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Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
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Nova Scotia Securities Commission
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Re: Proposed Amendments to National Instrument 45-106 *Prospectus and Registration Exemptions and Companion Policy 45-106CP Prospectus and Registration Exemptions;*

and

Proposed Amendments to OSC Rule 45-501 *Ontario Prospectus and Registration Exemptions*;

and

Proposed Multilateral Instrument 45-108 *Crowdfunding and Companion Policy 45-108CP Crowdfunding, and Proposed Form 45-106F10 Report of Exempt Distribution for Investment Fund Issuers (Alberta, New Brunswick, Ontario and Saskatchewan) and Form 45-106F11 Report of Exempt Distribution For Issuers Other Than Investment Funds (Alberta, New Brunswick, Ontario and Saskatchewan)*

Dear Sirs/Mesdames,

We are writing in response to the March 20, 2104 *Request for Comment* from the Ontario Securities Commission (OSC) regarding the above-noted matter.

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On March 20, 2014, the Ontario Securities Commission (OSC) published for comment proposed rules for several new exemptions to the prospectus requirement, including an offering memorandum prospectus exemption (the OM exemption). The proposed exemptions are intended to facilitate the ability of issuers to raise capital from potential investors in Ontario without having to file a prospectus.

We support the OSC's broad and ongoing review of Ontario's exempt market and possible introduction of new prospectus exemptions that would facilitate capital raising for business enterprises, including start-up businesses and small- and medium-sized enterprises while protecting and promoting the interests and opportunities of individual retail investors.

Our comments are largely confined to the proposed four new capital-raising prospectus exemptions, attendant crowdfunding portal and ancillary required documentation:

- an offering memorandum prospectus exemption (the OM exemption);
- a family, friends and business associates prospectus exemption (the FFBA exemption);
- a prospectus exemption for distributions by a reporting issuer to its existing security holders (the Existing Security Holder exemption);
- a crowdfunding prospectus exemption (the crowdfunding exemption);
- the regulatory requirements applicable to a crowdfunding portal; and
- various attendant fees, charges and filing documents.

The exempt market has proven itself to be instrumental in the process of capital raising across Canada. Small- and medium-sized enterprises are often too small to be able to afford cost-effective access to public equity markets through the issuance of a prospectus. That's why the OSC's proposal to introduce an OM exemption, a FFBA exemption, and an ESH exemption are such positive developments, with the potential to increase investor opportunity and capital formation, perhaps dramatically so.

TABLE OF CONTENTS

PART ONE: OFFERING MEMORANDUM PROSPECTUS EXEMPTION 4
General 4
Issuer qualification criteria 5
Types of securities 8
Offering parameters 9
Registrants 10
Investor qualifications – definition of eligible investor 18
Investment limits 20
Point of sale disclosure 23
Advertising and marketing materials 24
Ongoing information available to investors 25
Reporting of distribution 26

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PART TWO: FRIENDS, FAMILY AND BUSINESS ASSOCIATES PROSPECTUS EXEMPTION 27
Types of securities 27
Offering parameters 27
Investor qualifications 28
Investment limits 28
Risk acknowledgement form 29
Reporting of distribution 29
PART THREE: EXISTING SECURITY HOLDER PROSPECTUS EXEMPTION 29
Issuer qualification criteria 29
Offering parameters 30
Resale restrictions 31
PART FOUR: CROWDFUNDING PROSPECTUS EXEMPTION AND CROWDFUNDING PORTAL REQUIREMENTS 31
1. CROWDFUNDING PROSPECTUS EXEMPTION 31
Issuer qualification criteria 31
Offering parameters 33
Restrictions on solicitation and advertising 35
Investment limits 35
Statutory or contractual rights in the event of a misrepresentation 36
Provision of ongoing disclosure 36
Other 38
2. CROWDFUNDING PORTAL REQUIREMENTS 39
General registrant obligations 39
Additional portal obligations 39
Prohibited activities 40
Other 41
PART FIVE: ACTIVITY FEES 43
PART SIX: PROPOSED REPORTS 44
CONCLUSIONS AND LOOKING AHEAD 45

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

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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.

For your ease of reference and review, the *Request for Comment*'s question-and-answer format is reproduced below. Advocis has inserted its comments and concerns in the appropriate locations.

PART ONE: OFFERING MEMORANDUM PROSPECTUS EXEMPTION

General

1.1	We note that the existing OM Prospectus Exemption available in other CSA jurisdictions has not been frequently used by start-ups and SMEs. Have we proposed changes that will encourage start-ups and SMEs to use the OM Prospectus Exemption?

Yes. The changes proposed by the OSC will encourage certain start-ups and SMEs to use the OM Prospectus Exemption.

The major benefits of Ontario's proposed OM exemption are its:

- broad scope of application: the OSC's proposed OM exemption will be available to a very wide range of potential issuers, to reporting and non-reporting issuers (but not investment funds) and will allow an issuer to issue securities – with the understandable exceptions of derivatives and structured finance products – by providing prospective investors with a prescribed-form offering memorandum;

- entrepreneur-friendly character: As well, the proposed rules place no restrictions the number of offerings that may be made by any individuals involved with the issuer;

- rules that are designed to reduce the costs of accessing capital: The proposed rules place no restrictions on (1) the amount of money an issuer can raise; (2) the number of offerings an issuer can make in any given time period; and (3) the length of time an offering can remain open. By permitting SMEs or start-ups to raise an unlimited amount of money through a single offering under the OM exemption, their transaction costs of going to market to raise capital are significantly reduced; and

- evidence shows the Alberta OM exemption is a favourite of small issuers – the type of issuer Ontario needs to help: Ontario's proposed OM exemption is based largely on the "Alberta Model." Alberta's statistics on the use of the offering memorandum exemption in section 2.9 of National Instrument 45-*106 Prospectus and Registration Exemptions* indicate that the

> OM exemption the province's second most frequently used type of prospectus exemption in Alberta: with 41% of distributions in 2012 being made under the OM exemption. Since the value of the securities distributed in 2012 was 500 billion, or just 3.8% of the total, it is clear that the OM is being used by relatively small issuers, almost all of whom were non-reporting issuers.[1]

However, it must be stated that in other provinces that the OM exemption is not as widely used as might be expected. There is often no longer a significant cost savings to be realized by preparing an OM in lieu of a prospectus. Ongoing concerns about legal liability have inexorably resulted in increased due diligence activities and more extensive, prospectus-style legal review. As the cost difference between financing under the OM exemption or under a prospectus lessens, more issuers to decide to enter the exempt market under a different exemption altogether, or, if they can afford to spend the longer period of time it takes to prepare a prospectus, they will decided to bear the additional preparation costs and issue a prospectus. The additional costs of preparing a prospectus are mitigated by the fact that a prospectus has fewer inherent restrictions than an OM and generally appeals to a wider pool of investors.

1.2	What else could we do to make the OM Prospectus Exemption a useful financing tool for start-ups and SMEs?

Advocis submits that a one possible avenue towards making the OM exemption a more useful financing tool for start-ups and SMEs would be to look at ways of enhancing levels of investor understanding and peace or minds. One admittedly unorthodox proposal would be to have the OSC waive the cost of filing documents if the issuer agrees to let the OSC query retail investors on a confidential and anonymous basis about the efficacy of the risk acknowledgement form, or poll them on the timing and nature of various forms of disclosure. For example, would investors prefer to be informed about the production of ongoing disclosure or the announcement of material changes to the issuer via the social media channel (perhaps in the form of a tweet with an embedded link to alert investors to upcoming or just released documentary disclosure)?

Issuer qualification criteria

2.1	We have concerns with permitting non-reporting issuers to raise an unlimited amount of capital in reliance on the OM Prospectus Exemption. Should we impose a cap or limit on the amount that a non-reporting issuer can raise under the exemption?

[1] In 2011 and 2012, approximately $824 million was raised by 223 Alberta-based issuers under the OM Exemption. Approximately 155 (about 70%) of these issuers self-reported their industry category as real estate or mortgage-investment corporations, and were responsible for 76% of the total raised by Alberta-based issuers under the OM Prospectus Exemption. See "Annex B Background – Local Experience with OM Exemption" in the 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.

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Advocis does not believe that capping the amount of capital a non-reporting issuer can raise under an OM-exempt offering is necessary in terms of investor protection, given present Know Your Client, Know Your Product and other suitability requirements. As well, the use of a risk acknowledgement form which highlights the main risks of investing in a non-reporting issuer's securities will drive home to retail investors some of the specific risks associated with investment products non-reporting issuers. A cap is certainly not advisable in regard to the promotion of capital-raising in Ontario.

It is our position that the disclosure obligations proposed by the OSC, which mirror those currently used in other jurisdictions, provide sufficient levels of information for investor protection. For example, the OM exemption will require that non-reporting issuers disclose of several key indicia for investor risk exposure (including for possible fraud or abuse by the principals of the issuer), such as whether they own securities of the issuer and, if so, the number, type and percentage of securities held after completion of the offering (including any minimum and maximum offering), any issuances in the past 12 months of securities of the same class as those to be offered under the OM, and the details of any loans to or from principals of the issuer.

As well, non-reporting issuers using the OM exemption must deliver to the OSC and make available to purchasers (e.g., by posting on a public website), audited annual financial statements within 120 days of the issuer's year-end, together with a notice disclosing the use of the aggregate proceeds raised by the issuer through the exemption. In addition, non-reporting issuers would be required to notify their investors within 10 days of certain prescribed events, including significant changes to the issuer's business or capital structure, certain material transactions and changes in its directors and officers.

If the OSC is conceived existing investor protection safeguards are not sufficient, then a more measured response would be to permit non-reporting issuers to raise an unlimited amount of capital in reliance on the OM exemption, but require that non-eligible investors must consult a registered professional advisor before making a purchase. This would further limit access to the investment product by those investors least able to withstand liquidity risk. Another option would be to prohibit non-eligible investors from purchasing the OM-exempt securities of non-reporting issuers unless an IIROC member, a registered exempt market dealer, or perhaps some other registrant, is involved in the distribution. If, after implementing one of these more measured responses, the OSC gathers clear evidence that non-reporting issuers are abusing the purpose of the exemption through fraud or inadequate disclosure, then at that point OSC would be in a proper position to consider capping or limiting the amount which may be raised under the exemption.

2.2 If so, what should that limit be and for what period of time?

While we oppose the use of a cap or limit in the absence of empirical evidence of widespread abuse or fraud of the OM exemption by non-reporting issuers, any general limitation to apply to all non-reporting issuers would be better conceived as a time restriction only, and not as a monetary limit.

We would submit that before any general time or amount limitation is place on all non-reporting issuers, specific industry categories in which abuse or fraud is a concern should be subject to restrictions of the amount of capital to be raised and/or the permissible time frame.

2.3 For example, should there be a "lifetime" limit or a limit for a specific period of time, such as a calendar year?

Based on the answers above, there is no need at present for the OSC to consider a lifetime limit or a limit in the form of a specifically restricted period of time

3.1 What type of issuer is most likely to use the OM Prospectus Exemption to raise capital?

At least at the outset, real estate forms and mortgage investment companies seem the most plausible candidates to use the exemption in Ontario, as well as various successful firms which seek additional capital but prefer to remain a non-traded organization.

3.2 Should we vary the requirements of the OM Prospectus Exemption to be different (for example, disclosure requirements) depending on the issuer's industry, such as real estate or mining?

We would prefer the OSC vary the requirements of the OM exemption based on the issuer's industry, in lieu of it simply banning outright certain categories of issuers from using the exemption. Perhaps regional differences in the types of industry issuers using the OM exemption will emerge over time. Our understanding is that in western Canada the most important use of the OM exemption is for the purchase of flow-through shares (mainly in the mining sector) for clients with incomes beginning at $80,000. It is also used for real estate investments (mortgage investment corporations, land development, etc.). Any introduction of special requirements for the OM exemption should take the nature of its use at the local level into account. Regional differences in terms of requirements for the OM could arise; the loss of harmonization would be a factor for regulators to take into account when considering such amendments.

