SINCLAIR-COCKBURN
FINANCIAL SERVICES, INC.
Licence No. 11391

June 17, 2014

The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, ON M5H 3S8
E-mail: comments@osc.gov.on.ca

Re: Notice and Request for Comment
Proposed Amendments to National Instrument 45-106 and
Related and Consequential Amendments

This submission is being made on behalf of Sinclair-Cockburn Financial Services Inc. ("**Sinclair-Cockburn**") in response to the Notice and Request for Comment on Proposed Amendments to National Instrument 45-106 *Prospectus and Registration Exemptions* and the related and consequential exemptions published March 20, 2014.

Sinclair-Cockburn is registered with the Ontario Securities Commission ("**OSC**") in the category of exempt market dealer ("**EMD**"). However, it is primarily in our role as an issuer of securities, rather than as an intermediary, that we are making these submissions.

Executive Summary

We welcome the proposed introduction of an offering memorandum prospectus exemption ("**OM Exemption**") which we agree will contribute to capital formation in Ontario and provide better access to capital by small and medium size enterprises ("**SMEs**"). We believe that issuers and other SMEs across the breadth of the Ontario economy would benefit from improved access to capital and financing.

It would therefore be a poor policy choice to effectively shut out issuers like us from the benefits of the OM Exemption. For the reasons given below, this would be the result if registrants who are related to the issuer are prohibited from participation in an OM distribution.

We submit that there is little reliable evidence to support the view that investor protection requires the exclusion of related registrants from participation in OM distributions. To the contrary, we submit that our existing investors and prospective investors would be better served by extending the benefit of the OM Exemption to placements of our securities.

9140 Leslie Street, Suite 405, Richmond Hill, Ontario L4B 0A9
Tel: 905-762-3399 Fax: 905-762-3377 Web: www.scmic.ca

Background to this Submission

Sinclair-Cockburn is a registrant and its primary activity relates to the distribution of the shares of a related issuer, Sinclair-Cockburn Mortgage Investment Corporation ("**Sinclair-Cockburn MIC**"). Sinclair-Cockburn MIC is among the class of issuers who are "mortgage investment entities". Mortgage investment entities (**"MIEs**") have been the subject of various staff notices, including CSA Staff Notice 31-323.[1]

Sinclair-Cockburn MIC is among a class of issuers who are not reporting issuers and whose securities are distributed on a private placement basis directly or through an affiliate. The distributions are made primarily in reliance on the accredited investor exemption and to a lesser extent on the minimum amount exemption. Distribution is effected through an exempt market dealer who is most often the manager of the investment entity or an affiliate under common control with the manager of the investment entity.

The OSC in its most recent *Statement of Priorities* has noted that "smaller participants are facing challenges raising capital through traditional sources (e.g. banks). To support capital formation the OSC needs to find ways to improve access by small and medium enterprises to capital raising alternatives ..."[2] Sinclair-Cockburn is precisely such a "smaller participant". Sinclair-Cockburn MIC is a mortgage lender and many of its borrower clients are also "smaller participants who face challenges raising capital".

OM Exemption

The introduction of an OM Exemption in Ontario would be a welcome development.

As the OSC has noted, SMEs require access to capital. In the aftermath of the financial crisis of 2008/2009, bank financing for SMEs has been more difficult to obtain. Becoming and maintaining status as a reporting issuer is unrealistic for most SMEs. This leaves raising capital through the issuance of securities in reliance on one or more of the available prospectus exemptions. Practically speaking, issuers like Sinclair-Cockburn MIC are limited to distributing our securities to accredited investors. The OM Exemption would allow for a broadening of our investor base; today, we are often forced to turn away investors for whom the shares of Sinclair-Cockburn MIC would be a suitable investment because they do not meet the criteria for being an accredited investor.

Exclusion of Related Dealers from OM Distributions is Unfair

The OM Exemption, in the form proposed by the OSC, would have the effect of excluding an issuer from being able to rely on the OM Exemption if the distribution is made via a related dealer.

---

[1] Guidance Relating to the Registration of Mortgage Investment Entities (2011) 34 OSCB 2248. See also CSA Staff Notice 31-322, Extension of Omnibus/Blanket Order Exempting Mortgage Investment Entities from the Requirement to Register as Investment Fund Managers and Advisers.
[2] Ontario Securities Commission Notice 11-769 Statement of Priorities (2014), 37 OSCB 3339

This limitation represents real difficulty and hardship for issuers such as Sinclair-Cockburn MIC which offers its product almost exclusively through its related dealer. In this business model, the related dealer been formed primarily or precisely for the purpose of distributing the related issuer's product, often with the explicit encouragement of staff of the OSC.

