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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, Northwest Territories
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RE: CSA Notice and Request for Comment on Proposed Amendments to National Instrument 45-106 *Prospectus and Registration Exemptions Relating to the Accredited Investor and Minimum Amount Investment Prospectus Exemptions*

Dear Sirs/Mesdames,

On February 27, 2014, the Canadian Securities Administrators (the CSA) published for comment proposed amendments relating to the Accredited Investor prospectus exemption and the Minimum

Amount investment prospectus exemption in National Instrument 45-106 *Prospectus and Registration Exemptions*.

EXECUTIVE SUMMARY

The changes proposed to National Instrument 45-106 *Prospectus and Registration Exemptions Relating to the Accredited Investor and Minimum Amount Investment Prospectus Exemptions* and its attendant forms and *Companion Policy* reflect the CSA's latest efforts to improve investor protection for Canadians. As such, Advocis supports the underlying purpose of the proposals, but we have concerns with the specifics of several of the amendments as currently drafted.

Under the changes envisioned by the CSA, advisors, issuers and dealers will have to carry an increased compliance burden to help ensure that investors properly appreciate the risks of participating in the exempt market under the accredited investor exemption. While we agree with the CSA's continued focus on ensuring the flow of meaningful information between issuers, advisors, dealers and investors in exempt offerings, we would prefer that the CSA abandon the more stringent paperwork requirements attendant to the new risk acknowledgement form (Form 45-106F9) in favour of a more principles-based regulatory approach. We believe that the most significant impact of the proposed amendments on advisors, dealers and investors will be the increased costs and additional procedural and administrative steps associated with the administrative, recordkeeping, executory and delivery requirements the CSA has established around the new form – almost all of which will fail to generate any appreciable increase in consumer protection.

Part One: General Comments and Criticism on Changes to National Instrument 45-106

Advocis supports the CSA's decision not to alter the income and asset thresholds required to qualify as an accredited investor. Certainly increasing these thresholds would further limit the ability of small- to medium-sized issuers to access to capital.

Part Two: Changes to The Accredited Investor Prospectus Exemption

The CSA has proposed the following eight major changes to the accredited investor Exemption:

1. Creation of Form 45-106F9 *Risk Acknowledgement Form for Individual Accredited Investors*: Form 45-106F9 describes the categories of individual accredited investor and the protections an investor is renouncing by purchasing under the accredited investor exemption. Among other requirements, individuals who qualify for the accredited investor exemption would have to complete and sign the new Form 45-106F9 and indicate which category of accredited investor they satisfy. In a departure from existing securities legislation, the issuer would have to maintain records of *all* Form 45-106F9s relied on for a period of eight years following the distribution.

Advocis believes that these very stringent procedural and delivery requirements which the CSA has attached to Form 45-106F9 will lead to very high administrative, compliance and transaction costs for advisors, dealers, issuers and salespersons. The inevitable outcome will be that small- to mid-sized

issuers, as well as individual accredited investors who do not qualify for the "permitted client" exemption from Form 45-106F9, will no longer participate in many exempt market distributions. This outcome must surely be inconsistent with the CSA's admirable decision to not raise the qualifying income and asset thresholds of the accredited investor exemption.

Overall, though, Advocis strongly supports the introduction of a risk acknowledgement form, and indeed called for the creation of one in connection with the CSA's 2012 review of the accredited investor and minimum amount prospectus exemptions. Accordingly, we are pleased to offer a number of textual amendments to Form 45-106F9 to better enhance investor understanding of the nature and risk of exempt market products and investing.

We believe that Form 45-106F9 should emphasize the varying levels of investment risk associated with the differing classes of exempt market products, and the desirability of consulting with a registered financial advisor. This advisor should be a member of a professional association which requires that advisors act in the best interests of their clients, meet ongoing continuing education obligations, and carry suitable amounts of professional liability insurance.

2. Application of the *Risk Acknowledgement Form* requirement to all individual accredited investors: The requirement to sign Form 45-106F9 would apply to all existing categories of individual accredited investor. Advocis supports this amendment, insofar as it calls for investors to read, understand and sign Form 45-106F9, but believes that there should be an exception made for discretionary managed accounts, as in those cases a risk acknowledgement form is both conceptually and practically irrelevant.

3. A "permitted client" exemption from the *Risk Acknowledgement Form*: The CSA proposes that individual accredited investors who meet the permitted client test (an individual owning financial assets in excess of $5 million) under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* would not be required to execute Form 45-106F9. Advocis supports this amendment, as it lessens the compliance burden on stakeholders.

The CSA has proposed the following amendments to the accredited investor exemption which will create additional requirements to exhaustively document securities offerings made to accredited investors:

4. All salespersons and finders must execute the *Risk Acknowledgement Form* and deliver originally signed copies of it to all purchasers: Any salesperson or finder, whether registered or not, who is involved in the trade to the individual investor will be required to execute Form 45-106F9. This requirement will have a detrimental effect on the ability of small- to medium-sized issuers to raise capital in today's markets, as it will significantly disrupt existing sales practices, retard the use of electronic documents, and delay the ability to complete transactions in a timely manner. Advocis therefore opposes this amendment.

5. Issuers and dealers must verify the individual's accredited investor status: The *Companion Policy* of National Instrument 45-106 sets out additional guidance on the steps issuers, advisors and dealers should take to verify an individual's accredited investor status. These proposed additional procedures go far beyond the guidance set out in the existing *Companion Policy* and will unnecessarily complicate the capital-raising process. Moreover, the proposed process requirements cannot be reconciled with current industry practices in the exempt market and, again, will no doubt prove so onerous as to deter capital-raising efforts. We believe that, in the final analysis, verification of an individual's accredited investor status must begin and end with the individual. Shifting responsibility for verification onto the shoulders of advisors and dealers and forcing them to undertake what amounts to an intrusive documentary discovery of their clients in fact undercuts the very notion of individual risk assessment and risk acknowledgement which underpins the use of any risk acknowledgement document. At minimum, Advocis believes that issuers, advisors, dealers and other parties should be able to rely on representations made by corporate and institutional investors, permitted clients, portfolio managers and registered advisers when they state that they fulfill the criteria of the accredited investor exemption. Advocis outlines in more detail an alternative verification regime further below.

6. Identification of all categories of accredited investor applicable to the purchaser: Issuers would be required to identify the category of accredited investor of each purchaser in the *Report of Exempt Distribution* (Form 45-106F1 and, in British Columbia, Form 45-106F6). Advocis believes this amendment will place too great a compliance burden on registrants. In the absence of the CSA making publicly available a compelling cost-benefit analysis, this amendment should be abandoned.

7. Family trusts and accredited investors: The CSA wishes to amend the definition of accredited investor to include family trusts established by an accredited investor for his or her family, provided the majority of trustees of the family trust are accredited investors. Advocis supports this amendment as it will lead to greater efficiencies in tax and estate planning.

8. Managed accounts and accredited investors: In all Canadian jurisdictions except Ontario, fully managed accounts are permitted to purchase investment fund securities using the managed account category of the accredited investor exemption. Advocis supports this amendment as we believe that in Ontario, managed account clients should have the benefit of the accredited investor exemption whether investing in securities directly or indirectly through an investment fund.

Part Three: The Minimum Amount Investment Prospectus Exemption

The CSA proposes to amend the minimum amount exemption so that it is only available for distributions to non-individuals. Advocis supports this amendment with qualifications: we believe certain lower-risk products should still be available to individual investors through the minimum amount exemption, such as certain types of investment funds and principal-protected notes.

Part Four: Reports of Exemption Distributions

The CSA wishes to amend the *Reports of Exemption Distributions* (Form 45-106F1 and, in British

Columbia, Form 45-106F6) to require additional disclosure, including of the category of accredited investor relied on by each purchaser; population of an updated and expanded list of industry categories; and new information on any person being compensated in connection with the distribution, including identification of which purchasers for whom the person was compensated. These amendments are intended to assist the CSA in its compliance and data gathering functions.

Advocis opposes this last set of amendments. The net effect is that issuers are being asked to pay the price of the CSA's data collection project. Significant privacy concerns will be raised by the mandatory production of the additional information being requested. These concerns, coupled with the increase in transaction costs, will discourage the participation of investors, issuers, advisors, dealers, salespersons, and finders in exempt distributions. The end result can only be a reduction in issuers' access to capital and investors' access to opportunities.

