securities, Nunavut

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Re: CSA Notice and Request for Comment – Proposed Amendments to National Instrument 45-106 Prospectus and Registration Exemptions Relating to the Accredited Investor and Minimum Amount Investment Prospectus Exemption (the “Notice”)

Dear Mesdames/Sirs,

Accredit Inc. is an information technology company specializing in (i) investor identification and investor status verification; and (ii) background checks in relation to issuers, directors, executive officers and controlling shareholders. Accredit Inc.'s services are offered through its web-based platform named *Accredited Access*TM. Accredit Inc. appreciates the opportunity to provide comments on the proposed amendments to National Instrument 45-106 and its Companion Policy.

Accredit Inc. was originally organized to assist U.S. based issuers ensure that they have undertaken reasonable steps to verify that purchasers of securities under new Rule 506 (c) of Regulation D of the *Securities Act of 1933* ("**Rule 506 (c)**") are accredited investors.

THE JOBS ACT AND RULE 506 (C) OFFERINGS

Section 201(a)(1) of the *Jumpstart Our Business Startups Act* ("**Jobs Act**") directed the U.S. *Securities and Exchange Commission* ("**SEC**") to amend Rule 506 of Regulation D under the *Securities Act of 1933* (the "**Securities Act**") to eliminate the prohibition on using general solicitation and general advertising to market private placements provided that all purchasers of securities under the exemption are accredited investors and the issuer takes reasonable steps to verify that the purchasers are accredited investors using such methods as determined by the SEC. The SEC has indicated that the purpose of the verification mandate of Section 201(a) of the Jobs Act is to address concerns, and reduce the risk, that use of general solicitation in Rule 506 offerings could result in sales of securities to investors who are not, in fact, accredited investors.

Rule 506(c) was adopted by the SEC to implement Section 201(a) of the JOBS Act. In Rule 506(c), the SEC has set forth a principle-based method of verification which requires an objective determination by the issuer (or those acting on its behalf) as to whether the steps taken are "reasonable" in the context of the particular facts and circumstances of each purchaser and transaction.¹ The SEC provided the following examples of the factors that an issuer would consider under this principles-based method:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be²;
- the amount and type of information that the issuer has about the purchaser³; and

¹ Page 27, SEC Release No. 33-9415 (July 10, 2013), "Final Rules re Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and 144A Offerings"

² Similarly to Section 1.1 of National Instrument 45-106, the definition of accredited investor under Regulation D contains various enumerated categories of accredited investor where the category of natural persons who meet net worth or annual income criteria is only one among many. For instance, under both the U.S. and Canadian definitions registered broker dealers qualify as accredited investors. The SEC recognizes that the steps that may be reasonable to verify that a broker-dealer is an accredited investor would differ from those that would be reasonable for a natural person. The implication being that the use of one of the non-exclusive methods of verification described further below would be warranted for natural persons and not for certain other categories of accredited investors.

³ At page 28 of SEC Release No. 33-9415 (July 10, 2013), "Final Rules re Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and 144A Offerings", the SEC indicated that the more information an issuer has indicating that a prospective purchaser is an accredited investor, the fewer steps it may have to take, and vice versa. Depending on the facts and circumstances, it might be reasonable for an issuer not to take any steps to verify that a purchaser accredited investor status.

- 3.
- the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as minimum investment amount.

The SEC has indicated that the foregoing “factors would be interconnected, and the information gained by looking at these factors would help an issuer assess the reasonable likelihood that a potential purchaser is an accredited investor, which would, in turn, affect the types of steps that would be reasonable to take to verify a purchaser’s accredited investor status.”⁴

The SEC received a number of comments on this principles-based method of investor verification, including that the SEC should provide a non-exclusive list of verification methods in Rule 506(c) offerings in order to provide legal certainty that the verification requirement has been satisfied in any given situation particularly since the verification obligation is separate from and independent of the requirement that sales be limited to accredited investors, and must be satisfied even if all purchasers happen to be accredited investors.