4. We have identified certain concerns with the sale of real estate securities by non-reporting issuers in the exempt market. As phase two of the Exempt Market Review, we propose to develop tailored disclosure requirements for these types of issuers. Is this timing appropriate or should we consider including tailored disclosure requirements concurrently with the introduction of the OM Prospectus Exemption in Ontario?

Given the unique nature of the risks and opportunities of real estate securities, especially in Ontario and British Columbia, Advocis believes it would be best to introduce the tailored disclosure requirements concurrently with the introduction of the OM exemption in Ontario. The disclosure required in the OM exemption should be harmonized among jurisdictions whenever possible.

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Types of securities

5.1	We are proposing to specify types of securities that may not be distributed under the OM Prospectus Exemption, rather than limit the distribution of securities to a defined group of permitted securities. Do you agree with this approach?

Advocis agrees that for the purposes of establishing a market in OM-exempt securities, an express specification of the types of securities that *may not* be distributed is preferable to having the regulator attempting to exhaustively list only which types *may* be distributed. However, we believe that in a mature exempt market the ideal policy should reflect that principle that if investors are provided with disclosure sufficient to ensure a sufficient understanding of the risks and benefits of the security being contemplated as an investment option, then that security is by its nature an acceptably designed product offering. Besides increasing the range of investment options open to investors, this policy will lead to greater certainty for issuers and distributors when considering what sort of financing mechanisms and exit strategies should be included in the design of the security.

5.2	Should we exclude other types of securities as well?

At this point, no. The regulator should be wary of excluding specific classes of securities unless sufficient empirical evidence is brought forward to indicate that a harm is occurring to investors and a category-wide ban is the most cost-effective or efficient solution available.

6.	Specified derivatives and structured finance products cannot be distributed under the OM Prospectus Exemption. Should we exclude other types of securities in order to prevent complex and/or novel securities being sold without the full protections afforded by a prospectus?

In an established market characterized by informed trading in OM-exempt securities, the ideal policy position would be to enforce the principle that when an offering is made with more novel or complex securities, disclosure should be more expansive, particularly risk disclosure. Fortunately, the template of the offering memorandum is so broadly worded that it need not be amended in order to allow for enhanced disclosure when necessary. This will help ensure the OM exemption remain an avenue for the distribution of as many types of securities as practicable while still promoting capital raising and preserving investor protection.

However, in the case of newly established, fledgling market in OM-exempt securities, characterized by sporadic levels of trading and irregular flows in trade-related information, the exclusion of complex and novel securities from clouding the regulator's purview is at the least prudent and probably advisable. Among other things, such exclusion will simplify the regulator's job out of the starting gate by letting it more fully focus on the initial task of establishing a fair and efficient market trading in the more commonly issued kinds of OM securities. It is quite possible that the OSC will soon find itself in a situation where it has approved the use of three or four new prospectus exemptions and is tasked with tracking and monitoring a series of new and unanticipated problems

in all of them. A prudent allocation of regulatory resources suggests that new and especially complex securities be kept off the regulator's watch-list until the market is more established.

Once Ontario has shown that it has an OM exemption which meets the needs of capital raisers but maintains appropriate levels of investor protection, then the OSC can determine what sorts of more exotic securities may be useful to permit under the OM exemption.

Moreover, if the OM exemption is offered in conjunction with one or more of the other exemptions currently under consideration in the *Request for Comment*, then because of the range of exemptions suddenly available to Ontario's issuers, it is not likely that that the exclusion of complex and/or novel securities will lead to a negative impact on capital raising, at least for start-ups and small- to medium-sized issuers.

If, in the years to come, Ontario develops a flourishing exempt market in OM-exempt securities, then the OSC may wish to consider permitting more complex securities instruments to be brought to market. If it does so, then it should seek to promote: (1) harmonization with the types of securities other provinces permit under their OM exemptions; and (2) the distribution of securities with more sophisticated mechanisms for returning capital to investors once the issuer completes its exit phase strategy.

Offering parameters

7.1	We have not proposed any limits on the length of time an OM offering can remain open. This aligns with the current OM Prospectus Exemption available in other jurisdictions. Should there be a limit on the offering period?

We do not believe that there is any need for Ontario, if it adopts an OM exemption, to inhibit capital raising by imposing a time limit on the permissible offering period. In the absence of any policy argument for limiting the offering period, the OSC should ensure its OM exempt market is in harmony with the rest of Canada's.

7.2	How long does an OM distribution need to stay open?

The best answer to this question is that it depends a calculation based on the type of security the issuer wishes to issue, the number of securities it wishes to issue, and the amount of capital it wishes to raise, as well as any unusual or unique characteristics of the issuer and, to a lesser extent, of its industry category; i.e., is the issuer in a market category which is prone to cyclical variations in the speed of its distribution?

As well, the OSC would need to review empirical evidence, including historical data, to properly evaluate the degree of undue risk exposure to consumers due to stale disclosure or other concerns directly tied to the length of the OM-exempt securities offering period.

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7.3 Is there a risk that "stale-dated" disclosure will be provided to investors?

Theoretically this is always a risk, yet the evidence from other jurisdictions in Canada suggests that in practical terms this is not such a material risk that Ontario needs to depart from the practices of other exempt market regulators. Ontario should of course ensure that issuers understand the obligation to update the text of the offering memorandum in the event of material changes to already provided disclosure. In short, if the disclosure is up to date, the OM offering should remain open.

Registrants

8. Do you agree with our proposal to prohibit registrants that are "related" to the issuer (as defined in National Instrument 33-105 *Underwriting Conflicts*) from participating in an OM distribution? We have significant investor protection concerns about the activities of some EMDs that distribute securities of "related" issuers.

We find it problematic that the *Request for Comment* does not indicate in sufficient detail what evidence the OSC is relying on to support its decision to preclude issuers from distributing OM-exemption securities through a related dealer. Advocis does not believe there should be a prohibition in respect of registrants that are related to the issuer. We note that no such restrictions currently exist under the existing form of the OM exemption in Canada. Indeed, other than Ontario and New Brunswick, no CSA member has proposed such a ban.

Since the OSC first released its proposed restriction on related party product distribution on March 20, 2014, a number of advisory industry stakeholders have in various formal and informal channels expressed strong views on the matter. A consensus view has emerged that that the regulatory focus on related party product distribution under an OM exemption is somewhat odd, given that the affiliated or in-house dealer who is engaged in retailing only the one issuer's product is a mainstream method of distribution for banks and insurance companies.

Problems with the OSC's proposed ban on related party product distribution

To restrict related party product distribution in the establishment of an OM-exempt market is a distressing regulatory precedent. There is simply no evidence that this long-standing, widely-used traditional distribution model is now unsuitable for Ontario's issuers and individual investors.

Advocis members know first-hand that many advisors in the mutual fund sector regularly sell proprietary products. Some do so exclusively. The model of a financial advisor or investment dealer distributing the products of a related issuer (or, indeed, of any advisor distributing any financial product, from life insurance to guaranteed income certificates) is a time-tested model which yields proven economic efficiencies – and one which has shown itself amenable to the evolving suitability requirements of KYP and KYC and the ongoing roll-out of the Client Relationship Model.

Our members who are IIROC-licensed are regularly asked to promote and sell to the public a wide range of securities, including manufactured financial products and shares issued pursuant to an initial public offering. When the broker is employed by the same institution that underwrites the offering, or creates the financial product, we see evidence of a similar level of potential bias or conflict. However, we see insufficient evidence that exempt market dealers or IIROC-licensed advisors are harming the public as a result of this potential conflict.

The impact of banning related party products

Under the related party prohibition, companies seeking to raise capital will be prohibited from retaining a related registered dealer or even a registered affiliate to sell its securities pursuant to the OM exemption. This means issuers with in-house registered dealers — including mortgage investment corporations, real estate investment trusts, and oil and gas companies— will be effectively barred from selling the securities of their own issuers to Ontario investors. To do so, these issuers will have to employ a third party dealer, which will add an additional layer of cost – and perhaps risk, since third party distributors also face incentives to engage in mis-selling. These incremental increases in cost will ultimately be passed on to and paid by the consumer. The increased transaction costs and fees (and perhaps commissions and sales bonuses) incurred through the regulator-mandated involvement of an outside, third-party dealer – even though a less expensive in-house one is available – will, in the end, reduce the proportion of the funds flowing from investors which can be converted into capital for issuers. All other things being equal, the third-party dealer will always take a larger portion of those fund flows, given it is not as closely monitored as the in-house dealer, and in fact has the issuer at a regulated disadvantage, since the issuer will have to deal with it or one of its competitors (who also face the same incentive to charge slighter higher costs than their in-house counterparts). If the same amount of capital is raised by an in-house dealer and by a third-party dealer, the inevitable result is a reduction in the sum of money which actually ends up deposited in the issuer's account.

It is unlikely that any but a handful of start-up businesses or small- to medium-sized enterprises will find it cost-effective to establish a related registrant to sell its securities. However, there will be without doubt a certain number of shrewd and financially sophisticated entrepreneurs who would prefer the ability to rely on the acumen and expertise of a professional financial advisor to distribute their investment products in as an effective, professional, and expeditious manner as possible – and to do so through a relationship of such relative proximity that it promotes the establishment of trust and the unconstrained exchange of information common to that found between parties devoted to a mutual enterprise. Such proximity characterizes the relations between the issuer and the in-house or even affiliated dealer. Denying experts the ability to harness the skills of other experts will stand in the way of effective capital formation and impede the ability of the more promising investment opportunities from being presented to investors in a timely and compliant manner.

In short, the related party prohibition will have a significant impact on any issuer which has an in-house registered dealer. The added transaction costs of distributing securities through an independent dealer will in the end be borne by the consumer.

Is the ban driven by regulatory concerns over a possible conflict of interest, or suitability requirements?

The differential treatment by the regulator of exempt market investment products as against public equity investment products can be stated this way: while the proper application of Know Your Product, Know Your Client and other suitability assessments conducted by an issuer's related dealer in the distribution of mutual funds are sufficient in the eyes of the regulator to permit the purchase of a mutual fund security by a retail investor, in the exempt market those same required Know Your Product, Know Your Client and related suitability assessments, while still conducted by the issuer's related registered dealer, are now *no longer sufficient* in the eyes of the regulator to permit the purchase of the security by the retail investor. This result will occur even if it is the same advisor and the same client involved in both purchases.

The OSC's position, therefore, amounts to a public statement that the policies and procedures used to mitigate conflicts of interest and assess suitability in our public equity markets are not adequate for the lower-volatility, lower-trading-volume products on sale in the exempt market. But without the relevant data, one is forced to ask if the regulator's supposition is really true.

In the absence of clear and compelling empirical data and analysis of the same, the rationale for the ban on related party product distribution becomes less an *experiential* justification and instead largely or even purely a *conceptual* one. It would seem that the conceptual basis for such a prohibition can only be that the OSC believes that in the exempt market there are conflicts of interest between the issuer and the related dealer so insurmountable that even: (1) disclosure of the possible conflict, (2) full application of all suitability requirements, and (3) enhanced product and risk disclosure for exempt market products, whether are separately or together, are not sufficiently curative in nature to permit even an eligible or accredited investor who is relying on professional financial advice from a registrant in his jurisdiction to purchase the product.

On the face of it this is puzzling: the offering memorandum and the risk acknowledgement forms used in the exempt market contain much more information about the investment and its hazards than the Fund Facts document used in the public equity markets. So, despite the rigors of the new National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, and in the absence of empirical data which would tend to support the claim that the new National Instrument is not working, the regulator is taking the position that a retail investor simply cannot be allowed to purchase a security – even a security which comes with the extensive disclosure supplied in an offering memorandum – if the suitability requirements are applied by an advisor employed by a dealer firm related to the issuer.

What is the harm? Where is the evidence?