Part One of this submission provides contextual information about Advocis, The Financial Advisors Association of Canada, and the larger background to and impact of the CSA's proposed amendments to the Accredited Investor and Minimum Amount Investor exemptions. Parts Two, Three and Four will provide comment on the specific elements of the proposed amendments identified by the CSA in its February 27, 2014 *Request for Comment*.

PART ONE: GENERAL COMMENTS AND CRITICISM

1. Advocis: Who we are

Advocis is the largest and oldest professional membership association of financial advisors and planners in Canada. Through its predecessor associations, Advocis proudly continues over a century of uninterrupted history serving Canadian financial advisors and their clients. Our 11,000 members, organized in 40 chapters across the country, are licensed to sell life and health insurance, mutual funds and other securities, and are primarily owners and operators of their own small businesses who create thousands of jobs across Canada. Advocis members provide comprehensive financial planning and investment advice, retirement and estate planning, risk management, employee benefit plans, disability coverage, and long-term care and critical illness insurance to millions of Canadian households and businesses.

As a voluntary organization, Advocis is committed to professionalism among financial advisors. Advocis members adhere to our published *Code of Professional Conduct*, uphold standards of best practice, participate in ongoing continuing education programs, maintain professional liability insurance, and put their clients' interests first. Across Canada, our members spend countless hours working one-on-one with individual Canadians on financial matters. Advocis advisors are committed to educating clients about financial issues that are directly relevant to them, their families and their future. Our following comments on the CSA's proposal reflect the priorities of Advocis' members and their clients.

2. Background and Overview of the Proposed Amendments

The proposed amendments arise from the CSA's review of the accredited investor and minimum amount exemptions that involved stakeholder consultation across Canada, an examination of enforcement cases, and an analysis of data provided by exempt distribution reports filed over a period of one year. The amendments are intended to address investor protection concerns; the major ones are set out below.

CSA's investor protection concern	CSA's proposal to amend National Instrument 45-106
• Individual investors do not understand the risks of investing under the accredited investor exemption.	• A new risk acknowledgement form for individual accredited investors that describes, in plain language, the categories of individual accredited investor, and the protections an investor will not receive by purchasing under the accredited investor exemption.
• Issuers and investors are hampered by a lack of harmony in the accredited investor exemption across provincial and territorial jurisdictions.	• An amended definition of accredited investor in Ontario to allow fully managed accounts to purchase investment fund securities using the managed account category of the accredited investor exemption, as is permitted in other Canadian jurisdictions. The Ontario Securities Commission's proposal to make this change would harmonize this category of the accredited investor exemption in Canada.
• Individual investors are allocating more than they can afford to risk in order to meet the requirements of the minimum amount exemption.	• Restriction of the minimum amount exemption to distributions to non-individual investors.

3. General contextual criticism of the Proposed Amendments and National Instrument 45-106

Given the other changes underway in the exempt market, such as a possible crowdfunding portal and an Offering Memorandum exemption in Ontario, Advocis supports the CSA's decision to not alter the income and asset thresholds required to qualify as an accredited investor. Certainly increasing these thresholds would further limit the ability of small- to medium-sized issuers to

access to capital. We believe the CSA has struck an appropriate balance between the issuer's access to capital and the investor's need for protection.

This submission now turns to the specific elements of the proposed amendments identified by the CSA in its February 27, 2014 *Request for Comment*. For your ease of review, the amendments are set out in the same sequence in which they were listed in the *Request for Comment.*

PART TWO: PROPOSED AMENDMENTS TO THE ACCREDITED INVESTOR EXEMPTION

The CSA, following on its review of the accredited investor Exemption, has concluded that issuers and dealers are failing to communicate the risks associated with investing in the exempt market, and that many investors do not properly qualify under the accredited investor thresholds. By way of response, response, the CSA proposes eight major changes to the accredited investor exemption. The following review canvasses these eight changes to the accredited investor exemption; they are set out in the order in which the CSA has raised them in its *Request for Comment*.

1. Creation of Form 45-106F9 *Risk Acknowledgement Form for Individual Accredited Investors*

Under the proposed amendments Individual accredited investors will have to complete and sign a new risk acknowledgement form, Form 45-106F9 *Risk Acknowledgement Form for Individual Accredited Investors*. For the accredited investor exemption to apply to a distribution, the issuer must obtain from the individual purchaser a signed risk acknowledgement form before or at the same time that the purchaser signs the purchase agreement. Form 45-106F9 uses plain language to set out the categories of individual accredited investors and the protections such an investor renounces by purchasing under the accredited investor exemption. The investor is required to indicate on the form which category of accredited investor they satisfy.

Advocis notes that the RAF, on its own, does not augment the individual investor's ability to determine if the investment is appropriate for them. Indeed, similar language on risk may be found in the subscription agreement which the investor must sign and complete when purchasing an exempt market product. For the less sophisticated investor Form 45-106F9is presumably meant to protect, the form may therefore be seen as simply contractual form duplicating information which may be found elsewhere – a bureaucratic "paperwork" formality to be quickly reviewed, signed and appended to the investment's subscription agreement.

The problem, then, is how to get the less sophisticated investor to truly understand the importance of Form 45-106F9's purpose and contents. Advocis believes that Form 45-106F9 should emphasize the high risks of investment losses historically associated with certain types of exempt market products and emphasize the desirability of consulting with a registered financial advisor. This advisor

should be a member of a professional association which requires that advisors act in the best interests of their clients, meet ongoing continuing education obligations, and carry suitable amounts of professional liability insurance.

(a). The general impact of the proposed Form 45-106F9: Advocis believes that the very stringent procedural and delivery requirements the CSA has attached to Form 45-106F9 will lead to very high administrative, compliance and transaction costs for advisors, dealers, issuers and salespersons. There will be a chilling effect on the ability of individual accredited investors to participate in exempt distributions.

It is unlikely that junior issuers will want or be able to comply with the compliance requirements set out for Form 45-106F9. Certainly most selling individual securityholders will be unable to comply with them. The result of the proposed amendments will be that small- to mid-sized issuers, and individual accredited investors who do not qualify under the "permitted client" exemption from Form 45-106F9, will be excluded from many exempt market distributions.

(b). Form and layout issues: The proposed amendments governing the presentation, interpretation, completion, execution and delivery of Form 45-106F9 are in parts quite rigorous. For example, the formal requirements for Form 45-106F9 are particularly strict:

- it must be printed on one double-sided page;
- each of the investor, the issuer and salesperson (if any) must sign two copies of the form;
- each of the investor and issuer must receive a copy of the signed form;
- the salesperson (if any) must ensure that the purchaser and the issuer receive originally signed copies; and
- the issuer is required to retain a copy of the form for at least eight years after the distribution.

(c). Execution and delivery issues: It is not clear to us in the draft amendments to the National Policy and *Companion Policy* if Form 45-106F9 may be signed in counterparts. Nor is there explicit direction permitting or restricting the delivery of electronic or PDF copies of the form.
To begin, the CSA states that Form 45-106F9 must be presented to purchasers in a physical form in duplicate on one double-sided page. Moreover, another requirement holds that two copies of the form must be physically signed and that these "originally signed copies" must be delivered to the purchasers. This places an unnecessary administrative burden on issuers and is a step backwards from how exempt distributions transactions are often executed: indeed, we understand that the majority of documentary execution and delivery in the exempt market is now done digitally.

(d). The records retention requirement: Retaining paper copies of Form 45-106F9 for eight years is unnecessary. The requirement to retain Form 45-106F9 for eight years is excessively cautious. Several provincial law societies require that records for a securities financing be retained for six

years. The eight-year requirement is also at odds with the shorter retention requirements in other pieces of securities legislation: National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* mandates that a record be retained for seven years from the date the record was created (section 11). Certainly the harmonization of retention periods across National Instruments, with self-regulatory organizations such as IIROC, and with other applicable legislative acts should be a key priority of the CVSA; the current patchwork approach to retention periods only increase the increase the risk of inadvertent non-compliance.