In response to such comments, the final rule, in addition to the principles-based method of verification, contains a non-exclusive list of methods that issuers may use to satisfy the investor verification requirement for **natural person purchasers** since, as the SEC indicated, “the potential for uncertainty and the risk of participation by non-accredited investors is highest in offerings involving natural person purchasers.”⁵ In short, the use of one of the non-exclusive list of verification methods would be deemed to meet the requirement that reasonable steps be taken to verify that a purchaser is an accredited investor. The methods described in the final rule include the following, which vary depending on whether the assessment of an individual’s accredited investor status is being verified based on their income or their net worth:

1. **Satisfy the Income Requirement.** In verifying whether a natural person is an accredited investor on the basis of income, an issuer is deemed to satisfy the verification requirement in Rule 506 (c) if it reviews copies of any Internal Revenue Service form that reports income for the two most recent years, including, but limited to, Form W-2 (wage and tax statement), Form 1099 (reports of various types of income), Schedule K-1 of Form 1065 (partner’s share of income, deductions, credits, etc), and a copy of a filed form 1040 (U.S. individual income tax return), along with obtaining a written representation from such person that he or she has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year. In the case of a person who qualifies as an accredited investor based on joint income with the person’s spouse, an issuer would be deemed to satisfy the verification requirement in Rule 506(c) by reviewing copies of these forms for the two most recent years in regard to, and obtaining written representations from, both the person and the spouse.⁶
2. **Satisfy the Net Worth Requirement.** In verifying whether a natural person is an accredited investor on the basis of net worth, an issuer is deemed to satisfy the

⁴ Ibid. page 20.

⁵ Ibid. page 20.

⁶ Ibid pp. 36-37.

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verification requirement in Rule 506(C) if it reviews one or more of the following types of documentation, dated within the prior three months, and by obtaining a written representation from such person that all liabilities necessary to make a determination of net worth have been disclosed. In the case of a person who qualifies as an accredited investor based on joint net worth with that person's spouse, an issuer would be deemed to satisfy the verification requirement in Rule 506(c) by reviewing such documentation in regard to, and obtaining representations from, both the person and the spouse. For assets: bank statements, brokerage statements and other statements of securities holdings, certificates of deposit, tax assessments and appraisal reports issued by independent third parties are deemed to be satisfactory; and for liabilities: a consumer report (also known as a credit report) from at least one of the nationwide consumer reporting agencies is required. Finally, given the difficulty in obtaining a complete picture of a natural person's liabilities, the SEC requires an issuer to obtain a written representation from the person that all liabilities necessary to make a determination of net worth have been disclosed.⁷

- 3(a). **Use of Enumerated List of Third Parties.** An issuer is deemed to satisfy the verification requirement in Rule 506 (c) by obtaining a written confirmation from a registered broker-dealer, an SEC-registered investment adviser, a licensed attorney, or a certified public accountant ("**Enumerated Third Parties**") that such person or entity has taken reasonable steps to verify that the purchaser is an accredited investor within the prior three months, and has determined that such person is an accredited investor.⁸
- 3(b). **Use of Third Party Verification Services.** Depending on the circumstances, the SEC has provided that an issuer may also be entitled to rely on the verification of accredited investor status by a person or entity other than Enumerated Third Parties, provided that any such third party takes reasonable steps to verify that purchasers are accredited investors and has determined that such purchasers are accredited investors, and the issuer has a reasonable basis to rely on such verification.⁹
4. **Prior 506(b) Offerings.** With respect to any natural person who invested in an issuer's 506(b) offering as an accredited investor prior to the effective date of Rule(c) and remains an investor of the issuer, for any Rule(c) offering conducted by the same issuer, the issuer is deemed to satisfy the verification requirement in Rule 506(c) with respect to any such person by obtaining a certification by such person at the time of the sale that he or she qualifies as an accredited investor.

Based on the above, the SEC has explicitly provided that verification of a person's status as an accredited investor by a third party other than by Enumerated Third Parties is a valid means of verification, provided that the issuer has a reasonable basis to rely on such third party verification. The SEC recognized that such a third-party service, as opposed to the issuer itself, could obtain appropriate documentation or otherwise take reasonable steps to verify accredited investor status. The SEC also indicated that it will be important for issuers and their verification service providers to

⁷ Ibid. pp. 37-38.

⁸ Ibid. p. 38

⁹ Ibid. pp. 38-39

retain adequate records regarding the steps taken to verify that a purchaser was an accredited investor.