The commentary accompanying the proposal contains little elaboration on this proposed limitation. The OSC states that "we have significant investor protection concerns about the activities of some EMDs that distribute securities of related issuers". Neither the nature of the concerns nor a description of the activities giving rise to them are described. There is therefore no way for us to evaluate or comment on the investor protection concerns. Indeed the exclusion of related dealers (and the issuers to whom the dealer is related) from the significant benefits available through use of the OM Exemption seems to us to be arbitrary and unfairly discriminatory.

No evidence that Investors Better Served via Third-Party Distribution

If the OM Exemption is to be prohibited to EMDs and other dealers who are related to the issuer, products such as the Sinclair-Cockburn MIC could be distributed on the basis of an OM Exemption only through third-party (unrelated) dealers. The significance of the OM Exemption, indeed its key feature, is that the group of investors is widened beyond accredited investors to include "eligible investors" and ordinary members of the investing public: the "non-eligible investor" (subject to the proposed caps and other conditions). It is unclear that third party distribution to eligible investors and non-eligible investors would result in any better outcomes for such investors -- i.e. that such investors would have their rights better protected.

Third party distribution relies heavily on commission payments and other incentive compensation. The OSC has implicitly acknowledged the conflicts inherent in embedded compensation, particularly in the area of mutual funds. The OSC has announced its intention to study this matter, a clear indication that it finds the status quo problematic.

It therefore makes no logical sense to assume that the embedded compensation model – i.e. distribution through third-party EMDs, will result in better investor protection compared to issuers who distribute their own product that they created and know well.

The shares of MIEs are yield products. Our investors rely on the income stream that we are able to generate. If we are forced to sell through third party EMDs, the only way that we would be able to compete on the shelves of such EMDs would be by offering an attractive selling commission, likely consisting of an up-front payment and a trail. This compensation paid to the EMDs will directly affect the yield of the MIE, resulting in a decreased payout to investors.

It is unclear to us what our clients would gain by buying through a third-party EMD in place of direct purchases through a related EMD. The related EMD is under a regulatory obligation to assess suitability and to only recommend a purchase where it is suitable for the particular investor. This regulatory obligation is exactly the same as that which applies to a third-party EMD.

Structural Incentives Argue for Self Distribution

In addition to their regulatory obligations, issuers such as Sinclair-Cockburn MIC have a structural incentive to deal honestly and in good faith with their investor, with a view to a long term relationship with the investor. Sinclair-Cockburn MIC and other MIEs began life as issuers, not as intermediaries. In most cases, the founders and owners of the business have long

established relationships with their investors which they continue to maintain and to cultivate. These investors are the source of our business and referrals. The relationship between the investor and the issuer is long-term, not transactional. The MIE's revenues are derived from its success as an issuer. They generally do not pay compensation to themselves in the form of a sales commission because they are selling their own product.

Historically, prior to Registration Reform, many MIEs relied on the trade-based exemptions, in order to distribute their securities. Although under the regulations then in place, certain private placement exemptions were "not available" to market intermediaries and distributions were to have been made via a Limited Market Dealer, the fact is that in many instances there was direct distribution to accredited investors. The point here is not to argue about what should have occurred, it is to provide you with an understanding of why it is that MIEs have the kinds of relationships that they do with their investors.

The key consideration is that for MIEs operating on our business model (self-distribution), the investor is coming to the issuer because they are interested in purchasing our securities. The investor is not expecting to receive comprehensive financial planning advice. We do not hold ourselves out in that fashion. We make no implied promises of any sort that in our capacity as dealer, we will scour the investment universe and carefully select from among the available investment products a few to present to the investor for consideration. Rather, our investors already know that what we have on offer are the shares of Sinclair-Cockburn MIC and little else. In compliance with regulatory requirements, prior to concluding any sale, we as dealer obtain the KYC information, make the required disclosures and conduct a check of suitability. We submit that there is a place in the investment ecosystem for this model, and that this model does not pose undue risk of harm to investors.