Upon a careful reading of the proposed amendments, it is not clear to us whether Form 45-106F9 is absolutely required to be retained in its physical form, but we must assume so out of an abundance of caution. Overall, then, the CSA's requirements that Form 45-106F9 be a physical document (and not a digital one), be physically signed in duplicate by the purchaser, the salesperson and the issuer, and then be stored for eight years after the date of distribution, is simply too onerous and complicated. Plus these requirements yield no discernible increase in investor protection.

The administrative burden of maintaining multiple copies of Form 45-106F9 for eight years for a single purchase means large issuers will literally have to maintain rooms full of paper. Certainly consumers will ultimately pay for the issuer's use of off-site storage. As well, mandatory paper-based recordkeeping is wholly incompatible with the current business practices of issuers and dealers and with the direction from the Ontario Securities Commission that registrants move from paper-based to electronic filings.

Advocis believes that the CSA must abandon this retrogressive commitment to paper-based recordkeeping. Surely the investor protection the CSA seeks to achieve can be realized through a less onerous combination of paper and digital storage. Accordingly, Advocis suggests that the administrative storage cost for issuers would be greatly lessened if the requirement for paper documents was limited to two years, after which digital record storage would be mandatory.

(e). Suggested amendments to Form 45-106F9:

(i). The acknowledgement of risk clause: Many securities offered to investors through the accredited investor exemption are no riskier than those offered pursuant to a prospectus. The statement that "I acknowledge that this is a risky investment" should be amended to "I acknowledge that this may be a risky investment." This statement could then be supplemented by product-specific check boxes for securities. This approach will be explained in more detail below.

We also note that some of Form 45-106F9's warning language is largely included in the subscription agreement. While Advocis is in favour of full, true and plain disclosure, we do not believe that much reliance should be placed on the protection offered to the investor by mere disclosure. Regardless of how thorough the disclosure is and how much emphasis is placed on

risk factors, and regardless of how clear and understandable the disclosure may be, the fact is that all too often disclosed information is not read or understood. To better protect investors in the exempt market through a simple paper form, regulators must look to the subgroups of investors how are at the greatest risk – that is, investors who elect to disregard disclosed information altogether.

Prior to the purchase of a product pursuant the accredited investor exemption, the individual investor must sign a risk acknowledgement form which clearly advises that the investor should consult with a registered financial advisor in order to review the investment's details before executing the risk acknowledgement form and related purchase documents. This registrant advisor should be a member of a professional association which requires he or she act in the best interest of the client, meet ongoing continuing education requirements, and carry suitable professional liability insurance. This use of a risk factor document required to be signed by the investor after having been advised to consult with a professional financial advisor will provide regulators with further assurance that the investor has read and understood the risks. This document would provide the dealer with a degree of protection in regard to allegations of misconduct.

Finally, we note that as Form 45-106 is currently drafted, the proposed warning to the investors includes only two of the acceptable sets of criteria for qualification as an accredited investor. The form could be misread the unwary into thinking that the other accredited investor qualifications are no longer available. The form should clearly indicate that it only applies to individuals relying on the accredited investor exemption's net worth and income categories.

(ii). Consequences to the investor of renouncing of prospectus protections: Advocis submits that it will enhance the investor's understanding of the risks involved if Form 45-106F9 itemized the major protections foregone by selecting an investment which does not come with a prospectus. A general list of protections foregone by, for example, a prospectus-protected mutual fund security would be helpful to investors considering an exempt market investment fund, such as (as the case may be) statutory rights of rescission, minimum working capital and reporting requirements, a registered fund manager, regular compliance reviews, and so on.

(iii). Investor liquidity: Considering the size of an investment as a percentage of one's net assets always helps one better grasp the scope of the potential risk exposure involved. Accordingly, Advocis believes that the risk acknowledgement form should also indicate that as a general principle an investor's total exempt market holdings should not amount to more than 10 per cent of the investor's net assets (excluding the primary residence), due to liquidity concerns. This would assist investors in determining the security's suitability and, by extension, their overall financial position and the products position in it. Moreover, the complexity of determining the relation to and impact on net assets for a novice or unsophisticated investor

points out the desirability of consulting a registrant such as a professional financial advisor for tailored advice.

(iv). Leveraging: The consumer protection value of Form 45-106F9 would be enhanced by having the investor declare if the issuer, registrant advisor or dealer or other salesperson facilitating trade advised the investor borrow money for purposes of making the investment.

(v). The nature of the security issued and Form 45-106F9's applicability to it: It is an interesting exercise to consider how many accredited investors can answer questions such as: Is the security is novel or complex structured product. Is in a pooled fund or a principal-protected note? In general, exempt market products target higher-than-normal returns while offering limited liquidity options. Some are backed by tangible assets. However, the sole common characteristic of exempt market products is their exemption from the prospectus requirement. In practical terms, this means that exempt products is a category with tremendous diversity in product design. Even the basic taxonomy of the main exempt market products — principal-protected notes, limited partnerships, hedge funds, real estate investment trusts, flow-through shares of a principal-business corporation, and private placements to corporations — fails to capture the tremendous range of product variegation of — and risk associated with — exempt market products. Such categorical breadth, however, does indicate the unfeasibility of providing a single set of rules based on product type for regulating investor access to the exempt market. Presently, the same set of rules governs investor access to a complex private business project with an Offering Memorandum, as well as the purchase of a relatively simple principal protected note. Clearly, ascribing the same level of risk to both types of investments is a disservice to issuers and investors alike.

Advocis does not propose that the policy focus of the accredited investor exemption should be shifted from investors' capacities and capabilities to the products themselves. However, attempting a basic categorization of the product on Form 45-106F9 will help investors who are determined not to rely on professional advice with additional information a direction for future research.

(vi). The nature of the issuer and/or dealer: Regulators do not differentiate between an exempt market investment which is "structured" (that is, managed) by a securities registrant, and an investment which is brought to market by a "promoter," most of whom are not registered, as is the case with a private real estate investment trust. Accordingly, Advocis proposes Form 45-106F9 make a distinction between a registrant, for example registered portfolio managers or exempt market dealer, whose status as a registrant should allow him or her to offer individual investors products under a revised set of rule, and a non-registrant.

If the products are sold by registrants, the investor is afforded a significant layer of protection. Form 45-106F9 could, in a brief series of check boxes, segment the exempt market between products which come from a registrant and with high degree of information, and those that do not. This would be a low-cost yet effective form of regulation.

Flagging products that are managed by a registered portfolio manager, or distributed through a financial advisor who is registered with an exempt market dealer, come with an offering memorandum with full disclosure of risks and statutory rights of rescission, and provide audited financial statements through a series of check boxes will provide the investor with a much better level of understanding than the current draft of Form 45-106F9.

Other areas the risk acknowledgment form could identify for the investor are:

- **Is the issuer of the security is a reporting issuer?:** In general, the requirement of a reporting issuer would provide an additional layer of protection to investors motivated enough and capable of reviewing a reporting issuer's materials, and would help fulfill the CSA's mandate of fostering confidence in the capital markets.

- **Is the issuer or dealer a registrant who has an obligation to recommend only suitable investments to the purchaser?** Advocis submits that if the distribution involves a registrant who is under an obligation to recommend only suitable investments to the individual investor, the level of investor risk is weakened. Investors should be made aware of this.

- **Does the issuer or dealer have a recognized exempt markets designation? Upon review of** recent OSC rulings and orders, Advocis has concluded that the exempt market actor best able to evaluate the suitability of an exempt market product for individual investors is in many cases an exempt market registrant, including a financial advisor who has taken a recognized exempt markets course. While exempt market dealers and chief compliance officers are required to complete the Canadian Securities Course Exam and the Exempt Market Products Exam, Advocis submits — given the growing complexity of exempt market products — that all exempt market registrants be required to complete an exempt markets course, to ensure a basic standard of proficiency is met by key parties to an exempt market transaction. This requirement would enhance the value of advice available to prospective individual exempt market investors.

(vii). The presence or absence of disclosure: The draft version of Form 45-106F9 states that "In certain circumstances I may not be provided with ongoing information from the issuer I invest in." This statement is not accurate with regard to certain exempt market securities. For example, certain investment funds also come with continuous disclosure to the investor. An amended Form 45-106F9 should have a series of potential check boxes to better reflect the

disclosure the security being issued may offer. The above statement would be supplemented by a statement that "I understand that this investment fund, pursuant its constating documents and/or National Instrument 81-106, is required to provide me with financial reports on a regular basis.