The OSC states that through compliance reviews it has identified significant compliance issues with exempt market dealers which distribute securities of "related issuers" and "connected issuers" as those terms are defined in National Instrument 33-105 *Underwriting Conflicts*. An OSC sweep in 2013 of 45 registered exempt market dealers revealed that almost one in five had sold securities to

investors who did not qualify under the exempt market's current accredited investor criteria. What's more, a number of these dealers routinely failed to disclose to investors the fact that the investments were instances of related party product distribution.

After a review of the results of this sweep of related party dealers involved in real estate investments, the OSC seems to have reasoned that since the OM exemption will expand the class of investors to whom an exempt market dealer may deal securities to include non-accredited retail investors, then the past non-disclosure of related party distribution in the sale of real estate investment products to accredited investors will be in the future repeated writ large across *all* OM-available asset classes and will be expanded to include non-accredited retail investors.

This calculation of investor risk exposure from exempt market dealers related to particular issuers is being made, of course, before a *single* product has been sold in Ontario pursuant to an offering memorandum by a fully independent or fully in-house dealer which was issued by either an established or newly founded reporting or non-reporting issuer. Placing such constraints on the still-to-be-implemented OM exemption may in fact further exacerbate levels of investor risk in product distribution, instead of eliminating them.

At this point, we should consider the obligations exempt market dealers currently face with regard to disclosure. At present, an exempt market dealer is not permitted to make a recommendation to buy, sell, or hold a security issued by the exempt market dealer, or by a "related issuer" or "connected issuer" of the exempt market dealer, unless the exempt market dealer discloses the nature and extent of the relationship or connection between the firm and issuer.

Is the problem flagged by the OSC caused by confusing disclosure requirements?

National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* sets out in section 13.6 the disclosure requirements for exempt market dealers who have relationships with related and connected issuer. However, and it is suggested by industry observers that this may be a partial source of the problem identified by the OSC, many exempt market dealers are not aware that their related and connected issuer disclosure requirements are also set out in NI 33-105. The result of the gap in knowledge is that some exempt market dealers incorrectly believe that NI 33-105 *only* applies to registered investment dealers who act as underwriters in prospectus offerings.

Section 2.3 of the *Companion Policy* to NI 33-105 makes it clear that the disclosure obligations in NI 33-105 generally apply to exempt market dealers who act as a principal or an agent in connection with most types of prospectus-exempt distributions, including distributions made in reliance on the accredited investor exemption in section 2.3 of National Instrument 45-106 *Prospectus and Registration Exemptions*. Confusion among exempt market dealers on disclosure has apparently arisen from the fact that, in Ontario, NI 33-105 does not apply to exempt market dealers selling mutual fund securities or certain exempt markets securities, including forms of securities of private investment funds or loan and trust pools, securities issued by co-ops and credit unions, and debt

securities issued or guaranteed by the federal or provincial governments. So certain exempt market dealers in Ontario have been unaware that their disclosure obligations under NI 33-105 even exist, or if they are aware they exist, are apparently unaware that while these disclosure requirements are not applicable to certain securities, they do apply to prospectus-exempt real estate investment products.

Again, let us reiterate that it is the OSC's position that neither disclosure by the advisor that the dealer firm is related to the issuer, nor a properly executed risk acknowledgement form, nor even the investor making recourse to independent financial advice from a registered advisor of his choosing, prior to purchase, can sanitize or otherwise save this transaction.

Given the fact that the relatively new disclosure obligations of exempt market dealers are spread across several national instruments and also vary across provinces, it is not entirely surprising that there is some confusion on the part of exempt market dealers as tie their obligations *vis-à-vis* any given retail investor. This confusion is no excuse, but surely the first step in ameliorating the problem is to enhance the knowledge and education requirements of exempt market dealers, rather than introducing a categorical ban on tied dealers for an entire class of securities.

Because of the pronounced lack of empirical evidence, even if just in the form of rough data from the field, on the investment products which gave rise to the OSC's concerns, we do not believe that the OSC's proposed ban can be justified. It seems to us that the OSC' concerns are therefore not based on real-world disclosure concerns connected to the asset classes most commonly allocated under the OM exemption, such as real estate. Instead, we believe that the OSC's entire justification for the ban on distributing related party products stems from its identification of a possible perceived conflict of interest and its unsupported corollary assumption that all curative measures are insufficient.

It is an inevitable consequence of human interaction that conflicts of interest do in fact arise. When they do, it is then necessary to determine the nature and scope of the harm – if, indeed, there is one. In the case at hands, if there is a harm of sufficient impact on investors to warrant the consideration of possible regulatory intervention, then the first and least intrusive response is to ensure mandatory disclosure of the relationship between the distributor and the producer. While the actions of exempt market dealers who fail to disclose their involvement in related party product distribution are clearly inexcusable, those actions are not an excuse for the OSC to shut down the entire OM category for all advisors and dealers before they (or anyone) have even had the *possibility* of exercising their ability to access it.

Instead, at this stage the regulator should issue guidance to the apparently non-compliant dealers and engage in various forms of monitoring, perhaps including compliance sweeps, to determine if guidance on disclosure is an effective curative measure. This has been a regulatory response of proven efficacy in other Canadian jurisdictions, in numerous foreign jurisdictions, and of course in Ontario itself.

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Additional problems entailed by allotting priority to concepts over proof

The establishment of a ban on related party product distribution decision seems to have been made by the regulator at the purely conceptual level, without any cost-benefit analysis that is informed by timely empirical data. In short, it is a regulatory categorization made on an *a priori* basis that a long-used method of distribution is unsuitable. As such, it is also a pre-judgment — and a statement of conclusion — and one made apparently without informed comment from the stakeholders who stand to be most impacted by it, and without current and relevant empirical evidence. For the regulator to undertake such a decision and frame the debate on the future of a significant part of Ontario's exempt markets is distressing from the point of view of Ontario's entrepreneurs, venture capitalists, small business persons, and any investors who seek investment opportunities which fit with their own portfolios' unique risk/reward calculus, particularly those persons interested in early-stage, potential high–reward investment products.

The onus rests with the regulator to make its case: have it collect data

It may well be that an outright ban on practicing this method of product distribution is appropriate and justifiable. But that appropriateness and justifiability cannot be *known* without resort to an informed evaluation of the practice of advisors and dealers in all of its "in-the-field" actuality. We believe it is incumbent on OSC to make present its case on a factually-informed basis; therefore, we would urge the OSC to permit related party product distribution while simultaneously requiring that the buyers and sellers of related party products submit useful data to the regulator. This avenue will enable the OSC to make a fair and informed decision on this distribution model and avoid creating the perception among stakeholders that the regulator has arbitrarily exercised its prerogative to create what in effect would be a partial product ban for retail investors and a very damaging barrier to entry for issuers seeking to raise capital through their trusted dealer associates.

An alternative regulatory response

It should at this stage be clear that it will be highly problematic for the OSC to prohibit a model for the distribution of securities which has proven to work in other OM jurisdictions in Canada on the basis of a perception of improper disclosure and conflicts of interest arising in the future among different dealers, issuers and investors. Along with the additional industry guidance suggested above, part of a proportionate regulatory response would include reliance on enhanced versions of industry-accepted tools of conflict mitigation, including, for example, a risk acknowledgment form specific to related party product distribution under the OM exemption:

> You are purchasing an investment product from a distributor who is related to the issuing entity of the product and may therefore be seen as having a strong incentive to sell you this product. As an investor you should be aware of your rights to the full application of product and client suitability requirements to ensure that this investment is suitable for you. You should consider seeking professional financial advice from a financial advisor registered in the province in which you reside prior to purchasing this investment product.

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The OSC should permit related party products to be sold under the OM exemption and consider a pilot program of monitoring such distributions so that its staff may be in a position to determine if proper adherence to suitability requirements by the related or in-house exempt market dealer is occurring.

In sum, in the absence of empirical evidence and a cost-benefit analysis from the OSC – the latter being a part of its mandate – a total prohibition on related party product distribution seems a very disproportionate response, disruptively so, as there is no current jurisdiction in Canada which has implemented such a ban. A balanced assessment of the costs and benefits of such a ban should form part of a justificatory statement from the OSC on why it proposes to preclude related party product distribution under the OM exemption.

The situation as it stands now

There is no evidence that the lack of disclosure of related party product distribution by certain exempt market dealers in Ontario was anything but a sin of omission. Imputing the sins of a small group of exempt market dealers to *all* current and future exempt market dealers is wrong. Doing so does little for the overall and ongoing promotion of investor protection and capital raising. Importing those sins from one set of investor and product categories to a second, still-to-be-created set of investor and product categories is just as clearly wrong. Doing so in order to provide justification for the proposed creation of regulatory barriers previously unknown in Canada is classic regulatory overreaction. Permitting the proposals to be implemented un-amended will be classic regulatory overreach.

9.1	Concerns have been raised about the role of unregistered finders in identifying investors of securities. Should we prohibit the payment of a commission or finder's fee to any person, other than a registered dealer, in connection with a distribution, as certain other jurisdictions have done?

Yes. The CSA has been gathering evidence that non-registrant persons – chiefly, finders and referral agents – are engaging with investors in registerable selling activities. As non-registrants, they are not subject to formal oversight, so it is entirely appropriate that the OSC move to restrict their activities in the exempt market. There are significant investor protection concerns relating to the provision of unauthorized advice and the ability of regulators to oversee and regulate individuals participating in the market should be a paramount concern of all responsible stakeholders.

Regulators should recognize that there is nothing wrong if an unregistered person on occasion engages in activities such as suggesting an investment or otherwise advising the interlocutor to contact the dealer, as long as they are not doing so with any regularity, for a business purpose, and for compensation.

However, persons who carry out these activities for a business purpose should be registered. Given the risks to one's investment principal and the general levels of illiquidity presented by the typical

exempt market security, investors who are considering such a purchase will be better protected if as much of the process of engaging, discussing and selecting possible investment options is conducted by a registered advisor or dealer.. Even if the transaction is turned over to a registrant prior to the formal confirmation of the suitability review – the use of a non-registrant will always put investors at greater risk – even if a regulator reviewing the transaction found the steps taken by the non-registrant to be, in a purely notional sense, fully compliant. Similarly, the use of non-registrant finders and agents will always disadvantage the regulator and lead to greater risks of non-compliance within the particular prospectus exemption being used by the issuer.

9.2 What role do finders play in the exempt market?

In Ontario, finders are used to assist the capital-raising efforts of issuers listed on the TSX Venture Exchange, as well as some private companies which are considering becoming publicly owned ones.

9.3 What purposes do these commissions or fees serve and what are the risks associated with permitting them?

The finder's fee is compensation for locating and introducing participants in private placements conducted by the issuer. The risks to a retail investor are most acute when: (1) unregistered persons, like finders, undertake the selling and advising activities of an advisor or dealer, and (2) receive commissions for the sale, which gives incentives to further repetitions of the transgressive behaviour and perversely legitimizes the transaction in the eyes of the investor. These non-registrants can at times operate in the shadows and thus marginalize the regulator, which reinforces in unethical non-registrants that the regulator does not and in fact cannot know what is being transacted, which leads to the inevitable result that investors are further exposed to more unnecessary risk.

Many finders are not OSC registrants – registered advisors or dealers – and so are beyond the range of many OSC, MFDA and IIROC requirements and enforcement and disciplinary mechanisms. Yet they lack the necessary expertise and licences to perform trade-related activities properly. As the CSA has noted, finders and other unregistered persons who conduct "acts in furtherance of a trade" are typically:

1. distributing offering and marketing materials involving a potential investment;
2. preparing and disseminating forms of agreements for signature by investors;
3. conducting information sessions with groups of investors; and
4. meeting and communicating with individual investors.

When unregistered persons are essentially performing registerable selling activities but then attempt to "sanitize" the trade by redirecting the investor to a registered dealer to conclude the last stage of the transaction, the investor may think a regulator-sanctioned trade has been performed and all KYC, KYP and other suitability requirements properly adhered to. The investor may think that

all necessary rules have been followed, when in fact they have not. The result is always unnecessary and undue risk exposure for investors.