We hope and expect that our investors will be with us for a period of years. The core of our relationship is not the sale of the shares of Sinclair-Cockburn MIC. The sale marks the beginning of the relationship; as stated, our investors come to us because they are interested in the income stream. So every quarterly payment or in some cases monthly distributions marks a point of contact with the investor. Whereas a third-party EMD may simply complete the sale, get paid the commission and move on.

In our submission, our clients are better served by our own organization as a related dealer. We would be loathe to put our clients into the hands of a non-related EMD who is likely to sell our clients not the product that is in the best interests of our client, but the one that pays the highest commission.

No Evidence that Non-Accredited Investors Need Third-Party Dealers

It is proposed that the OM Exemption not be available for use by related dealers. It would continue to be open to the related dealer to rely on other prospectus exemptions, including the accredited investor exemption. The related dealer could continue to provide an OM to describe the product being offered, but it would not be the basis for a prospectus exemption. The end result would be that MIEs like Sinclair-Cockburn MIC would continue to distribute shares via the related dealer to investors in reliance on the accredited investor exemption. In essence the status quo would continue.

What then is the basis for permitting related party product to be sold to accredited investors but not to non-accredited investors? Is it that accredited investors are more sophisticated and have less need of investor protection measures? This seems inconsistent with the view that individual

accredited investors are in need of enhanced protection. In the Proposed Amendments to the Accredited Investor and Minimum Amount Investment Prospectus Exemptions[3], the CSA states that amendments to the accredited investor exemption are required "to address investor protection concerns, particularly that some individual investors may not understand the risks associated with exempt market investments."[4] The CSA propose to address this by requiring the individual accredited investor to complete and sign a risk acknowledgement Form, proposed form 45-106F9. This document differs little in form and function from proposed Form 45-06F13, the risk acknowledgment which would be signed by an investor (whether accredited, eligible or non-eligible) purchasing under the OM Exemption.

It would appear that for individual investors, both accredited and non-accredited investors are in need of enhanced investor protection in terms of understanding risk. That need is addressed through the risk acknowledgement forms. Over and above that, does the non-accredited investor purchasing under the OM Exemption need even more protection, of the kind that can only be delivered through a non-related (and commission-incentivized) dealer? Or put another way, the non-accredited investor purchasing under the OM Exemption will have the benefit of, among other prescribed measures, the following investor protections:

- hard limits on the amount the non-accredited investor can invest
- the disclosure contained in, and incorporated by reference into, the OM
- the risk disclosure form
- the dealer's statutory obligations to "know your client", "know your product" and assess suitability and advise the investor accordingly
- the required disclosures provided to the client under the requirements of NI 31-103, including disclosure of conflicts of interest
- the availability of dispute resolution services in accordance with NI 31-103

Are we to believe that this is insufficient, and that in addition to the above, the non-accredited investor also needs to have his or her sale processed by a non-related a dealer? This seems highly doubtful to us. The OSC offers no evidence or even good arguments in support of this proposition. Hence we submit that excluding related dealers from the OM Exemption is arbitrary and unfairly discriminates against issuers distributing through related dealers.

Competitive Disadvantage for Related Issuers

Furthermore, Ontario-based issuers would be placed at a distinct competitive disadvantage compared to issuers based outside Ontario. Issuers subject to the rules of other jurisdictions (except New Brunswick) will be able to offer their securities to a broader range of investors. For example, MIEs based in British Columbia are able to raise capital from a much broader base of investors today. Better capitalized than their peers in Ontario, these MIEs are able to lend to borrowers located in Ontario or indeed anywhere in Canada.[5] This imbalance would be further exacerbated with the adoption of the OM Exemption as proposed.

Issuers such as Sinclair-Cockburn MIC would also be at a disadvantage compared to issuers who distribute via third party dealers. In fact, the net result of the OM Exemption as proposed would be to disadvantage smaller issuers, the very class of issuers that the expansion of the prospectus exemptions is intended to assist. It requires cost, resources and infrastructure to arrange for third-

---

[3] (2014) 37 OSCB (Supp-2)
[4] *Ibid*. p. 4.
[5] Although the B.C. based MIE would be subject to the Ontario OM Exemption rules if it were to distribute its securities to Ontario resident investors, there is no prohibition against the B.C. based MIE holding mortgage loans on Ontario properties.

party distribution. An issuer, engaging third-party distributors must compensate and manage a distribution network, a sales force, internally and externally. Such issuers typically need "wholesalers", to conduct training and education on the securities offered to ensure that the third-party distributors understand and are properly presenting the product. All of this tends to be more difficult for smaller issuers.