(viii). Redeemability of the security: Again, the draft version of Form 45-106F9 states that "I understand that I may never be able to sell these securities." This statement is not accurate with regard to principal-protected notes or investment funds which are redeemable upon demand. An amended form should have a series of potential check boxes to better reflect the type of security being issued. Thus the current statement of resale would be supplemented by one for investment funds: "I understand that I may never be able to sell these securities other than through the redemption rights offered by this investment fund."

(ix). Form 45-106F9's relation to the subscription agreement: We would also note that most of the information included in Form 45-106F9 is information typically found in the investor/issuer subscription agreement. The requirements of Form 45-106F9 will be seen as questioning the validity of representations made by a registrant in the subscription agreement.

(x). Fees disclosure: It should be noted that not all sales fees can be directly connected to any one individual transaction. Sales fees are often divided between the salesperson and the finder. The practice of paying a portion of a sales fee for a "general introduction" can further skew the accounting required to comply with this part of Form 45-106F9. Complicating the identification of any given transaction's applicable fees is the fact that an investor may purchase the securities through two or accounts.

(xi). Create an exemption for discretionary managed accounts: Registered advisers of discretionary managed accounts have a fiduciary duty to their investors. Indeed, a registered adviser of a discretionary managed account is the accredited investor for the purposes of National Instrument 45-106. In such cases, Form 45-106F9 – or any other risk acknowledgement form – is unnecessary. In general, investors receiving investment management services from a portfolio manager do not require Form 45-106F9.

Advocis' recommendation: The CSA's proposal to introduce the use of Form 45-*106F9 Risk Acknowledgement Form for Individual Accredited Investors* should be approved. Advocis supports the creation and implementation of the risk acknowledgement form, but has some suggested textual changes to enhance investor understanding of the nature and risk of exempt market products. However, we would prefer that the CSA abandon the more stringent paperwork requirements attendant to the new Form 45-106F9 in favour of a more principles-based regulatory approach. We believe that the most significant impact of the proposed amendments on advisors,

dealers and investors will be the increased costs and additional steps associated with the administrative, recordkeeping, executory and delivery requirements the CSA has established around the new form – almost all of which will fail to generate any appreciable increase in consumer protection. We believe that Form 45-106F9 should emphasize the varying levels of investment risk associated with the differing classes of exempt market products, and the desirability of consulting with a registered financial advisor. This advisor should be a member of a professional association which requires that advisors act in the best interests of their clients, meet ongoing continuing education obligations, and carry suitable amounts of professional liability insurance. Please see several proposed textual amendments to Form 45-106F9 we have set out above which we believe will enhance investor protection.

2. Form 45-106F9 would apply to all existing categories of individual accredited investor

The CSA proposes that the requirement to execute Form 45-106F9 would apply to all existing categories of the individual accredited investor – that is, all individuals who:

- earned net income of $200,000, or $300,000 with a spouse, in each of the two most recent calendar years, with a reasonable expectation to exceed that level in the current calendar year,
- own financial assets (cash and securities – no real estate), alone or with a spouse, in excess of $1 million, or
- own net assets of at least $5 million (this last is a new exemption).

In general, Advocis agrees with the CSA's proposal, subject to the possible exemption below.

Proposed exception for discretionary managed accounts: Advocis believes that the CSA should consider an exemption to the Form 45-106F9 requirement in the context of a discretionary managed account for the following reasons:

1. the investor whose investment accounts are being managed on a discretionary basis by, for example, a portfolio manager, does not want or need a risk acknowledgement form;
2. pursuant to National Instrument 45-106 the registered adviser of a discretionary managed account is the accredited investor of the account and so Form 45-106F9 is not necessary;
3. the registered adviser of a discretionary managed account has a fiduciary duty to the investor; requiring Form 45-106F9 in these instances actually serves to undermine the fiduciary nature of the advisor-client relationship; and
4. requiring the execution of Form 45-106F9 in the context of a discretionary managed account only adds to the compliance burden for the registrant and the investor without increasing the level of investor protection.

Advocis' recommendation: The CSA's proposal that Form 45-106F9 apply to all existing categories of individual accredited investor should be approved. Advocis supports this amendment, insofar as it calls for all accredited investors (except permitted clients) to read, understand and sign Form 45-106F9. Advocis also proposes an exception be made for discretionary managed accounts.

3. Exemption from Form 45-106F9 *Risk Acknowledgement Form* for "permitted clients"

Section 13.3(4) of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (National Instrument 31-103) gives a "permitted client" — an individual who owns financial assets in excess of $5 million — the ability to waive suitability requirements. To help reduce the administrative burden of the draft amendments, the CSA proposes that individual accredited investors who meet qualify as accredited investors on the basis of owning financial assets in excess of $5 million and therefore also meet the "permitted client" test under National Instrument 31-103 will not be required to complete and sign the RAF.

Advocis welcomes this proposed amendment, as it both lessens the compliance burden of the issuer and dealer and harmonizes National Instrument 45-106 with National Instrument 31-103. We would ask for clarity from the CSA that the representation by the client that he or she is a permitted client under the National Instrument 31-103 test is sufficient verification of the individual's permitted client status and by incorporation his or her Accredited Investor status. Otherwise, Advocis is unsure of how an advisor or dealer is expected to validate the investors permitted client status.

Advocis' recommendation: The CSA's proposal to exempt "permitted clients" from Form 45-106F9 *Risk Acknowledgement Form* should be approved. Advocis welcomes this proposed amendment, as it both lessens the compliance burden of the issuer and dealer and harmonizes National Instrument 45-106 with National Instrument 31-103. Advocis asks the CSA for clarity in terms of how an advisor or dealer is expected to validate the investor's permitted client status.

4. All salespersons and finders will be required to complete and sign Form 45-106F9

Advocis finds problematic the CSA proposal that all applicable sales personnel will have to complete the new risk acknowledgement form. The new requirement states that "any salesperson or finder, whether registered or not, involved in the trade to the individual investor would be required to complete and sign Form 45-106F9." Moreover, the salesperson or finder will be required to ensure that the purchaser and the issuer receive originally signed copies. As discussed below, Advocis believes that this proposed amendment will be difficult to implement and unfortunately not conducive to even a marginal improvement in consumer protection. It will, however, add to the

transaction costs of the investor, registrants, including dealers and portfolio managers, and non-registrants.

National Instrument 45-106's other risk acknowledgement forms do not require signatures of salespersons: In contrast to the proposed amendment, the other risk acknowledgement forms used pursuant to National Instrument 45-106 – such as Form 45-106F4 *Risk Acknowledgement Form,* used for offering memoranda, or Form 45-106F5 *Risk Acknowledgement - Saskatchewan Close Personal Friends and Close Business Associates* – do not require the signature of any party involved in the sales process. Typically, the investors using these forms are less sophisticated than Accredited Investors, which suggests the amendment requiring salespersons' signatures is not proposed as a means of enhancing consumer protection.

Distribution of "originally signed copies": Requiring that original signed paper copies be distributed is a retrogressive and impractical departure from generally accepted business practices in an era of digitized capital and information flows.

For multi-jurisdictional transactions, mandating that the salesperson must ensure the purchaser and issuer receive originally signed copies is at best a nuisance and at worst a potential derailing the transaction. Even for intra-provincial transactions this requirement will create bottlenecks for active issuers and dealers. Most jurisdictions have laws and regulations governing the use of electronic signatures in securities documents. Requiring the issuer, the purchaser, the salespersons and any finders involved in the transaction to physically sign and either deliver or take receipt of original documentation in, for example, a syndicated transaction, will be exceedingly complex and time-consuming.

In sum, the distribution of "originally signed copies" will result in significant delays in the raising of capital, deter smaller issuers from relying on the accredited investor exemption, and increase transaction costs for issuers who do rely on the exemption – and without a significant impact on levels of investor protection. There is no reason to make the accredited investor exemption subject to the delivery and receipt of multiple originally signed copies when in the capital markets at large transactions may be executed in counterparts via facsimile transmission or e-mailed pdfs files through multiple, identical copies.

Impact on the sales process: the proposal will result in significant additional burden to on the issuer and any intermediaries. Depending on the nature of the deal, it can double or treble the number of required signatures required and copies to be distributed.