We believe the SEC's elaboration of a non-exclusive list of verification methods for natural persons and its clear statement permitting issuers to rely on third party verifiers to fulfill their verification obligation was a necessary development to help address concerns regarding whether natural persons who participate in Rule 506(c) offerings actually qualify as accredited investors. The SEC recognized the importance of this means of investor verification for the purposes of investor protection as a counter-balance to the capital raising imperatives underlying Rule 506(c) and the potential for unscrupulous actors to sell securities to natural persons who do not qualify as accredited investors.

We believe, however, that the SEC, in its efforts to modernize U.S. securities laws as a means to spur job growth by facilitating capital formation, should have gone further in protecting investors by mandating that investor status verification should only be undertaken by uninterested and unbiased third parties. To that end, it should have made reliance on an independent third party to verify investor status a clear-cut safe harbour and elaborated on the documentation required to be reviewed by such a third party to trigger such a safe harbour. We believe such documentation is already described in the rule; namely, in the passages relating to the documentation to be reviewed by an issuer with respect to either income or net worth. We believe the rule's presumption that an issuer has fulfilled its verification obligation should have been explicitly extended to the verification of such documentation by an independent third party undertaking the verification irrespective of whether they are in the list of Enumerated Third Parties.

We also believe that, unless an issuer, or dealer acting on its behalf, forms a reasonable belief of a natural person's status as an accredited investor based on an objective determination (i.e. based on documentary evidence) pursuant to the principles-based method of verification, it should be obligated to undertake one of the non-exclusive methods of investor status verification and that such verification should only be undertaken by independent third parties with no economic interest in a given securities offering or other form of potential conflict of interest irrespective of whether they are in the list of Enumerated Third Parties. So long as any independent third party verifies the documentation in the list of non-exclusive methods to verify accredited investor status, provides a written confirmation with respect thereto and issues an investor status certification report, then a presumption of discharge of the verification obligation should be triggered and a clear-cut safe harbour should accrue to an issuer with respect to selling securities to a purchaser under Rule 506(c). Even the SEC acknowledged the risks associated with the principles-based "reasonableness" verification method when it stated the following:

"[t]he greater flexibility of the principles-based "reasonableness" verification method could result in less rigorous verification, thus allowing some unscrupulous issuers to more easily sell securities to purchasers who are not accredited investors and perpetuate fraudulent schemes, or it could create or promote legal uncertainty about the availability of Rule 506(c), which may cause some issuers to interpret "reasonable steps to verify" in a manner that is more burdensome than if specific methods were prescribed, thus incurring higher costs. We believe that the non-exclusive list of specific methods of verification we are including in Rule 506(c), as adopted, should help mitigate the impact of these costs"¹⁰

We believe a clear-cut safe harbour in relation to the use of independent third party verification service providers will likely increase the use of Rule 506(c) offerings since it will significantly decrease regulatory risk for issuers and their intermediaries by providing greater certainty with

¹⁰ Ibid. page 98.

respect to compliance with the verification obligation and also by encouraging them to rely on cost-effective independent third parties rather than the more expensive and potentially conflicted persons or entities in the list of Enumerated Third Parties. We believe issuers who cannot conclude, based on the principles-based method of investor verification, that a purchaser is an accredited investor, might pass on an investor's participation given the incremental costs they would have to incur in using a licensed attorney, a registered broker-dealer, an SEC-registered investment adviser or a certified public accountant to undertake the verification.

By allowing independent third parties to undertake investor verification based on clear guidelines on which documents they would be required to review, compliance-related costs associated with 506(c) offerings would decrease by (i) reducing legal advisory fees necessary to assess specific investor status questions; (ii) reducing the costs associated with lawyers or accountants actually undertaking the verification; (iii) reducing the amount of compliance staff required at intermediaries to undertake investor verification; and (iv) creating a universe of highly specialized third party investor verification companies with significant economies of scale to provide such services in a timely and cost-effective manner.