Issuers like Sinclair-Cockburn MIC who do direct distribution already know their own products (which they created) and don't have to manage a sales force.

In effect, forcing third party distribution makes it much less likely that smaller issuers can thrive and grow and succeed. The OM Exemption as proposed would have the effect of stacking the deck against the smaller issuers. Regulators have not explained how this end result is consistent with the stated objectives -- improving access to capital by SMEs.

Investment Restrictions

We are not in disagreement that some restrictions may be appropriate in terms of the amounts that can be invested by non-accredited individual investors.

Generally our products are intended to be held for the medium to longer term. Most securities offered by MIEs are redeemable. There is no secondary market for the shares and liquidity is provided through redemption rights, similar to investment funds. We would urge regulators to consider a netting concept so that if an investor redeemed his investment within 12 months of his initial purchase, and wished to purchase another investment with the proceeds of redemption, that the investor be permitted to do so provided that the net investment within the 12-month period is with the investment limits. Otherwise the eligible investor is in effect forced to either hold his investment for a minimum of 12 months, or else must have his capital remain not invested from the date of his redemption to the date that is 12 months from the date of the last purchase. This seems to us to be unintentionally punitive and may inhibit the advisor from acting in the best interests of the investor.

Need for Harmonization

It has long been unsatisfactory that we have a patchwork of regulatory rules for private placements across Canada. In a web-connected world where the primary means of communications are not limited by geography, this problem becomes particularly acute. It is very difficult to explain to our investors why it is that someone in the same financial circumstance is able to invest in BC but not in Ontario.

The CSA, of which the OSC is a member, state [6]

> The OM Exemption is an exemption designed to facilitate early stage and small business financing. Not surprisingly this type of financing tends to be quite local in nature. Consequently, differences in approach among jurisdictions can very appropriately reflect differences in local capital markets.

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

With respect, financing activity is not mostly "quite local". In today's connected, digital environment, capital is fluid and mobile. Information crosses geographical boundaries effortlessly. This is now true even in the SME space. Issuers are no longer limited to looking for financing within so many square miles of home. A "community" is now united by areas of interest or familiarity with a subject, not by physical proximity. The assumption underlying "local" financing is that the participants (i.e. the SMEs who require capital and the people with savings wishing to invest) are primarily defined as a group by geography. This becomes less true with every passing day.

One is also hard pressed to know how the local capital markets of BC, Newfoundland and Labrador and Nova Scotia are sufficiently similar to have the same OM Exemption, yet different enough from the local capital markets of Manitoba, Northwest Territories, Nunavut, Prince Edward Island and Yukon, to merit a slightly different OM Exemption. What are the features of each of the local markets that makes one OM Exemption Rule a better fit than another very similar one? What key features do the capital markets of Ontario and New Brunswick have in common such that they would have the identical OM Exemption? It would not appear to be based on the local economies.

Lack of consistency and harmonization is a recipe for confusion and inadvertent non-compliance. The failure to harmonize is more than merely irritating. It makes compliance unwieldy, time-consuming and expensive. It results in large amounts of time and effort being expended in an unproductive, one might even say pointless, manner. Ultimately, it increases the cost of capital and makes Canadian companies less competitive. The proposals of the OSC and the other members of the CSA offer no relief for this problem and in fact compound it. We urge regulators to resolve this and achieve something close to uniformity across all Canadian jurisdictions.

Some Concluding Thoughts

Our investors trust us and we have long-established relationships with them which are working well. They do not want to be forced to go to a third party dealer in order to buy our product. Please do not adopt policies which produce that result.

The stated purpose of the expansion of the prospectus exemptions is to improve access to capital by SMEs. Excluding related EMDs from being able to participate in OM distributions will have the exact opposite effect and impede issuers in our position from accessing capital.

We therefore urge you to take this into consideration as you proceed to the next steps of formulating policy in this important area.

We would be pleased to meet with you in person to further discuss our submissions.

Yours sincerely,

Chris Pridham CFP, AMP
President

9140 Leslie Street, Suite 405, Richmond Hill, Ontario L4B 0A9
Tel: 905-762-3399 Fax: 905-762-3377 Web: www.scmic.ca