Privacy concerns in multi-jurisdictional transactions: mandating that the salespersons and finders involved in a multi-jurisdictional transaction must sign Form 45-106F9 and ensure that the purchaser

and issuer receive the original signed copies of the form could trigger issues related to the sharing of personal information under various pieces of privacy legislation involved.

Collapsing of the registrant/non-registrant distinction: The proposed amendment regarding signature and delivery of Form 45-106F9 imposes identical obligations on both registrants and non-registrants. Historically, regulators in the exempt market have allowed the concurrent existence of both registrant and non-registrant classes of individuals and entities to distribute securities. Now, however, for the purposes of the accredited investor exemption, the CSA is proposing a single, cumbersome set of regulatory requirements for what amounts to a highly heterogeneous group of assorted registrants and non-registrants. This strikes us as problematic and an unnecessary expansion of the regulator's ambit beyond the existing client and product suitability requirements and established compliance practices for new clients.

Advocis' recommendation: The CSA's proposal that all salespersons and finders should be required to complete and sign Form 45-106F9 is too onerous and should be dropped. The new requirement states that any salesperson or finder, whether registered or not, involved in the trade to the individual investor would be required to complete and sign Form 45-106F9 and ensure that the purchaser and the issuer receive originally signed copies. Advocis believes that this proposed amendment will be costly, difficult to implement and unfortunately not conducive to even a marginal improvement in consumer protection.

5. New guidance and required procedures for verifying a purchaser's accredited investor status

The CSA proposes additional guidance in the *Companion Policy* 45-106CP – *Prospectus and Registration Exemptions* on the steps advisors, dealers, issuers and other persons should take to verify accredited investor status, including explaining the different tests and asking questions to obtain factual information from purchasers about their income or assets before discussing the investment.

The proposed *Companion Policy* now states that the responsibility for determining when and if the accredited investor exemption is available lies with the persons distributing or trading the securities. Significantly, the CSA proposes that simple reliance on standard representations in the subscription agreement will not suffice for such verification, unless such person has taken "reasonable steps" to verify the representations.

These steps go beyond current standard market practices of issuers raising funds in the exempt market and include:

- establishing policies so that issuers and their employees, agents or finders understand the accredited investor exemption, and
- asking questions and gathering information from the purchaser to to verify accredited investor status, including explaining the different tests and asking questions to obtain factual information from purchasers about their income or assets before discussing the investment.

The CSA notes that the kinds of measures that will be considered to be reasonable are contextual in nature: they will depend on the particular facts and circumstances and the exemption being relied upon, and may involve asking the purchaser additional questions about their past net income and expectations of future incomes.

It will be the responsibility of the person relying on the exemption to determine what sort of documentation should be collected and retained to provide sufficient evidence that the appropriate procedures were followed for verification that the purchaser met the conditions of the exemption. According to the CSA, the kinds of documentation to be requesting from the investor can include copies of documents such collected can include copies of documents such as income tax returns, bank statements, investment statements, tax assessments or appraisal reports issued by independent third parties.

How much verification of the same information is needed? The proposed changes to Section 1.9 of the *Companion Policy* state that issuers should "verify the purchaser meets the conditions of the exemption" and should "gather information from the purchaser to confirm their status, before discussing the details of the investment". This is simply too repetitive and onerous an obligation: first, this information often appears in a certified subscription agreement; second, this information will be included in 45-106F9, which is to be, executed either before or when the investor signs the purchase agreement.

Impact on the subscription agreement: By stating that it is not sufficient to accept standard representations in a subscription agreement or an initial beside a category on Form 45-106F9 "unless the person relying on the exemption has taken reasonable steps to verify the representation," the CSA is in effected questioning the validity of the representations made in the subscription agreement.

Impact on the distribution process: Advocis believes that the issuer and dealer should not be required to verify an investor's accredited status. Form 45-106F9 is mean to help ensure that the investor is sufficiently about potential exempt market risks. Numerous advice and information channels are available for the investor to consult. Making these registrants verify the *bona fides* of the investor will dramatically hinder the sales process, possibly violate the investor's privacy, and

create a new form of litigation risk as investors seek to bring claims based on allegations of negligence in verification.

Impact on the issuer: Section 1.9 conflates the roles of the issuer and the dealer. If an issuer has no direct contact with the purchaser of its securities, it will be difficult if not impossible for the issuer to fulfill any of the guidance set out in section 1.9. When an investor purchases securities directly from the issuer, and the transaction is conducted without the use of a registered dealer, and the issuer relies on the accredited investor exemption, is the issuer then responsible for conducting the appropriate due diligence that the *Companion Policy* requires?

The verification requirements for Form 45-106F9, and the related amendments in the *Companion Policy*, mean that non-brokered transactions will become more costly, as issuers will not be able to meet their obligations through reliance on the due diligence and compliance of dealers, agents and underwriters. In addition, issuers will face a series of new changes:

- directors and officers of issuers will need to evaluate their increased exposure to potential liability for misrepresentations in Form 45-106F9;
- issuers will have to revise the texts of their existing templates of subscription agreements to reflect the new guidance in the *Companion Policy*; and
- issuers will have to undertake enhanced due diligence to confirm whether their investors meet the test for the accredited investor exemption and demonstrate a sufficient understanding of the risks of investing in the exempt market under the accredited investor exemption.

Ambiguities inherent in Form 45-106F9 and in the *Companion Policy* to National Instrument 45-106: Form 45-106F9 itself states that it is required "to be completed by the person involved in the sale of the securities. The form further provides that "Any person involved in meeting with the purchaser or providing information to the purchaser must complete this section by answering 'yes' or 'no' and filling in their contact information before delivering this form to the purchaser."

A high degree of vagueness attends to the CSA's direction regarding a "person involved" in the "sale" or "meeting." "Involved" is an exceptionally broad category that on its face includes individuals are not direct participants in the sale of the securities. Since there will be numerous persons involved besides the registrants and salespersons, such as legal counsel, compliance staff, and referring parties, the potential outcome is that multiple original Forms 45-106F9 will have to be completed for a single investor in order to cover off the various persons involved in the sale. Clearly only one registrant or issuer or their authorized representative should be required to complete Form 45-106F9; conversely, only one Form 45-106F9 should be required for each purchaser, even if the purchase goes through multiple accounts.

Section 1.9 of the *Companion Policy* states that "it will not be sufficient to accept standard representations in a subscription agreement or an initial beside a category on the Form 45-106F9 Risk Acknowledgement Form for Individual Accredited Investors unless the person relying on the exemption has taken reasonable steps to verify the representation." It further provides that "A person distributing or trading securities is responsible for determining when an exemption is available." There is a degree of ambiguity here: are both the issuers and dealer or dealers responsible for conducting the due diligence necessary to establish that the accredited investor exemption is being met by the investors?

Section 1.9 also states that "persons relying on an exemption that requires the purchaser to meet certain characteristics should", among other things:

> Establish policies and procedures – A person using an employee, officer, director, agent, finder or other intermediary should establish policies and procedures to ensure these parties understand the exemptions, are able to describe them to potential purchasers and know what information and documentation they need to gather from potential purchasers to confirm the purchaser meets the conditions of the exemption.

Is it the issuers who are required to conduct diligence on all dealers involved in a distribution to ensure the dealers have put in place the requisite policies? Again, who is referenced by the clause "persons relying on an exemption" – registered issuers or dealers, or both?

The *Companion Policy* also holds that "the person relying on the exemption may take further steps or collect additional information depending on the circumstances" Is the "person relying on the exemption" the issuer or the dealer? What are the "circumstances" that trigger additional steps of due diligence and the collection of additional information?

Privacy concerns: If issuers are required to conduct additional diligence with respect to the purchasers and dealers involved in the distribution, issuers will have to ensure that mechanisms are in place to ensure any such information is gathered, used and maintained in compliance with applicable privacy legislation. It is on the face of it problematic that unique client information is to be provided to the issuer who, unlike a registered advisor, is unlikely to be a party with whom the investor has a pre-existing relationship. The highly individualized nature of the information, which comes from bank statements, investment statements, income tax returns, tax assessments, and third-party appraisal reports, raises major privacy concerns. As the amendment is currently drafted, significant guidance is needed on the collection and retention of such information.