Finally, we also believe that the provision of investor verification services by independent third parties will help address one of the reasons put forth by some as to why there have not yet been a much greater number of Rule 506(c) offerings in the U.S. For example, in a speech given to the Angel Capital Association on March 28, Mr. Keith Higgins, The Director, Division of Corporate Finance at the SEC, referenced the belief by some that the number of Rule 506(c) offerings might not have been as robust as expected due to concerns by "potential purchasers who are interested in making an investment, but wary of turning over financially sensitive information, such as tax returns or brokerage statements, to the issuer for verification." For purchasers who are active in investing in private placements this concern would be multiplied by the number of issuers they contemplate investing in. A rule that would encourage the use of independent third parties for investor status verification would significantly reduce this concern since a natural person can use one investor status verification service for all of their potential 506(c) investments and disclose sensitive financial information to only one party which would issue a report to any issuer regarding the purchaser's accredited investor status. Any remaining privacy concerns would be addressed by privacy policies that could be vetted by regulators.

NATIONAL INSTRUMENT 45-106 AND COMPANION POLICY 45-106

Our comments to the proposed amendments to Companion Policy 45-106 ("**45-106 CP**") are provided with the benefit of the work already undertaken by the SEC in connection with Rule 506(c). More specifically, our comments with respect to the investor status verification provisions of Rule 506(c) are generally applicable to our comments on the investor status verification provisions of 45-106 CP, as elaborated more fully below. That being said, we are fully cognizant that Rule 506(c) is relatively new and that the SEC may provide additional guidance in the future as issuers and their intermediaries increasingly rely on it to raise capital.

One key difference between the prohibition on general solicitation and advertising that was in place prior to the adoption of Rule 506(c) by the SEC and 45-106 CP, in its current and proposed form, is that Section 3.1 of 45-106 CP provides that the capital raising exemptions in NI 45-106, Part 2, Division 1 in National Instrument 45-106 ("**NI 45-106**"), do not prohibit the use of advertising in any form, including internet, e-mail, direct mail, newspaper or magazine, to solicit purchasers under any of the exemptions. The only limitation as regards solicitation contemplated in Section 3.1 of 45-106 CP is that "[a]ny solicitation activities that aim to identify a particular category of investors should clearly state the kind of investor being sought and the criteria that investors will be required to meet. Any print materials used to find accredited investors, for example, should clearly and prominently state that only accredited investors should respond to the solicitation." In other words,

in Canada the proposed investor verification provisions in Section 1.9 of 45-106 CP have nothing to do with a concern about a new means of marketing private placements to the public, but simply an acknowledgement by the CSA that the current regulatory regime likely results in distributions of securities to purchasers who do not qualify under an applicable exemption.

In the Notice, the CSA indicated that the "Proposed Amendments are intended to address concerns that some individual investors...may not in fact qualify as accredited investors." To address this concern, the CSA proposed additional guidance in 45-106 CP on the steps issuers should take to verify investor status, including explaining the different tests and asking questions to obtain factual information from purchasers to confirm their status. For instance, the proposed amendments indicate that for an accredited investor the questions could relate to a purchaser's income or assets. We agree with the proposed approach of requiring a person relying on an exemption to gather information from a purchaser to confirm their status before discussing the investment, but believe that verbally asking questions is not a sufficiently robust means of due diligence to ensure a natural person meets the financial criteria for qualifying as an accredited investor or an eligible investor. The intent of the CSA to require a review of documents supporting an investor status determination prior to an issuer, selling security holder or exempt market dealer discussing the terms of an investment with a purchaser is not clear in the proposed amendments to Section 1.9. If a review of documentation to ascertain investor status is not required at this stage, we recommend that the CSA explicitly state so to avoid confusion with respect to this particular obligation as it might be interpreted otherwise in the market and engender verification costs that are not required at this stage of the investment process. If, on the other hand, the intent of the CSA is to require a person relying on the exemption to form a clear view of an investor's status prior to discussing an investment with a purchaser, then we believe the CSA must mandate that such a determination at this stage triggers an obligation to undertake reasonable steps to verify investor status.

We take cognizance of the fact that the CSA has also adopted a principle-based method of determining whether the types of steps are reasonable, which depends on the particular facts and circumstances of the investor and the offering, including:

- how the person relying on the exemption identified or located the potential investor;
- what type of accredited investor the investor claims to be; and
- how much and what type of background information is known about the investor.