9.4	If we restrict these commissions or fees, what impact would that have on capital raising?

We believe that restricting the commissions and fees of finders will ultimately have a negligible impact on capital raising as companies will instead engage with registrants who will perform the same functions.

If this belief is wrong, that it may be that compensation for connecting an issuer with an investor should be permitted, as long as the investor understands through documentation provided by the finder the central importance of various suitability requirements such as Know Your Product and Know Your Client obligations and that these requirements *must* be applied to the investor by the dealer. It may be that a finder's category of registrant should be created to allow for the payment of fees from the issuer to the finder on a contingent basis. The contingency fee would be paid if the investor was deemed, upon evaluation by the dealer, to have been a suitable investor for the security.

Investor qualifications – definition of eligible investor

10.1	We have proposed changing the $400,000 net asset test for individual eligible investors so that the value of the individual's primary residence is excluded, and the threshold is reduced to $250,000. We have concerns that permitting individuals to include the value of their primary residence in determining net assets may result in investors qualifying as eligible investors based on the relatively illiquid value of their home. This may put these investors at risk, particularly if they do not have other assets. Do you agree with excluding the value of the investor's primary residence from the net asset test?

In general, Advocis disagrees with the decision to exclude the value of the primary residence from the net asset test for individual eligible investors. Ontario is the only jurisdiction currently proposing the implementation of such exclusion. Moreover, the OSC has not provided arguments in support of this change. At least Alberta, Quebec and Saskatchewan have meanwhile recognized the need to conduct further research and analysis in respect of the consequences of excluding the principal residence. Given the lack of an articulated argument supported by empirical evidence, we do not believe that a case has been made that the exclusion is necessary.

However, we would note that if the OSC does intend to adopt an automatic exclusion of the value of the individual's primary residence from the net asset test, it should consider allowing for an exception to the exclusion, based on the size of the ownership interest the individual has accumulated in the primary residence. This would mean that individuals who have a significant equity interest in their homes, but fall short on the net asset test, could still qualify as eligible investors. And in turn, this would mean that persons who are committed savers and have almost

retired the mortgage on their primary residence would be able to access exempt market products. Such products typically come with lower volatility but more illiquidity and are generally a fit with the investment profile of committed savers.

We would therefore suggest that if the individual's mortgage is at or under 20 per cent of the primary residence's current market value, and if the individual has received advice on the risks of the transaction from a registered advisor, such as an "eligibility advisor," then he should be permitted to include the residence's value in the calculation of his net assets under the eligible investor test. Of course, the OSC would need to determine if such an amendment would be problematic in so far as it would create disharmony with the OM exemption in other provinces and territories.

10.2	Do you agree with lowering the threshold as proposed?

We would be interested in seeing Ontario retain the old test while introducing the proposed new test with its lower threshold and exclusion of the primacy residence for the determination of net assets. This might yield useful information about how well Ontarians evaluate investment risk and liquidity when considering the allocation of their assets to high-potential investment opportunities. Such information could assist regulators in crafting more informed policy and help issuers develop better pricing strategies for future investors.

11.1	An investor may qualify as an eligible investor by obtaining advice from an eligibility advisor that is a registered investment dealer (a member of the Investment Industry Regulatory Organization of Canada). Is this an appropriate basis for an investor to qualify as an eligible investor?

Advice from an IIROC member is an appropriate basis on which to qualify an investor as an eligible advisor, given the Know Your Product and Know Your Client requirements and other suitability-related obligations. We would suggest that the OSC require that an eligible advisor, in cases where the offering memorandum documentation indicates that the issuance is for an early-stage, high-potential, growth start-up company, be obligated to indicate to the investor what experience and expertise he possesses with high risk early-stage investments.

11.2	Should the category of registrants qualified to act as an eligibility advisor be expanded to include EMDs?

Exempt market dealers are under robust Know Your Product and Know Your Client requirements and other suitability-related obligations; therefore, we are comfortable in suggesting that those dealers who have additional experience or expertise in conducting due diligence-style research to evaluate statements made in offering memoranda should be able to provide investors with sufficient protection. As such, they should be able to qualify as an eligible investor. Our reasoning is that suitability-based advice is always a much stronger level of investor protection for any given

individual retail investor than a "bright line" test based on net assets and/or the income from the last two calendar years plus the current year's anticipated income: a proxy for the ability to withstand investment losses should always be accorded a lower priority than tailored or individualized professional financial advice from a registrant who discharges all relevant duties connected to suitability requirements.

Investment limits

12.1 Do you support the proposed investment limits on the amounts that individual investors can invest under the OM Prospectus Exemption?

The OSC's proposed investment cap of $30,000 a year under the OM exemption for retail investors will make it much more expensive and time-consuming for companies to raise capital, as they will now have to seek out significantly increased numbers of individual investors. Ontario has apparently convinced New Brunswick to follow its lead on introducing aggregate annual investment caps; other jurisdictions, including Alberta, are also at least considering it.

Any change to the OM exemption must should take into account the nature of its use by issuers and investors: as noted earlier, in western Canada the most important uses of the OM exemption is for the purchase of flow-through shares (mainly in the mining sector) for clients with incomes beginning at $80,000, although it is also used for real estate investments (mortgage investment corporations, land development, etc.).

OSC-sanctioned undermining of professional financial advice and suitability requirements

The OSC does not offer a satisfactorily explanation for its proposal to place an investment limit on a retail investor who wishes to purchase a security from a registered dealer, even if: (1) the investor is an eligible investor; (2) the investor has duly executed a risk acknowledgement form; and (3) the investor willing documents the fact that he or she is acting in reliance on professional financial advice from a registered advisor.

Under the OSC's proposal it is possible for an investor with net assets of $400,000 to be prohibited from investing in more than $30,000 of suitable exempt market securities. But another investor, one with twice as much in net assets, $800,000, may be told by his advisor that an exempt market product priced at $25,000 is wholly unsuitable for him, given his vastly different life situation, portfolio structure, and unique investment needs and goals. Still another investor, also with net assets of $800,000, but who does not qualify as an accredited investor, may be freely permitted to invest in more than $30,000 of suitable exempt market securities.

These fact situations indicate why registered advisors and dealers have suitability obligations. The OSC's decision to in effect remove their ability to exercise their professional judgment to assess and evaluate the suitability of an investment for a client is problematic – and not just for advisors, but also for their clients and for issuers of capital.

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It cannot be emphasized enough that members of the CSA have existing jurisdictional capabilities to investigate and pursue regulatory action in the event an investment product is sold which is unsuitable for a client because of the nature of the client or the product, including the size of the investment.

It is because of the uniqueness of every individual investor that the regulators have brought in suitability rules. Though this is a somewhat tired truism, it is still true. The rules exist and they should be allowed to function – and perhaps up to the point where they seem they may seem open to future malfunction. The information which can be extracted from such situations can be valuable and may assist in the creation of more responsive regulatory policy. It is better to replace a broken part than trash the whole enterprise.

The OSC needs to show investors and issuers it has confidence in the regulatory framework it has developed in conjunction with other stakeholders. The OSC needs to permit registered advisors and dealers to perform their jobs in a professional manner, to gather convincing evidence to document cases in which they are failing to perform professionally, and to then suggest proportionate and minimally disruptive responses, such as: (1) issuing regulatory guidance to further clarify how suitability may be executed in a cost-effective, compliant manner under the OM exemption; (2) enhancing educational standards in certain specific areas for intermediaries; or (3) creating outreach programs for consumers to increase their levels of financial and regulatory literacy.

Lack of evidence and cost-benefit analysis

Finally, the OSC has not offered any Ontario-based data to justify the sum of $30,000 as the proposed limit. Nor has it provided any evidence or analysis to scope out the negative impacts of the proposed limit, such as the number of times an eligible investor will be barred from making an entirely suitable investment solely because it costs $30,001 or more. Nor has the OSC made an effort to determine the impact on individual issuers seeking to raise capital, or the impact on Ontario's capital raising when considered as a sum total.

In general, then, we do not believe that the imposition of limits on the annual amount a retail investor, whether non-eligible or eligible, can invest under the OM exemption is appropriate. The *current* Alberta model is, we believe, what Ontario should implement. However, the OSC should require the use of a risk acknowledgement form which describes the possibility of losing all of one's money in certain OM investments, and the dangers allocating more than 10% of one's capital in an illiquid security.

The ability of the aggregate annual limit to fulfill its stated purpose seems doubtful

It is not at all clear that the proposed aggregate annual investment limit will stop any of the losses which it is apparently designed to prevent. Indeed, most of the scandalous losses which continue to animate much of the current regulatory concern over the exempt market occurred well before September 2010 and the advent of the new National Instrument 31-103 *Registration Requirements and Exemptions*. In those losses, bogus issuers advertised and sold directly to the general public. We

are unaware of data which can reliably attribute even a small amount of these impugned investment products – indeed, if any – to sales conducted through registered independent exempt market dealers who carried and provided advice on a wide array of products.

In addition, forcing annual investment caps on legitimate exempt market dealers who perform all applicable suitability requirements is especially problematic, since bogus issuers can simply bypass the exempt market dealer channel. (In western Canada the Northwest exemption is a readily available option for bypassing normal channels of distribution).

Effective enforcement of the aggregate annual limit seems unlikely

It will prove exceptionally difficult, if not practically impossible, for the exempt market dealer channel to track and police compliance by investors regarding their annual investment limits. For an exempt market dealer to try to monitor and enforce the annual cap for even just a single client would be an exercise in intrusive questioning and re-questioning, one which would potentially cause serious harm the advisor-client relationship. There is simply no way for a dealer who has sold his client $30,000 of, for example, flow-through shares to "know," even if "knowing" only means on the balance of probabilities, that the client did not make the same purchase from the dealer across the street fifteen minutes earlier.

If a client investor, through omission or commission, fails to provide the advisor or dealer with an accurate tabulation of investments made under the cap, and subsequently compliance action is required, the spectre is raised of the advisor then being forced to attempt to unwind an illiquid investment – even though the advisor fulfilled all suitability requirements and documented the client's statement that the purchase would not exceed his annual investment cap.

Tracking the purchase of exempt market securities under the OM exemption across all issuers and asset classes for all investors for a 12-month period will be a mammoth undertaking for the exempt market dealer channel, regardless of whether or not the final responsibility lies with the individual investor to make proper disclosure to the dealer, or whether the responsibility for gathering, recording and reporting information on an investor's aggregate annual investments is apportioned among issuers, dealers and investors.

In the final analysis it is only the issuer who can determine when an individual investor has reached his or her annual limit – and that limit can only be known in terms of the products distributed by that particular issuer.

Amending the proposal

If the OSC is absolutely determined to apply aggregate annual investment caps to retail investors, Advocis suggests that the caps be adjusted upwards and only be applied to related exempt market dealers – those dealers who are essentially tied to one related party product issuer, or are otherwise a related dealer, including of course dealers under the in-house model. Registered exempt market dealers who diligently fulfill their suitability obligations and are not tied-product or tied-party sellers

should not have their advice and product shelf made subject to the limitations of the proposed aggregate annual investment cap.

12.2 In our view, limits on both eligible and non-eligible investors are appropriate to limit the amount of money that retail investors invest in the exempt market. Are the proposed investment limits appropriate?

For the reasons outlined above, we are in general opposed to the idea of blanket annual investment limits which apply to such broad classes of retail investors – and particularly so when the restrictions are directed at investments which come with a fair degree of independently reviewed or audited disclosure. However, given the concerns the OSC may have about implementing and regulating an OM exemption for the benefit of investors who are essentially newcomers to the offering memorandum, it may want to require retail investors who are not accredited investors to execute a properly worded risk acknowledgement document and seek advice from a registered advisor on the specific characteristics of the security, and its suitability with regard to the investor's overall portfolio and financial planning.

Point of sale disclosure

13.1 Current OM disclosure requirements do not contain specific requirements for blind pool issuers. Would blind pool issuers use the OM Prospectus Exemption?