The requirement on investment advice is too vague: Advocis believes that the requirement that a "person" "involved" in the distribution of the securities must select "Yes" or "No" in response to the

statement the he is "generally not qualified to provide investment advice" is unhelpful. Many investors confuse being licensed to sell securities as co-extensive with being able to offer professional advice. A better approach would be to set out a set of qualifications, including professional designations, and years experience in transactions involving the exempt market product at issue. An advisor or dealer may have extensive experience with junior issuers in British Columbia minerals, but no experience in advising on the merits of investment funds. We do not take issue with certification as to whether a person involved with the sale of securities is registered with a securities regulator, which by contrast, is clear and factually based.

Overall impact of the proposed amendment: The proposed changes will drive up compliance costs significantly, as in-house compliance or legal counsel review every individual form and query every investor. The new obligations place on issuers and advisors/dealers in terms of the time and cost devoted to compliance will amount to a material impediment to an issuer's ability to complete a financing in a timely and cost-effective manner. Reliance on the exempt market by small- to mid-sized issuers will be eroded.

A possible amended approach to verification of an accredited investors' status:

(a). Grant an exemption to verification in the cases of permitted clients, registered advisors, portfolio managers or institutional investors who assert that they are accredited investors: Advocis believes that the issuer, dealer and other parties should be able to rely on representations made by permitted clients, corporate and institutional investors, portfolio managers and registered advisers that they fulfill the accredited investor exemption criteria. The CSA accepts such representations from prospective purchasers when it grants relief orders for the distribution of foreign securities. Issuers and other registrants should be able to rely on the representations of appropriately registered dealers, who have stringent Know-Your-Client and other client and product suitability obligations in regarding the applicability of the accredited investor exemption to any particular client.

(b). The CSA's proposed verification scheme should be limited to non-registered and limited-registration salespersons: Once an exemption is granted to verification in the cases of permitted clients, registered advisors, portfolio managers or institutional investors who assert that they are accredited investors, then the CSA's scheme for verification of an investor's accredited investor status could be applied to transactions in which the sale is not conducted by a registered advisor or dealer.

To reduce the administrative burden, while still promoting investor protection, verification by a salesperson would only be required by non-registered and limited-registration salespersons. When one considers, for example, the extensive registration requirements to which IIROC members are subjected, the proposed amendments on verification do not amount to an enhancement of

regulatory oversight that can justify the tremendous costs of obtaining verification. This cost/benefit balancing does not include justifying the costs of the impact on the client relationship which will accrue from the intrusive nature of the documentary discovery of the client's personal financial records which verification will require.

(c). In all other transactions, make registered advisors and dealers responsible for clients participating through the accredited investor exemptions: In transactions which do not have accredited investors who are also permitted clients, registered advisors, portfolio managers or institutional investors, then registered advisors and dealers could be held responsible for the investor's avowal of accredited investor status through professional liability insurance.

(d). Retain the current section 1.9 of the *Companion Policy*: Advocis believes that existing investor protection rules are sufficient for the accredited investor exemption to work properly, For example, when a registered dealer is involved in the distribution, that dealer has client and product suitability obligations that will provide investor protection. Subject to changes to reflect (a) to (c) above, the current guidance in section 1.9 of the existing *Companion Policy* provides sufficient steps to determine if the accredited investor exemption is available and what steps should be taken by parties to the distribution process to verify an investor's accredited investor exemption eligibility. Form 45-106F9, either as proposed by the CSA or amended in the manner we set out above, will provide further security that the representation of accredited investor eligibility is accurate.

Advocis' recommendation: The CSA's proposed additional guidance in *Companion Policy* 45-106CP – *Prospectus and Registration Exemptions* on the steps which advisors, dealers, issuers and other persons should take to verify accredited investor status is too onerous. Advocis believes that the proposed changes will drive up compliance costs significantly, and place on issuers, advisors and dealers various time and cost constraints which will materially impede an issuer's ability to complete a financing in a timely and cost-effective manner. Reliance on the exempt market by small- to mid-sized issuers will be eroded. At minimum, Advocis believes that the issuer, dealer and other parties should be able to rely on representations made by permitted clients, corporate and institutional investors, portfolio managers and registered advisers that they fulfill the accredited investor exemption criteria. Advocis outlines an alternative verification regime in the paragraphs immediately above.

6. Issuers must identify all categories of accredited investor for each purchaser in the *Report of Exempt Distribution* (Form 45-106F1 and, in B.C., Form 45-106F6)

Under the proposed amendments, issuers will be required to identify *all* applicable categories of accredited investor (or categories of other capital raising exemptions) for each purchaser in the report of exempt distribution, using Form 45-106F1 (or, in British Columbia, Form 45-106F6). This

means that simply identified only the broad category of exemption (i.e., accredited investor, or family, friends and business associates, and so on). This is proposed in order to assist the CSA's compliance and enforcement departments better review adherence to the accredited investor exemption.

Is this an additional duty on issuers and dealers? Schedule 1 of Form 45-106F9 requires that all applicable categories of accredited investor must be disclosed. However, since only one category is required to be able to rely on the exemption, Advocis would like guidance if Schedule 1 is meant to impose an additional obligation on issuers. For example, will non-compliance with the requirement, however accidental, open the issuer to fines, penalties or other forms of disciplinary action? Will an error in determining which categories apply give the investor rescission rights? What happens if the category actually relied on by the issuer for the accredited investor exemption is wrong but another category is correctly listed as applicable? Will that preserve the transaction for the issuer and/or investor in the eyes of the regulator?

What is the CSA's justification for requiring the listing of all potential accredited investor categories? Requiring the issuer to determine all applicable categories which apply to a single accredited investor will be time-consuming and surely intrusive to any client who simply wants to purchase a security. It is not apparent what benefit will accrue to *any* stakeholder from further information-gathering and analysis of all other applicable yet not-relied-on accredited investor categories. Further explanation from the CSA on what it seeks to accomplish in terms of policy objectives or outcomes is necessary. Since this amendment will cause too great a compliance burden on registrants, we believe that, in the absence of a compelling cost-benefit analysis, this amendment should be abandoned.

Impact on investor privacy: Advocis would note that an individual retail investor relying on the accredited investor exemption may not wish to disclose every category applicable to him on the basis of privacy concerns.

An additional compliance burden with no apparent increase in consumer protection: Advocis believes this proposal will create an unnecessary and – in the absence of a compelling public policy objective – an unjustifiable compliance burden on issuers and dealers.

It seems clear to us that on an *a priori* basis the additional costs incurred by ensuring that the purchaser both comprehends and confirms every paragraph that can possible apply to his situation simply cannot be justified by any potential and indeterminate incremental gain in consumer protection. Even if the collection of this information will yield a definite consumer benefit at some future point in time, it is by no means clear why the present investor and issuer should have to bear its costs.

As it stands, the salesperson relying on the accredited investor exemption must take "reasonable steps" to confirm that the exemption is in fact available. This further obligation to determine if every possible category set out in the definition of accredited investor is applicable is tantamount to an "unreasonable step"; it is simply too onerous a burden to assume and will amount to a further bottleneck in the processing of transactions.

An alternative proposal: Advocis would suggest that the CSA not adopt the obligation to determine all categories of the accredited investor definition applicable to an investor. A more reasonable alternative would be to require entity or institutional investors (but not the issuer) to determine the full range of categories which apply to them; (2) in the case of an individual retail investor, to require the issuer to determine if one other category is applicable; and (3) to exempt altogether individual investors who are "permitted clients" under the National Instrument 31-103 test.

Advocis' recommendation: The CSA's proposal that issuers must identify all categories of accredited investor for each purchaser in the *Report of Exempt Distribution* is too onerous. Advocis suggests several less costly and intrusive alternative approaches in the paragraphs immediately above.

7. Proposed amendment to accredited investor definition - family trusts

The CSA proposes to amend the accredited investor definition to include family trusts established by an accredited investor for the benefit of his or her family, provided that the majority of trustees are accredited investors and all of the beneficiaries are the spouse or a parent, grandparent, brother, sister, child or grandchild of that accredited investor or of that accredited investor's spouse. Driving this proposal is the desire to remove the inconsistency that an Accredited Investor cannot not purchase securities on behalf of a trust established for the benefit of the Accredited Investor's family.