Based on the foregoing principles-based method, we recommend that the CSA explicitly state that if a person relying on an exemption (i) located a potential natural person purchaser through general solicitation and advertising efforts or through a referral from a third party, such as an exempt market dealer, who also lacks proof of the investor status of a purchaser; and (ii) such purchaser claims the individual accredited investor or eligible investor exemption, depending on the nature of the offering, then the person relying on the applicable exemption must undertake additional documentary due diligence to confirm such status. Like the SEC, the CSA should enumerate a list of documents that issuers or other persons relying on an exemption may review to satisfy the investor verification obligation for natural person purchasers.

We have grave concerns regarding the last paragraph of the proposed new Section 1.9 of 45-106 CP in that the CSA only mandates a documentary review in the event that an issuer has reason to believe that a potential purchaser does not earn the income they claim they do.

At the same time, the CSA in a preceding paragraph in the same Section 1.9 mandates that

8.

“a person distributing securities under an exemption should retain all necessary documents that show the person properly relied upon the exemption. The person relying on the exemption should consider what documentation they need to collect from purchasers to evidence the steps the seller followed to establish the purchaser met the conditions of the exemption. The seller should ensure it has that documentation signed by the purchaser before distributing securities to that purchaser.”

We believe the foregoing provides an appropriate framework for investor status verification. However, it requires further elaboration to provide exempt market participants with clearer guidelines. It is clear that securities regulators both in the U.S. and in Canada are mainly concerned with inappropriate distributions of securities to natural person investors who do not qualify as either accredited investors or eligible investors, depending on the exemption being utilized. As such, we highly recommend that the CSA provide additional guidance and details of what types of documents are appropriate to review to ascertain whether an investor meets either the assets or income components of the definitions of individual accredited or eligible investors in a way similar to what the SEC adopted in its non-exclusive list of methods that issuers may use to satisfy the investor verification requirement for natural person purchasers.

Particularly given the fact that general solicitation was never prohibited in Canada, we express concern regarding the additional expense and time that will be required by issuers and exempt market dealers to comply with these verification obligations especially if they are not expressly permitted to use the services of an independent third party to verify the investor status of any particular purchaser. If they are not permitted to use independent third parties to verify investor status, both issuers and exempt market dealers will either turn to expensive external advisors for guidance and assistance or, in the case of exempt market dealers, will be required to hire additional staff to undertake the necessary documentary review. In either case, the costs associated with capital raising in the exempt market will inevitably increase with a concomitant deleterious effect on capital formation activity in the exempt market.

As alluded to in our comments to the Rule 506(c), we have concerns regarding investor status verification undertaken by issuers' intermediaries, whether or not they are registered. We believe investor status verification should be undertaken by uninterested and unbiased independent third parties whose only compensation will be related to verifying an investor's status based on documentation provided directly by the investor and based on guidelines by the CSA. Accredited Access provides such a service by being able to review an investor's income tax returns, bank statements, investment statements, tax assessments, etc. and producing a certification report specifying which exemption(s), if any, an investor can rely on to participate in a private placement. Our service ensures an investor only has to share his or her confidential and private information with one entity. The documentation provided by an investor will be retained for a period of eight years or whatever other period established by regulators. Prior to issuing a certification report, Accredited Access requires investors to visit their page on our website to confirm that all of the documentation uploaded to our website is accurate and complete. Finally, given that our certification reports identify the category or categories of accredited investor met by any individual, it will allow issuers to easily enter such categories in Form 45-106 F1.

The SEC has already explicitly allowed issuers to rely on third parties to verify investor status. We believe the CSA should not only expressly allow issuers and their intermediaries to use an independent third party investor verification service provider, but we also believe the CSA should

9.
go one step further and actually require them to do so in the circumstances described above.¹¹
This would definitively eliminate any potential conflicts of interest and minimize the number of parties to whom an investor would be required to disclose confidential and private information.

We thank you for your time and consideration of our comments, and we look forward to engaging in a dialogue over the proposed changes to 45-106 CP as they relate to investor verification and the services we provide to facilitate such verification.

Yours truly,

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¹¹ i.e. if a person relying on an exemption (i) located a potential natural person purchaser through general solicitation and advertising efforts or through a referral from a third party, such as an exempt market dealer, who also lacks proof of the investor status of a purchaser; and (ii) such purchaser claims the individual accredited investor or eligible investor exemption, depending on the nature of the offering, then the person relying on the applicable exemption must undertake additional documentary due diligence to confirm such status by using an independent third party investor verification service provider.