It should be noted at the outset that blind pools raise investor protection concerns. The OSC would do well to conduct a cost-benefit analysis before permitting blind pools to use the OM exemption. Given the amount of retail capital that blind pools would likely raise from the OM exemption, and the level of risk involved, it may very well be imprudent to allow blind pools to use the OM exemption. Overall, there would seem to be little need for blind pools to be allowed to use the OM exemption. However, some blind pool issuers would at least attempt to make use of the OM exemption if they are permitted to do so.

Is not at all clear how much success issuers without a business plan are likely to have in convincing retail investors who are properly advised to invest in blond pool securities without first conducting a significant degree of due diligence. Blind pool issuers will be competing with more straightforward OM-exempt securities which set out the nature of the proposed business, its goals and milestones, and a coherent plan for attaining therm. The absence of such information is likely to be inhibitive to retail capital seeking out blind pools. Accordingly, we would not expect blind pools to be able to raise significant amounts of retail capital over the long term, as they would be competing with securities from existing or start-up businesses which will in contrast be disclosing what are essentially detailed business plans.

Again, we would expect the OSC to focus its efforts on establishing an exempt market for the more commonly issued securities before allowing blind pool issuers.

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13.2	Would disclosure specific to a blind pool offering be useful to investors?

Yes. Retail investors will want specifics in order to make an informed investment decision about a blind pool issuer. If blind pools are permitted to use the OM exemption, a starkly worded risk acknowledgment form and the requirement for professional financial advice would seem to be absolutely necessary forms of investor protection

14.0	We are not considering any significant changes to the OM form at this time. However, we are aware that many OMs are lengthy, prospectus-like documents. Are there other tools we could use at this time (short of redesigning the form) to encourage OMs to be drafted in a manner that is clear and concise?

The forms used for an offering memorandum quite purposefully contain open-ended questions to allow for – and in fact encourage – significant disclosure. The result is that a maximal amount of disclosure is generally provided. This is no bad thing for retail investors or their advisors; if an investor, advisor or dealer feels overwhelmed by the nature or amount of disclosure, then they should not be seeking to participate in the exempt market.

While there are other tools – in particular, other forms of disclosure documents with fewer questions, which are of a more restrictive nature – which the OSC could borrow from so that offering memoranda are drafted in a more clear and concise manner, we believe it would be ill-advised for Ontario to launch an OM exemption which does not replicate the essential template which has been used in other jurisdictions.

The current Alberta model would be our candidate for the OSC to follow. We are of the position that the launch of a market in OM-exempt securities in Ontario is not the time to introduce changes to a proven model which would limit disclosure to investors. It should be remembered that it is concerns about liability which have been one of the key drivers in the increased level of disclosure in offering memoranda in several provincial jurisdictions.

Advertising and marketing materials

15.0	In our view any marketing materials used by issuers relying on the OM Prospectus Exemption should be consistent with the disclosure in the OM. We have proposed requiring that marketing materials be incorporated by reference into the OM (with the result that liability would attach to the marketing materials). Do you agree with this requirement?

Yes. We would also emphasize that marketing materials should be required to reproduce the type of language found in many risk acknowledgement forms about the risk of loss of the investment principal and the ongoing exposure to illiquidity risk which is associated with many exempt market securities.

Ongoing information available to investors

16.1	Do you support requiring some form of ongoing disclosure for issuers that have used the OM Prospectus Exemption, such as the proposed requirement for annual financial statements?

Of special concern here will be the treatment of non-reporting issuers. As we understand the proposals, in order to rely on the OM exemption they will be required to deliver to investors (1) audited annual financial statements (within 120 days of their most recently completed financial year) and (2) a notice outlining the aggregate use of the proceeds raised by the issuer pursuant to the OM exemption.

As well, there will be some additional continuous disclosure obligations for non-reporting issuers relying on the OM exemption, such as notification of investors within 10 days of a fundamental change; a significant change to the issuer's capital structure; a major reorganization, amalgamation or merger; a take-over bid or issuer bid; or a significant acquisition or change to the directors and officers of the issuer. All of this is information which should be made available to investors.

Given the foregoing, our answer is a conditional yes: since adding ongoing disclosure requirements will increase costs for issuers and ultimately for investors, thereby further narrowing the cost differential between financing via a prospectus as against an offering memorandum, the OSC may consider limiting its proposed ongoing disclosure obligations to certain industry categories it deems open to fraud, abuse, or undue investor risk. The gains yielded by this approach would be offset by the problems caused by the introduction of further inconsistencies in OM disclosure requirements across jurisdictions.

16.2	In our view, this type of disclosure will provide a level of accountability. Should the annual financial statements be audited over a certain threshold amount?

Yes.

16.3	If the aggregate amount raised is $500,000 or less, is a review of financial statements adequate?

Yes.

17.0	We have proposed that non-reporting issuers that use the OM Prospectus Exemption must notify security holders of certain specified events, within 10 days of the occurrence of the event. We consider these events to be significant matters that security holders should be notified of. Do you agree with the list of events?

Advocis believes that requiring non-reporting issuers to notify security holders of specified events within ten days will increase the costs associated with financing under the OM exemption. We are

not certain about the value of the benefits such disclosure will bring, and so cannot determine if it is worthwhile on a cost-benefit basis. A related consideration is whether the proposed ten-day disclosure will create harmony or disharmony with other jurisdictions using the OM exemption.

That said, a fundamental change in the issuer's business, such as a significant change to the issuer's capital structure, or a major reorganization, amalgamation or merger, and changes in the composition of its directors and executive officers, all seem to us to be events which of necessity must be disclosed.

18.0	Is there other disclosure that would also be useful to investors on an ongoing basis?

Immediate disclosure of formal demands for payment from current creditors and suppliers, notices related to bankruptcy, insolvency or credit restructuring, and the commencement of legal proceedings, would all be useful to investors and not costly for the issuer to disclose.

19.1	We propose requiring that non-reporting issuers that use the OM Prospectus Exemption must continue to provide the specified ongoing disclosure to investors until the issuer either becomes a reporting issuer or the issuer ceases to carry on business. Do you agree that a non-reporting issuer should continue to provide ongoing disclosure until either of these events occurs?

Non-reporting issuers generally do not have an active market for their prospectus-exempt securities, so enhanced levels of disclosure may not be of immediate benefit to investors who own these illiquid investment products. That said, some form of ongoing disclosure of the non-reporting issuer's cash-on-hand position and an anticipated statement on prospective cash holdings could be easy enough to disclose and perhaps provide a metric of some utility to current and potential investors.

19.2	Are there other events that would warrant expiration of the disclosure requirements?

No.

Reporting of distribution

20.0	We believe that it is important to obtain additional information to assist in monitoring compliance with and use of the OM Prospectus Exemption. Form 45-106F11 would require disclosure of the category of "eligible investor" that each investor falls under. This additional information is provided in a confidential schedule to Form 45-106F11 and would not appear on the public record. Do you agree that collecting this information would be useful and appropriate?

We support the collection and use of this information in order to help the regulator better monitor and evaluate the use of the exemption.

PART TWO: FRIENDS, FAMILY AND BUSINESS ASSOCIATES PROSPECTUS EXEMPTION

Types of securities

1.0	Do you agree with our proposal to limit the types of securities that can be distributed under the FFBA Prospectus Exemption to preclude novel and complex securities?

In general, we do not support restrictions on the ability of the issuer to issue or the investor to invest in products of their choosing. However, until the FFBA exemption is shown to be effective at raising capital without undue risks to investor safety, complex or novel securities should not permitted, unless the investor has had advice from a professional registrant regarding the proposed transaction and has executed a risk disclosure document which clearly sets out the risks associated with novel or complex securities. In addition, the registrant providing the advice should have to affirm that he has experience in dealing with such securities. This should make for sufficient investor protection in the form of competent professional advice, while still providing issuers with the ability to access trusted sources of capital in the form of family, friends or business associates, by issuing securities with features expressly designed to suit the unique needs of their enterprise.

1.1	Do you agree with the proposed list of permitted securities?

Since no limit has been proposed on the size of an offering made under this exemption, it is reasonable for the OSC to limit the set of securities eligible for distribution. The proposed pool of permitted securities is sufficiently broad for the purpose of investors and issuers: indeed, common shares, non-convertible preference shares, securities convertible into common shares or non-convertible preference shares, non-convertible debt securities, limited partnership units and flow-through shares are all permitted. Another limitation on distribution and therefor on investor risk is that while the exemption is available to both reporting and non-reporting issuers, investment funds are excluded.

Offering parameters

2.0	Should there be an overall limit on the amount of capital that can be raised by an issuer under the FFBA Prospectus Exemption?

There should be no overall limit on the amount of capital that can be raised under this exemption, provided that annual statements and annual corporate filings, when available, are provided to investors before they elect to invest pursuant to the FFBA exemption. There are already reasonable constraints in place to prevent undue expansion of the FFBA category in the form of prohibitions on providing compensation to "finders" and on advertising in order to solicit investors.

In cases where there is no prior corporate, partnership or other business documentation to be disclosed, such as with a start-up venture by a "neophyte" or unproven entrepreneur, the regulator may consider mandating production of personal income tax returns to the investor prior to purchase. Basically, in order to raise an unlimited amount of funds under the exemption, issuers should be obligated to provide at least the same level of disclosure to friends, family or business associates that they would be required to provide to a financial institution in order to access capital.

Investor qualifications

3.1	Do you agree with the revised guidance in sections 2.7 and 2.8 of 45-106CP regarding the meaning of "close personal friend" and "close business associate"?

The OSC has expanded the guidance to be used in determining who can invest under the FFBA exemption to account for the length of time that the investor has known a director, officer, founder or control person of the issuer, as well as the nature of their relationship. We believe that the revised guidance will provide sufficient clarity to help mitigate against the risks to investors resulting from improper reliance on the exemption.

The revised draft guidance may also be considered sufficient by virtue of several investor protection features of the exemption: (1) the onus will be on issuers to establish that a potential investor does meet such criteria; (2) a report of trade will have to have to be filed in connection with a distribution under the exemption; (3) investors will have to fill out a risk acknowledgement form prior to or at the time of purchasing the security; and (4) when the investor is provided with a so-called "voluntary" offering memorandum (as defined under Ontario's *Securities Act)*, he will have a statutory right of action based on a misrepresentation.

3.2	Is there other guidance that could be provided regarding the meaning of these terms?

Rather than suggesting additional guidance at this time, the OSC should monitor the roll-out of the FFBA exemption and position itself for a point 24 to 36 months in the future when it can better determine what additional guidance, if any, is needed. Perhaps a confidential online board could permit issuers to submit questions about who qualifies under the FFBA without revealing the particulars of their identity. From this list of questions the OSC could develop additional guidance.

Investment limits

4.0	Should there be limits on the size of each investment made by an individual under the FFBA Prospectus Exemption or an annual limit on the amount that can be invested?

At this time there is no need to consider limits on the size of investments made by individual investors under the exemption.

Risk acknowledgement form

5.0	Does the use of a risk acknowledgement form that is required to be signed by both the investor and the person at the issuer with whom the investor has the relationship mitigate against potential risks associated with improper reliance on the FFBA Prospectus Exemption?

A risk acknowledgment form under this exemption should be required to be executed by the investor and the family member, friend or business associate. It should also itemize the main concerns for investors which are unique to this exemption, and include summary guidance on the approved meanings of "close personal friend" and "close business associate" and links to further information on the same.

Reporting of distribution

6.0	We believe it is important to obtain additional information in Form 45-106F11 to assist in monitoring compliance with and use of the FFBA Prospectus Exemption. Form 45-106F11 would require disclosure of the person at the issuer with whom the investor has a relationship. This additional information is provided in a schedule to Form 45-106F11 that does not appear on the public record. Do you agree that collecting this information would be useful and appropriate??

Collecting this information will be useful if it can assist in the evaluation of the efficacy of the exemption's operations and administration and, in the event of legitimate complaints of investor losses or abuse, help determine what sort of additional guidance might be needed to ensure the suitability of investments purchased under the exemption, or possible restrictions on which persons may qualify as a friend or business associate.