We support the amendment to the definition of Accredited Investor in National Instrument 45-106 to include family trusts established by an accredited investor for his or her family, with the condition that a majority of trustees of the family trust are also Accredited Investors. The proposed amendment will facilitate more advanced estate planning and help fulfill the policy goals of the exemption.

The proposed definition should be revisited by the CSA to provide greater clarity over the treatment of trusts whose beneficiaries are the accredited investors' former spouse and/or the family members of the former spouse. As well, the CSA may wish to consider whether family trusts should be treated as an individual Accredited Investor in terms of having to acknowledge risk; as with an individual's holding company which functions as an Accredited Investor, the presence of the trust

structure in no way demonstrates a greater ability to evaluate investment risk or exercise higher levels of financial acumen.

Advocis' recommendation: The CSA`s proposal to amend the accredited investor definition to include family trusts established by an accredited investor for the benefit of his or her family should be approved, subject to the qualifications outlined immediately above.

8. Proposed amendment to accredited investor definition – fully managed accounts to purchase investment fund securities in Ontario

In Canada, a registered adviser of a fully managed account is an accredited investor under the definition set out in National Instrument 45-106 and can purchase on an exempt basis all types of securities for the managed account. There is one exception to this rule for managed accounts: in Ontario, such an investor cannot buy investment fund securities. Accordingly, the Ontario Securities Commission (OSC) proposes to amend the definition of Accredited Investor in the provincial *Securities Act* to allow fully managed accounts to purchase investment fund securities in Ontario.

Some portfolio managers act solely as advisors to their clients, exercising discretionary responsibility over separately managed accounts, including ones held in custody at other financial institutions. The standards of proficiency and statutory fiduciary obligation of portfolio managers will provide Accredited Investors with more than sufficient levels of investor protection to justify the amendment from a consumer point of view.

Advocis believes that managers of discretionary accounts who qualify as accredited investors should be able to purchase as wide a range as possible of suitable securities for their clients; in specific, those clients should have the benefit of the exemption whether they invest in securities directly or through an investment fund. Moreover, harmonization will remove the disadvantage Ontarians currently face in comparison to the Canadians in other provinces. Investment funds often offer more diversification and cost less to the client than many mutual funds. Supporting this amendment is clearly in the consumer interest of Ontarians. Greater harmonization of all available prospectus exemptions across Canada will promote efficiencies in capital rising and eliminate disproportionate treatment of retail investors solely on the basis of their jurisdiction of residence.

Advocis' recommendation: The OSC's proposed to allow fully managed accounts to purchase investment fund securities in Ontario should be approved. Advocis supports the OSC's proposed amendment to the accredited investor definition in section 2.3 of National Instrument 45-106 and in section 73.3 of the Ontario *Securities Act* to allow fully managed accounts to purchase investment fund securities in Ontario. Any effort to harmonize the accredited investor definition and other aspects of Canada's exempt market regime is laudable.

PART THREE: PROPOSED AMENDMENT TO THE MINIMUM AMOUNT INVESTMENT PROSPECTUS EXEMPTION

The CSA proposes that the minimum amount investment prospectus exemption be amended so that it is only available for distributions to non-individual corporate and institutional investors (e.g., investment houses and other corporate entities, including holding companies). Merely by virtue of investing a minimum of $150,000 at one time with one issuer, individual investors will be excluded from accessing this prospectus exemption. The justification is to address investor protection concerns associated with the use of the exemption to distribute securities to individual investors. These concerns are:

1. the minimum amount exemption is often relied upon despite the investment clearly not being a suitable one for the investor;
2. when other exemptions are unavailable – such as the accredited investor exemption – individual investors are being wrongly encouraged to borrow money to qualify for the minimum amount exemption;
3. individual investors are being pressured to invest $150,000 when they would rather invest a lesser amount; and
4. the $150,000 amount required to qualify for the minimum amount exemption is not a sufficient proxy for investor sophistication or for the ability of an investor to withstand total loss of his investment.

There is a degree of dissonance with regard to the treatment of the accredited investor and minimum amount exemptions under the proposed amendments. The CSA does not explain why a risk acknowledgment document can address concerns over investor protection for those individuals acting as accredited investors, but cannot address the same concerns for individuals wanting to act as minimum amount investors.

Impact of the proposed amendment: The CSA notes that the minimum amount exemption is the second most frequently relied upon prospectus exemption' yet investments falling under the minimum amount category account for only 1% of all distributions to Canadian investors. Nevertheless, the proposal to limit the minimum amount exemption to non-individual investors will certainly have a negative impact on capital raising. Small to mid-size issuers, primarily those in western Canada, will be particularly affected. We would suggest that the CSA consider an exemption for single-security issues based on their industry category – e.g., oil and gas, minerals, etc.

Impact of the proposed amendments on entities specifically created to purchase/hold exempt market securities: Our interpretation of the proposed amendment to the minimum amount exemption is that it will not exclude holding companies or similar entities created by individuals to utilize the exemption. A holding company may seek to use the minimum amount exemption to

limited liability or for tax and estate planning reasons. We would ask the CSA to clarify whether the changes would impact the ability of such a company to invest using the minimum amount exemption.

The CSA's distinction between individual retail and entity investors: Any proposal to restrict the minimum amount exemption to non-individual investors leaves in place the CSA's concerns regarding the hazards of the minimum amount exemption in terms of investing sophistication and risk tolerance. The problem is that many non-individual investors are simply retail investing individuals who subscribe through a private holding company. The corporate form of the holding company offers very little in the way of tangible evidence that investment acumen is actually being wielded by the individual subscribers.

In fact, we note that the reasons which justify the outright elimination of the minimum amount exemption for individual investors can also be applied to the various entities the CSA proposed to permit to use the amended minimum amount exemption. Suitability concerns will apply to an entity using the minimum amount exemption no less than they apply to an individual retail investor. Indeed, many small closely-held companies will be just as exposed to liquidity, risk and diversification concerns when relying on the minimum amount exemption as individual investors. And there is no reason to assume the individuals who will make investment decisions for such entities will be any more sophisticated than the retail investors who in the past have relied on the minimum amount exemption – or feel any less pressure to "over-allocate" resources in order to meet the $150,000 threshold. Many small firms will be no better or worse equipped to access and evaluate information on the prospectus-exempt issuer, and address post-investment liquidity concerns, as the retail investors who utilized this exemption in the past.

Overall, we believe that the policy rationale for differentiating between retail and entity investors with regard to access to the minimum amount exemption does not justify the outright elimination of the exemption for individual investors. Instead, we believe that investor protection concerns could be addressed by retaining the ability of individuals to rely on the minimum amount exemption by restricting their use of it to investment funds. Entities could continue to use the exemption for the full range of available securities. Indeed, this would be the least intrusive way to amend the minimum amount exemption. If after a prescribed period of time the CSA still finds that retail investors are abusing the minimum amount exemption, or are otherwise placed at undue risk because of it, then the CSA could eliminate entirely its use among individuals.

Advocis believes that the CSA's proposal to totally remove the ability of individual retail investors to rely on the minimum amount exemption is excessive. It is our understating that investors sometimes rely on the minimum amount exemption out of disclosure and privacy concerns. Moreover, from a policy perspective a total restriction on individual access to the minimum amount exemption is inconsistent with the regulatory treatment of other prospectus exemptions.

However, the CSA's review of its empirical data provides documentary evidence legitimating its legitimate concerns with the use of the minimum amount exemption for individual retail investors. Many individual purchasers would prefer to invest less than the $150,000 minimum amount as a way of limiting their risk exposure. Moreover, while individual investors will still be able to invest $150,000 or more in a single transaction under the accredited investor exemption, not all persons previously relying on the minimum amount exemption will be able to qualify for the accredited investor exemption. That's why we believe permitting individuals to still be able to use the minimum amount exemption for a more diversified product like an investment fund is only sensible.

Limiting the minimum amount exemption to investment funds would also address concerns over proper risk diversification for retail investors, dilute the impact on capital-raising by smaller issuers of a full-scale elimination of the minimum amount exemption for retail investors, and promote better risk diversification for individuals.