PART THREE: EXISTING SECURITY HOLDER PROSPECTUS EXEMPTION

Issuer qualification criteria

1.0	Do you agree with allowing any issuer listed on the TSX, TSXV and CSE to use the Existing Security Holder Prospectus Exemption?

Allowing any issuer listed on the TSX, TSX-V or Canadian Stock Exchange to raise capital from existing security holders is a good idea for expanding comparatively safe, stable and discoverable opportunities for retail investors, and for promoting capital raising opportunities with minimally incremental costs to the issuer and regulator.

Considerable certainty is afforded to retail investors based on the issuer's listed exchange and its existing continuous disclosure obligations.

Offering parameters

2.1 Do you agree that the offer must be made to all security holders and on a *pro rata* basis?

Yes. This is in the interests of promoting capital raising and of ensuring basic fairness to all existing investors, as it is necessary to prevent *excessively* disparate treatment of investors arising merely from the date of the investor's purchase of the security. This is accomplished by giving priority to earlier date-of-record existing security holders, while still letting late-coming existing security holders participate when possible on a *pro rata* basis.

2.2 Do you agree that these conditions support the fair treatment of all security holders?

Yes. The proposed conditions are fair for security holders in terms of: (1) the security holder as a member of an identifiable class or group deserving of investor protection; and (2) fair within that group in terms of security holders' rights relative to one another.

In terms of (1), investor protection arises from:

a. the deliberative, documentable act of declaring eligibility: to put oneself forward to participate in an ESH-exemption offering, the investor must take several affirmative steps, including representing in writing to the issuer that he wishes to participate and that, as of the record date, that he held – and has continued to hold – the type of listed security he now wishes to acquire;

b. annual limits and the requirement for suitability advice: the investor will be limited to investments of no more than $15,000 every 12 months – unless he is a Canadian resident and obtains suitability advice in respect of the investment from a registered dealer in the same jurisdiction;

c. the nature of the issuer: since as a current security holder, the investor has a pre-existing degree of familiarity with the issuer; and since the issuer is a reporting issuer, and has been for at least 12 months (or recently became a reporting issuer upon issuing a prospectus), there is a considerable degree of protection afforded by disclosure; and

d. the nature of the existing securities: the securities must be listed on a reputable exchange platform: the Toronto Stock Exchange, the TSX Venture Exchange or the Canadian Securities Exchange.

In terms of (2), fairness between existing security holders, Ontario's proposed ESH-exemption will give all holders of ESH securities on the record date (which must be at least one day before a press release announcing the offering) the option to participate *pro rata* in the ESH offering. After that, the *pro rata* shares of any holders who elect not to participate can then be distributed to the other

security holders. This system preserves the priority of ESH holders at the record date, while also permitting remaining ESH holders the opportunity to participate. Finally, the proposed ESH exemption will be fair to ESH investors *vis-à-vis* one another in a more general sense – across multiple jurisdictions, since the OSC's ESH exemption will mirror the exemptions available in other provinces.

3.0	Do you agree that it is not necessary to differentiate between a security holder that bought securities in the secondary market one day before the announcement of the offering and a security holder that bought the securities some longer period before the announcement of the offering?

There is no need to differentiate between a security holder who bought securities in the secondary market one day before the announcement of the offering and a security holder who bought the securities two days before, two months before, or indeed any other period of time before the announcement. Conceptually, their position is substantively identical. The only pragmatic qualification we would offer here is that the regulator consider the value of consistency across multiple provincial jurisdictions; here, we note that the ESH exemption in other provinces doesn't differentiate on the basis of when a security holder bought the investment in the secondary market.

Resale restrictions

4.0	Should securities distributed under the Existing Security Holder Prospectus Exemption be freely tradeable?

Yes. There are several main considerations here. First, the existing level of investor protection for these ESH shares is fully sufficient to allow them to be freely tradable among retail investors. Second, in the interests of capital raising, the ESH-exempt securities should be able to replicate or mirror as closely as possible the original securities from which they are, in essence, derived. Third, the issue of harmonization is always a concern, so the regulator should also consider the need to maintain consistency with how freely ESH-exemption securities are allowed to be traded in other jurisdictions.

PART FOUR: CROWDFUNDING PROSPECTUS EXEMPTION AND CROWDFUNDING PORTAL REQUIREMENTS

1. CROWDFUNDING PROSPECTUS EXEMPTION

Issuer qualification criteria

1.0	Should the availability of the Crowdfunding Prospectus Exemption be restricted to non-reporting issuers?

No: as a matter of policy, the exemption should be open to *all* qualifying participants who can fulfill the required compliance obligations. Accordingly, we believe that the proposed crowdfunding exemption should be available to both reporting and non-reporting issuers; all public and private small- to medium-sized enterprises should be able to rely on the exemption to promote capital formation. This may be particularly useful to reporting issuers who are finding it difficult to raise capital through more traditional means in the current economic climate. Moreover, restricting the exemption to non-reporting issuers will prevent those enterprises which can identify and persuasively make the case that they can execute on early-stage, high-potential opportunities, but lack a cost-effective, easy-to-access avenue to capital, will be prevented from doing so — unless they go through the requisite process of becoming a non-reporting issuer. Since reporting issuers have a continuous disclosure record publicly available on SEDAR, they should not have fewer capital-raising options than non-reporting issuers.

2.0 Is the proposed exclusion of real estate issuers that are not reporting issuers appropriate?

The proposed *Companion Policy* for the crowdfunding exemption states that the exclusion is intended to capture non-reporting issuers whose primary business is focused on real estate, and not issuers whose real estate investment or development activity is ancillary to and perhaps purely in support of the issuer's primary business activity.

From the point of view of investors, the crowdfunding exemption will allow them to incorporate real estate into their retirement planning, presumably to promote portfolio diversification and the pursuit of potentially steady returns. From the point of view of the regulator, it may be that the OSC believes real estate investment trusts and mortgage investment corporations do not stimulate capital formation which will work to the benefit of small- to medium-sized enterprises – and accordingly they should not enjoy the benefit of the exemption.

Moreover, Advocis believes that rather than preclude, on the basis of their industry subsector, an entire group of non-reporting issuers from being able to rely on the exemption, the OSC should first attempt to institute a special set of private disclosure and reporting requirements unique to real estate investment firms. If the OSC can propose to bar an entire asset class from the exemption without proffering empirical evidence, surely it can accept the wisdom of first taking the less intrusive step of creating a special disclosure regime for that impugned asset class.

Despite current concerns about the possibility of a real estate bubble in certain markets, there is no case at present to exclude real estate issuers which are not reporting issuers from access to the crowdfunding prospectus exemption.

3.0 The Crowdfunding Prospectus Exemption would require that a majority of the issuer's directors be resident in Canada. One of the key objectives of our crowdfunding initiative is to facilitate capital raising for Canadian issuers. We also think this requirement would reduce the risk to investors. Would this requirement be appropriate and consistent with these objectives?

We believe that the regulator is correct that a requirement that a majority of an issuer's directors be resident in Canada will reduce risk exposure for retail investors, especially to incompetence and fraud. Other jurisdictions have successfully employed sophisticated regulatory criteria to govern the complex and fluid interplay between (1) the issuer's need to be able to direct the composition of its board of directors and slate of corporate officers and its need to access to crowdfunded capital and (2) the needs of transparency and investor protection. But such regulations are relatively expensive to implement, monitor and enforce.

Accordingly, the OSC would be best advised to properly allocate its regulatory resources by launching a crowdfunded exemption with the simple requirement that a majority of the issuer's directors be resident in Canada.

If the OSC is satisfied that the crowdfunding prospectus exemption is working properly, then at some point down the road (e.g., after 24 to 36 months), it may wish to amend the residency requirements by introducing provisions which permit relief based on the issuer's need for particular competencies and skills.

Two specific areas where relief from residency requirements would be welcome are: (1) early-stage, high-risk, high-potential firms which are approaching the second growth stage of their business development and now need more sophisticated guidance, and (2) more established business enterprises which are transitioning into new product categories or entering broader sectors of the market and, again, now require specialized forms of business advice. In each case, the business entity should be able to construct its boards in a way that enables it to best address the business needs which inevitably arise during such periods of transition and growth.

Offering parameters

4.1 The Crowdfunding Prospectus Exemption would impose a $1.5 million limit on the amount that can be raised under the exemption by the issuer, an affiliate of the issuer, and an issuer engaged in a common enterprise with the issuer or with an affiliate of the issuer, during the period commencing 12 months prior to the issuer's current offering. Is $1.5 million an appropriate limit?

The proposed $1.5 million limit on the amount which can be raised pursuant to the crowdfunding prospectus exemption is no doubt on the low end of what may be a suitable parameter for the initial rollout of the crowdfunding market in Ontario. Previously published OSC documentation indicates that the $1.5 million limit may derive from the *JOBS Act*'s $1 million limit in the United States. However, recent activity in the U.S. suggests that many stakeholders, in addition to issuers, believe the $1 million limit is too low.

Regardless of the amount of the initial limit, equity crowdfunding will no doubt prove to be a dynamic, evolving platform, so the OSC must be prepared to move with due speed to introduce a

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higher limit to accommodate future eventualities. It may be that within two to three years the regulator will be in a position to review the state of the crowdfunding market and determine that the proposed limit must be adjusted higher or eliminated altogether. It may be that certain industry categories or certain types of basic securities will suggest a category-based modification upwards or downwards of the $1.5 million limit. As well, accredited investors may be worth exempting from this requirement: their ability to act as "angel investors" means they can prove crucial to a timely attainment of the proposed amount of capital being sought. Finally, it may be that a handful of speculative and high-risk/high-reward crowdfunded proposals – ones which are truly *sui generis* – should be subjected to a different ceiling in the interest of consumer protection.

4.2	Should amounts raised by an affiliate of the issuer or an issuer engaged in a common enterprise with the issuer or with an affiliate of the issuer be subject to the limit?

No: the amounts raised by an affiliate of the issuer or an issuer engaged in a common enterprise with the issuer or with an affiliate of the issuer should not be subject to the limit.

<u>The affiliate/common enterprise relationship</u>

It is arbitrary to limit the amount of capital which an issuer can raise based the aggregation of it with amounts raised by an affiliate of the issuer. This arbitrariness is increased when the aggregation involves amounts raised by an issuer engaged in a common enterprise with the issuer or, even more remotely, an issuer engaged in a common enterprise with an affiliate of the issuer.

The arbitrariness arises from the initial assumption that the relationship between the issuer and the second entity automatically raises undue risks associated with excess capitalization or overconcentration among business units. This is then followed by the further assumption that these risks, while not necessarily open to precise calculation, must be so serious as to automatically trigger the $1.5 million limit.

On the face of it, the parent company, subsidiary or other affiliate may be involved in an entirely different business line. Issues of management specialization, geographical location or tax structuring may in fact encourage cross-participation in crowdfunding and possibly result in tremendous synergies – ones which may prove necessary to the issuer's success. By in essence treating the issuer and a related entity as a single issuer under the exemption, the OSC will prevent issuers from benefitting from the accrual of both anticipated and unforeseen synergistic gains and from the full use of their formal and informal organizational centres of excellence.

4.3	Is the 12 month period prior to the issuer's current offering an appropriate period of time to which the limit should apply?

While a period commencing 12 months prior to the issuer's current offering may be an appropriate period of time in which to limit the amount that can be raised, the assumption that a time limit is necessary is itself problematic.

5.1	Should an issuer be able to extend the length of time a distribution could remain open if subscriptions have not been received for the minimum offering?

Yes. The OSC should redraft the exemption so that a crowdfunding offering, if it meets certain requirements, be extended for a further window of time. Investor protection concerns dictate that the issuer update any stale information and correct any disclosure that time has rendered inaccurate.

5.2	If so, should this be tied to a minimum percentage of the target offering being achieved?

The idea of a graduated scale to be applied in determining what, if any, extension should be granted is workable and advisable – provided investors already subscribed can back out. They should be able to make use of the information represented by the collectivity of decisions made by other possible investors to not participate.

Restrictions on solicitation and advertising

6.0	Are the proposed restrictions on general solicitation and advertising appropriate?

The proposed restrictions on general solicitation and advertising are an appropriate starting point for the launch and initial formation of a crowdfunding market. Once the market is established and running in a manner satisfactory to the OSC in terms of its levels of investor protection capital raising capacities, the OSC may wish to amend the prohibition. At present, it should be emphasized that an issuer of a crowdfunding offering must be able to publish and disseminate documents containing factual business information related to the terms of terms of the offering. In the interest of investor protection, all general forms of solicitation and advertising should contain the text of the applicable risk acknowledgement form. As well, further guidance should be forthcoming on the use by portals of engagement tactics to locate – or be located by – potential investors such as search engine optimization techniques and targeted social media postings.

Investment limits

7.0	The Crowdfunding Prospectus Exemption would prohibit an investor from investing more than $2,500 in a single investment under the exemption and more than $10,000 in total under the exemption in a calendar year. An accredited investor can invest an unlimited amount in an issuer under the AI Exemption. Should there be separate investment limits for accredited investors who invest through the portal?

Yes. The AI exemption is a relatively long standing category of exempt market investor. In its role as a proxy for investor sophistication it is certainly imperfect. It has much greater utility in its role as a proxy for the ability to withstand investment losses and to be able to bear exposure over significant periods of time to illiquidity risk. In terms the individual accredited investor herself, since she is

allowed to invest an unlimited amount under the accredited investor exemption, she should be permitted to invest an unlimited amount in a crowdfunding issue. Finally, it can be a useful signal to other investors that a participating accredited investor is always allowed unlimited participation in the capital raising project, as this can be interpreted as another indication of the overall value of the project.

Statutory or contractual rights in the event of a misrepresentation

8.1	The Crowdfunding Prospectus Exemption would require that, if a comparable right were not provided by the securities legislation of the jurisdiction in which the investor resides, the issuer must provide the investor with a contractual right of action for rescission or damages if there is a misrepresentation in any written or other materials made available to the investor (including video). Is this the appropriate standard of liability?

This standard of liability is not just appropriate, but we believe it is also necessary, and consistent with current Ontario securities law, and will also be available under offering memorandum exemption.

8.2	What impact would this standard of liability have on the length and complexity of offering documents?

It will no doubt increase the length and complexity of certain offering documents, especially those prepared by early-stage, high-opportunity issuers. It is not clear whether the costs associated by this increase will be justifiable in terms of augmented investor safety for the specific crowdfunded offering under consideration; however, in the fullness of time one will see at least an incremental increase in the level of protection for all offerings.

Provision of ongoing disclosure

9.1	How should the disclosure documents best be made accessible to investors?

All initial disclosure documentation should be made accessible online to prospective and actual investors of an issuer. Issuers should be required to ensure that the portal website posts the information or at minimum provides a link to the issuer's website, plus a link to SEDAR.

Ongoing disclosure documents should be available online to participating investors though the issuer's own website. Instructions on how to access the ongoing disclosure should be set out on the issuer's website and distributed to investors electronically by the portal.

9.2	To whom should the documents be made accessible?

The disclosure documents should be made available to registrants, investors and potential investors in pdf files downloadable directly from the portal.

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10.1 Would it be appropriate to require that all non-reporting issuers provide financial statements that are either audited or reviewed by an independent public accounting firm?

The answer is to introduce a graduated scale of disclosure. Requiring all non-reporting issuers to provide the OSC with annual financial statements will be problematic, as the attendant costs will simply be too much for many issuers in light of the capital they will likely be able to raise. As well, the utility which accrues to even sophisticated investors from mandating the disclosure of financial statements is not always very great. For example, in the case of start-up companies, financial statements often yield very little in the way of useful information on which informed investment decisions can be made.

It may therefore be most effective to tie the quality of the endorsement or review of the financial statement disclosure to the sum of capital the issuer seeks to raise: i.e., director- and officer-certified financial statements could be disclosed for projects seeking to raise up to $750,000; independently reviewed financial statements would be required for raises from $750,000 to $1,500,000; and audited financial statements would be required for all capital raises thereafter.

10.2 Are financial statements without this level of assurance adequate for investors?

This answer can only be answered on a case-by-case basis. In some sectors, such as real estate, information in financial statements may be subjected to a proven set of interpretive and evaluative techniques. But in other sectors, such as software, the market is so dynamic and fast-moving that the financial statement may not produce much information which can be relied upon for more than a few months. This problem is compounded by the fact that, as noted, financial statements for start-up enterprises often yield a paucity of significant and actionable information.

10.3 Would an audit or review be too costly for non-reporting issuers?

In most cases, yes – especially at the initial stages of the issuer's business development. Successful issuers will of course be able to more readily bear the cost of disclosure than their earlier-stage, more risky competitors.

11.1 The proposed financial threshold to determine whether financial statements are required to be audited is based on the amount of capital raised by the issuer and the amount it has expended. Are these appropriate parameters on which to base the financial reporting requirements?

Yes.

11.2 Is the dollar amount specified for each parameter appropriate?

Please see the answer for Question 10.1, above.

Other

12.0 Are there other requirements that should be imposed to protect investors?

Yes. We would propose the following:

The development of best practices guidelines and investor guidance sheets

The OSC should periodically consult with stakeholders to develop guidance on approved best practices in those areas in which issuers do not typically come to market with a familiar or proven business model. In such areas, often involving start-ups and tech ventures, only "experience in the field," coupled with the regulatory acumen and experience of the OSC's staff, can readily identify and articulate those practice guidelines which would be appropriate responses to unique exempt market problems.

One such area where expertise should be pooled by all stakeholders is the development of guidelines for the common scenario of the retail investor who is dedicated to finding a tech start-up with the next "killer app." One example would be a document which advisors or portals could distribute to investors as a "reality check" about the difficulties of properly evaluating the potential suitability of a security for an early-stage, high-potential issuer which has a promising concept on paper but lacks a well-delineated business plan.

Establishing how and when a portal must report suspicions of fraud or FINTRAC-related concerns

Portals should have specified duties set out in writing to report suspicions of misrepresentation, fraudulent behaviour, and other violations of securities law to the OSC. They should also have specific obligations to report to the appropriate government agency violations of other relevant governmental laws and regulations, such as those promulgated by the CRTC and FINTRAC. All of these obligations need to be specified in a document and accompanied by clear guidance and easy-to-understand examples. It is simply too much to expect newcomers to the securities market to be able to fully grasp their responsibilities, especially as portal operators, without such assistance.

Ensuring portal operators can access the advice of registrants and other professionals

Several foreign jurisdictions have implemented crowdfunding or, more generally, crowdsourcing, platforms which offer the issuer access to some form of professional advice or review, sometimes on a volunteer basis in the case of arts- or community-themed crowdsourcing or for not-for-profit ventures. Once example of this approach in the context of crowdfunded securities issuances is the Australian Small Scale Offerings Board, which specializes in unlisted, high-growth, Australian companies. In order to raise capital through the Board the issuer must engage with an approved partner who, among other things, will provide assistance with meeting initial and ongoing compliance obligations. In the case of regulatory assistance, the partner may be a registrant or professional – such as an advisor, broker, lawyer, or accountant; for more business-oriented or

operational advice, the partner is often an officer, director or corporate advisor of an Australian company.

In lieu of the OSC permitting existing registrants the ability to operate portals, the OSC could easily provide portal operators with a list of approved registrants (and perhaps other professionals, such as lawyers, accountants and auditors), to help ensure that operators who need securities-related advice, guidance or professional services can access it from a reputable source.

2. CROWDFUNDING PORTAL REQUIREMENTS

General registrant obligations

13.0	The Crowdfunding Portal Requirements provide that portals will be subject to a minimum net capital requirement of $50,000 and a fidelity bond insurance requirement of at least $50,000. The fidelity bond is intended to protect against the loss of investor funds if, for example, a portal or any of its officers or directors breach the prohibitions on holding, managing, possessing or otherwise handling investor funds or securities. Are these proposed insurance and minimum net capital amounts appropriate?

The proposed insurance and minimum net capital amounts requirements place equity crowdfunding portals operating under the exemption under the same capital and bond requirements as exempt market dealers and recently approved restricted dealers in Ontario. They are appropriate on two counts: (1) they fit with the theory that a portal should be required to comply with the same obligations as exempt market dealers; and (2) more importantly, they should provide sufficient protection for the actions which the OSC proposes portals be permitted to do. However, as we argue in response to Question 16, below, the OSC should in fact expand the realm of permitted activities for portals. Doing so would mean the minimum figures would need to be adjusted upwards.

Additional portal obligations

14.0	Do you think an international background check should be required to be performed by the portal on issuers, directors, executive officers, promoters and control persons to verify the qualifications, reputation and track record of the parties involved in the offering?

Yes. A portal should be required to conduct background checks and otherwise verify the qualifications, reputation and track record of the parties involved in the offering. They are the party best positioned to do so and they face the strongest incentives to do these tasks correctly. Portals should be changed with vetting the transactions for FINTRAC compliance regarding anti-money laundering and anti-terrorist financing risks.

Prohibited activities

15.1	The Crowdfunding Portal Requirements would allow portal fees to be paid in securities of the issuer so long as the portal's investment in the issuer does not exceed 10%. Is the investment threshold appropriate?

Yes. The limitation on a portal not owning or controlling more than ten per cent of an issuer's securities is appropriate. The ten per cent figure is suitable for the purposes of promoting diversification and avoiding over-concentration in any one issuer. A portal must not become hostage to the self-interest and market fortunes of one of its listed enterprises.

The key requirement with which the OSC must ensure portal compliance is conflict of interest disclosure to all investors and issuers. See the last paragraph in the answer to Question 15.2 below.

15.2	In light of the potential conflicts of interest from the portal's ownership of an issuer, should portals be prohibited from receiving fees in the form of securities?

No. Portals should be able to accept securities from businesses listed on their portal as a portion of their fees. Most crowdfunded start-ups and small- to medium-sized enterprises will have limited cash with which to pay their portal fees.

Permitting crowdfunding enterprises to satisfy their portal fees in the form of their issued securities should be allowed since, it provides the portal with incentives to conduct additional due diligence to ensure any listed enterprise is of appropriate quality, and to engage in ongoing monitoring of the enterprise with regard to the hazards of inadequate disclosure, fraud, etc. A "virtuous cycle" may be formed as the portal achieves success by accepting partial payment in the form of securities from successful enterprises, which attracts further potential issuers to that successful portal, which can then continue to develop and refine its capacities for evaluating the value of accepting payment in securities from prospective issuers, and so.

It must be acknowledged that where a portal has a financial stake in any particular issuer, it may then have an incentive to promote that issuer over its other issuers. Disclosure to all issuers and investors of this potential perceived conflict should be considered a suitable curative measure. Accordingly, as noted above, this compensation arrangement must be fully disclosed to investors, and the investment would not result in the portal owning or controlling more than ten per cent of the issuer.

16.1	The Crowdfunding Portal Requirements restrict portals from holding, handling or dealing with client funds. Is this requirement appropriate?

No. The custodial restrictions on portals strike us as excessively cautious and will lead to an unnecessary increase in transaction costs for issues and ultimately for investors.

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16.2	How will this impact the portal's business operations?

Business operations will become more expensive and somewhat slower as portals will have to rely on third parties to execute certain tasks involving funds and the custody of securities.

16.2	Should alternatives be considered?

Yes. Portals should be permitted to hold and administer investors' funds in the same manner as an exempt market dealer. Appropriate adjustments to the proposed insurance and bond requirements could be made to address security concerns. This is not an unusual permission to grant for securities being offered through a portal which is registered as a restricted dealer.