Accordingly, Advocis would suggest that the minimum amount exemption be eliminated for single security issuers and retained for lower risk products such as principal-protected notes and investment funds.

We recognize that for individual investors $150,000 is a significant amount which must be invested with due care and expertise. Since the ability to invest $150,000 is an uncertain proxy for a certain level of financial sophistication and ability to withstand investment losses, Advocis believes that a Risk Acknowledgment Form for individual investors relying on the minimum amount exemption to purchase investment funds should contain an advisory clause that the investor should avail himself of investment advice from a registered financial advisor who is a member of a professional association.

This advisory should also be made to non-individual entity investors which are created by an individual for the purpose to buy and hold exempt market securities, such as a holding company.

Advocis' recommendation: The CSA should permit individual retail investors to still rely on the minimum amount exemption to purchase lower risk products such as principal-protected notes and investment funds. Advocis would prefer that the exemption still be available for individuals wishing to access certain lower-risk exempt market products, such as certain investment funds, principle-protected notes which come with a guaranteed rate of return or at least of the amount invested, and other relatively "safe" prospectus-exempt products. These are often far less risky than the investment products offered by single security issuers who rely on the minimum amount exemption.

PART FOUR: OTHER PROPOSED AMENDMENTS – AMENDING THE FORM OF *REPORT OF EXEMPT DISTRIBUTION*

The CSA proposes to amend the form of report of exempt distribution (Form 45-106F1 and, in British Columbia, Form 45-106F6) to gather additional information. These reports are to be filed no later than ten days following the distribution. The additional information being sought is intended to assist the CSA in its compliance and data gathering functions.

In specific, the CSA proposes several changes regarding the reporting requirements on the Form 45-106F1 – *Report of Exempt Distribution* to assist regulators in verifying compliance with the new rules.

Under revised Form 45-106F1 and its Schedule 1, issuers will have to:

- employ an expanded list of industry categories (there are now 23 categories, up from the previous 12),
- indicate all applicable categories of accredited investor (or categories of other capital raising exemptions) for each purchaser, rather than just the broad category of exemption relied upon under National Instrument 45-106, (i.e. accredited investor; family, friends and business associates, and so on),
- provide the accredited investor's name, email address and telephone number, and
- provide additional information on any person receiving compensation in connection with the distribution of the exempt market product, including the person's full name, whether the person compensated is an insider of the issuer or a registrant, and the specific purchasers in connection with whom he or she is receiving compensation.

We note that the CSA states that while amendments to the forms and the related additional requirements will impose additional administrative burdens and costs to issuers, sellers and registrants, it concludes that these costs are anticipated to be limited in nature and will be outweighed by the added investor protections afforded by the proposed amendments. While this may be true, we would like the CSA to provide the analysis it relied on to reach this conclusion. In the absence of a clearly stated policy rationale for the gathering of such sensitive information, and with the lack of suitable guidance and safeguards to protect the information, Advocis recommends that this amendment be scaled back dramatically.

Major privacy concerns: Much of the information the CSA proposed be collected is not currently being collected and to our knowledge has never been collect in the manner proposed. Collection will be onerous on issuers, intrusive to investors, and verification a sensitive matter. The risk of inadvertent disclosure of personal information and financial data seems quite high. Personal information (names, addresses, email addresses, and telephone numbers) and financial information

(accredited investor categories relied on, the names of compensated parties, and the relationships between investors and advisors, dealers and finders) should not be made public. The requirement that emails and telephone numbers be provided to the regulators seems quite remote from policy efforts to understand and regulate the exempt market. If the CSA is determined to go ahead with this information gathering, National Instrument 45-106 and its Companion Policy should be explicit that when an investor refuses to provide the information, there is no obligation on him or her to disclose it.

A need for guidance on the expended Industry Categories section: It would be helpful if category definitions were provided to eliminate some of the inherent ambiguity that inevitable comes with any list of this type.

Concerns over the increased compliance burden: The CSA has proposed to collect significantly more information from exempt market participants. It is clear that gathering and recording all of the information being sought will be a time- and labour-intensive and onerous process. The proposed filing process will be unduly burdensome to issuers and investors.

How many reports are necessary? It should be noted that the CSA has elsewhere proposed the creation of two new reports of exempt distribution: Form 45-106F10 and Form 45-106F11, for use in assorted jurisdictions. The result is that exempt market issuers will be required to file a combination of reporting forms, depending on the jurisdictions involved, the particular exemption being relied upon, and the type of security being issued.

Advocis recommends that that the CSA create one accredited investor form for all jurisdictions to streamline the capturing of basic information about the security issued, the category of industry, the type of exemption relied on. Avoiding the collection of personal information strikes us as an absolute necessity in maintaining the trust of Canadians – as well as that of foreigner investors – in Canada's capital markets. Harmonizing the exempt market reporting regime for issuers, dealers and other registrants will eliminate a significant degree of the complexity which currently characterizes distribution reporting in the exempt market. This should be a key goal for the CSA.

Disclosure of fees and commissions: The requirements of Forms 45-106F1 and 45-106F6 to capture the fees and commissions involved in the distribution are problematic. Depending on the nature of the issuer, the concept of disclosing what is being "paid to the salesperson" may be nearly impossible to determine for any single purchase.

Indeed, commissions are allocated in a myriad number of ways, and can change over the course of a year for any given individual or firm. Some firms disperse the entire commission across the firm – to its retail salespersons, either on a discretionary basis or through a fixed payout scheme, but also to its investment, finance and research departments. Does the CSA want to know what portion the latter parties receive? In a syndicated offering, the lead agents will take a portion of the commission

and smaller amounts will be allocated to sales group. Does the CSA want both figures, or just the sum of them?

Advocis would suggest that the CSA abandon the effort to collect this information from intermediaries and instead seek to discover from the issuers themselves the amounts of gross fees and commissions paid.

As well, the requirements of Forms 45-106F1 and 45-106F6 to provide the full name of any person compensated for the distribution of the securities is not necessary or acceptable. Surely the CSA would get a better picture of the dynamics of the exempt market if it obtained the names of the firms involved, rather than those of the individuals employed by the firms.

Advocis' recommendation: The CSA's proposal to amend Forms 45-106F1/45-106F6, *Reports of Exempt Distribution*, should be rejected in favour of a streamlined approach which eschews the collection of personal information. The net effect of the amendments will be that issuers are being asked to pay the price of the CSA's data collection project. Significant privacy concerns are raised by the mandatory production of the additional information being requested. These concerns, coupled with the inevitable increase in transaction costs, will discourage the participation of investors, issuers, advisors, dealers, salespersons, and finders in exempt distributions. The end result can only be a reduction in issuers' access to capital and investors' access to opportunities. While Advocis would support minor amendments to Forms 45-106F1/45-106F6 to enable the CSA to obtain more information about the exempt market, without a clearly stated policy rationale for the gathering of sensitive information – including in certain cases names, addresses, email addresses, compensation – and given the absence of suitable guidance and safeguards to protect the information, Advocis recommends that the amendment be scaled back dramatically. We set out some alternative proposals in the paragraphs immediately above.

CONCLUSIONS AND LOOKING AHEAD

The proposed amendments to National Instrument 45-106 and its attendant forms and *Companion Policy* demonstrate the CSA's deep commitment to fulfilling its investor protection mandate. However, under the changes envisaged by the CSA, issuers and dealers will have to carry an increased compliance burden to help ensure that investors properly appreciate the risks of participating in the exempt market under the accredited investor exemption.

While we agree with the CSA's continued focus on ensuring the flow of meaningful information between issuers, dealers and investors in exempt offerings, we would prefer that the CSA abandon the more stringent paperwork requirements attendant to the new risk acknowledgement form in favour of a more principles-based regulatory approach.

We believe that the most significant impact of the proposed amendments on advisors, dealers and investors will be the increased costs and additional steps associated with the administrative, recordkeeping, executory and delivery requirements the CSA has established around the new form – almost all of which will fail to produce any significant increase in consumer protection.

Subject to the qualifications outlined about, Advocis supports the CSA's efforts to improve consumer access to and protection in Canada's exempt markets.

We would be pleased to offer further comment or assistance on this matter at any time in the future. To discuss any of the issues that we have raised, please contact the undersigned, or email Ed Skwarek at eskwarek@advocis.ca.

Sincerely,

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