Other

17.0	Are there other requirements that should be imposed on portals to protect the interests of investors?

The OSC should consider the establishment of an independently run online registry. Its purpose would be to maintain secure and confidential records of the non-eligible, eligible and accredited investors using Ontario's crowdfunding exemption. It would update in close to real time their total annual investment participation in crowdfunding ventures. Inquiring persons and entities (the portal, a registered dealer or advisor working for the investor, or the investor him- or herself) could then inquire if the potential purchase would exceed the investor's annual investment cap (should one be in place and be applicable).

18.0	Will the regulatory framework applicable to portals permit a portal to appropriately carry on business?

Ultimately this question's answer depends on one's conception of how a portal should carry on business. The proposed crowdfunding framework has a significant flaw: as drafted, it would prohibit existing registrants from applying their expertise in the furtherance of safe and effective portal administration. Permitting a portal to be administered by an individual who may have no industry-recognized credentials or experience, and who has not been screened to see if he or she has met certain basic educational or proficiency standards, strikes us as problematic.

The remedy for this is simple: Advocis would submit that the crowdfunding exemption make provision for the mandatory involvement of registered intermediaries, as this will bring a pre-established level of securities expertise and regulatory accountability to the administration of a portal's sales of prospectus-exempt securities. Requiring the presence of an experienced registrant with a clean disciplinary history will greatly diminish the understandable concerns on the part of the regulator – and the public – about fraud during the first years of the exemption's operation; it will

also help bring the crowdfunding enterprise into accord with the reforming thrust of the general regulatory principles underlying the Client Relationship Model, the KYC and KYP obligations, and similar requirements, and with the ongoing move toward enhanced levels of professionalism in the advisory field.

The use by portals of experienced OSC registrants strike us as an absolute necessity in light of the tremendous amount of documentation which must be generated, delivered and filed in a securities issuance. Since such registrants have been and would continue to be accountable to the OSC, a further level of peace of mind would be afforded to investors and issuers. Fortunately, Ontario has a significant number of small-sized and fully registered investment dealers with the experience and skills most appropriate to assisting portals in conducting financing for small start-up issuers.

Pragmatically, the fact is that many of these dealers are still facing reduced demand for their services. They represent an ideal source of skilled professionals who can be engaged at reasonable levels of compensation to assist in the establishment and initial development of crowdfunding in Ontario. Excluding these registrants strikes us as being wholly at variance with the rest of the OSC's investor protection initiatives.

Consider, for example, how unreasonable it is to expect a portal operator to have the ability to discern the most cost-effective and compliant manner of fulfilling the operational responsibilities and regulatory obligations which are attendant to the process of funding a reporting issuer. Equity issuances are rich with the potential for numerous investor- and issuer-related problems to arise from inadequate administrative policies and inadvertent non-compliance with documentary and recordkeeping requirements.

The potential for such problems to hamstring a portal, if not immediately apparent, will certainly become visible once a crowdfunding issuer has enjoyed a level of success sufficient to have its principals elect to transform itself into a reporting issuer, with all the heightened obligations that it will then have to fulfill for its security holders. Similar concerns regarding the issuance, custody, transfer and administration of securities and certificates will arise if the crowdfunded entity begins trading securities on a listed exchange or on some form of alternative trading platform.

But with existing registrants precluded from participating in crowdfunding, it is not at all clear where the expertise to establish and administer crowdfunding portals will be sourced. No doubt the typical portal will be constructed by individuals with considerable skills in intellectual technology, and with the necessary acumen in building or programming securities-related trading, execution and recordkeeping software, but to expect back-office systems experts to also have experience in the nuances of engagement and sales activities typically conducted by registrants is to indulge an expectation that will put investors at undue risk.

Permitting existing registrants the ability to operate portals under a separate registration category would be an extremely cost-effective means of increasing the level of overall compliance among the

province's portal operators. And it might be the single most effective means of reducing crowdfunding fraud available to the regulator. There are legitimate legal, operational and recordkeeping concerns about how well an inexperienced portal operator will administer the issuance of securities and certificates pursuant to a crowdfunding exemption. Because of concerns such as these, crowdfunding portals in the United States are required to register with FINRA, and to adhere to a comparatively high broker-dealer standard which will ensure a proper *de minimus* standard level of dedicated oversight with regard to the interests of issuers and investors. Ontario should consider something similar.

One option is to permit existing registrants the ability to operate a crowdfunding portal. Another option to ensure the involvement of a registrant in the operations of a portal – or, at the least, a professional with industry experience – would be to consider a scheme along the lines of the Australian sponsorship model, which is referenced in the answer to Question 12, above.

PART FIVE: ACTIVITY FEES

1.1	Are the proposed activity fees appropriate? Do they address the objectives and concerns by which were guided?

While the fees strike us as appropriate, the OSC and those seeking to raise capital are best positioned to answer this question. It is not clear to us what the full purpose of the fee is – is it to raise money to pay for the administration of the payee's participation in the regulatory system? Is it intended, at least in part, to dissuade frivolous would-be issuers? It is no doubt a difficult calculation to determine the level at which such fees should be set in order to pay for all or in part the cost of implementing new and untested regulatory compliance and monitoring programs which crowdfunding will require. The regulatory obviously does not want to force smaller parties to pay more than they can reasonably be expected to bear and thus discourage the development of the exemption from the outset.

That said, the lack of harmonization across Canada is frustrating: while minimum filing fees are not collected in the Northwest Territories and the Yukon, in other jurisdictions they range from flat fees beginning at a low of $100 in Nova Scotia to a plateau at $500 in Ontario; Alberta and British Columbia complicate matters by collecting the greater of $100 or 0.01% of capital (B.C.) or $100 or 0.025% of capital raised (Alberta).

1.2	Do they address the objectives and concerns by which were guided?

Again, the OSC is best positioned to answer this question. In the interests of cost reduction on smaller issuers and distributors, we would suggest the OSC consider waiving the filing fee for the filing of an exempt distribution report pursuant to a crowdfunding exemption.

2.0	Should we consider any other activity fees for exempt market activity?

At this time, no. We would encourage the OSC and other CSA members to collect and publish data about the costs and resources devoted to the regulatory functions of administering and monitoring crowdfunding and other prospectus exemptions in their jurisdictions, as well as gathering information on the fees raised through filings, etc. It would be beneficial to market operations if the OSC could determine:

(1) if participants are ultimately paying a proportionate share of fees relative to the regulatory costs generated by their distribution channel; and
(2) which modes of capital-raising are actually most efficient from an overall (macro-level) welfare perspective.

Part Six: Proposed Reports

1.0	Do the changes to the reporting requirements strike an appropriate balance between: (i) the benefits of collecting information that will enhance our understanding of exempt market activity and as a result, facilitate more effective regulatory oversight of the exempt market and inform our decisions about regulatory changes to the exempt market? (ii) the compliance burden that may result for issuers and underwriters?

Advocis supports the OSC's proposal to collect more information in order to better understand the nature and details of transactions completed in the exempt market. However, with regard to the proposed amendments, we do not believe that the appropriate balance has been struck between (i) and (ii), above, with regard to the new administrative requirements for reports of exempt distributions. If all of the CSA's proposed exempt market reporting changes are implemented, issuers will face up to four different exempt distribution reports. A cursory review of the documents suggests that with some slight re-drafting the various proposed forms could be harmonized into a single reporting document.

There is no need for a multiplicity of exempt distribution forms and the attendant increase in compliance costs. It is not appropriate for the CSA to download these research costs onto the shoulders of stakeholders without first making an effort to minimize the compliance resources of registrants which will be consumed by its information requests. These costs will be borne by issuers and ultimately investors simply because the CSA wishes to collect information.

The CSA should ensure that the results of its various data-gathering efforts are centralized into a publicly accessible online database and also posted in the form of online reports.

2.1	Should any of the information requested through the Proposed Reports not be required to be provided?

No comment at this time.

2.2 Is there any alternative or additional information that should be provided that is not referred to in the Proposed Reports?

In order to further promote investor protection measures, we would be very interested in seeing data collected on the use by retail investors of certain registrants who provide advice to retail investors – e.g., the "eligible advisor" under NI 45-106 – and correlations between that use and investor reports of losses, unsuitable advice, etc.

CONCLUSIONS AND LOOKING AHEAD

The exempt market has proven itself to be instrumental in the process of capital raising across Canada. Small- and medium-sized enterprises are often too small to be able to afford cost-effective access to public equity markets through the issuance of a prospectus. That's why the OSC's proposal to introduce an OM exemption is a very positive development, with the potential to increase investor opportunity and capital formation.

However, there are two troubling aspects of the proposed OM exemption which we urge the OSC to reconsider: (1) the annual investment cap of $30,000 for eligible investors; and (2) the proposed prohibition on advisors and dealers selling the proprietary products of related issuers. Advocis believes both issues should be addressed in a methodical and transparent manner, one which entails the collection of substantive evidence to support the regulator's proposals. Such evidence should be in the form of a publicly disclosed cost-benefit analysis which is informed by data generated from statistically significant samples, and is made public along with its reviewable data sources, and/or qualitative evidence in the form of investigated and substantiated investor complaints, which are collated into a publically available legal report. Relied-upon quantitative and qualitative forms of evidence should be made available as appendices to the *Request for Comment*.

Now, in the absence of such substantive evidence, the OSC is proposing to undertake several forms of intrusive regulation which will disrupt the legitimate expectations of not only advisors and dealers, but also investors and issuers.

<u>Retail investors and the OSC's OM exemption</u>: The OSC, like certain other members of the CSA, is considering the introduction of a $30,000 annual investment cap on exempt market securities purchased under an offering memorandum. This proposal would, in effect, create for exempt market investing an annual limit akin to a form of annual "contribution room," but with no carry-forward, which would govern the investing habits of the vast majority of Ontario's investing public. Yet there is no evidence to support the existence of the harm the proposal purports to remedy, particularly in Ontario, where the offering memorandum market does not yet exist! The OSC should not be in the habit of tacitly and quietly following the lead of other CSA members who, it appears, are relying on very little evidence except that which was supplied by the Alberta Securities Commission. It should be recalled here that the offering memorandum is often used in west Canada for oil and gas companies, whereas in Ontario several industry observers assume it will largely be used for real estate/mortgage investment products. Regulation in the form of barriers to market

participation should be based on local "facts-on-the-ground," not on borrowed supposition and extrapolation.

<u>The OSC's OM exemption and the distribution of securities</u>: In the absence of a publicly disclosed and cost-benefit analysis with reviewable data sources which relies on statistically significant pools of data, or of other forms of substantive evidence, the OSC has proposed regulation which will seriously disrupt a long-accepted distribution model. The proposal will ban advisors and dealers from distributing related party products under the province's OM exemption. Since the offering memorandum is in its cost of preparation and degree of disclosure "more than half-way to being a prospectus," and indeed in some cases the offering memorandum will actually offer more investor-useful disclosure than a prospectus, the basis for concerns over the adequacy of disclosure are puzzling to us, and even counter-intuitive to practitioners in the field. This reaction may not be uncommon: although Ontario has been joined by New Brunswick in this idea, no other Canadian jurisdiction is currently contemplating it. Indeed, it is not clear when a major jurisdiction last proposed to ban in its entirety a tried-and-true model of distribution for an entire class of security in the context of retail investors.

Stakeholders are forced to conclude that the OSC is trying to introduce the notion of related party product distribution as being shot through with an inherently fatal conflict of interest – one so hazardous that no manner of disclosure and independent financial advice can possibly sanitize the purchase in the eyes of the regulator. This conclusion is problematic. The idea that an entire distribution model for an entire security can be banned across an entire market – and on a basis composed of extrapolation, conjecture, and precious little local hard evidence – is clearly distressing.

Transparency in the capital markets helps those markets run efficiently and with integrity. Achieving such transparency in the form of effective disclosure of information and of potential or real conflicts of interest to investors is a deservedly high priority goal of the OSC. Exempt markets are critical to the capitalization of start-up businesses and small- to medium-sized enterprises; accordingly, the proposed prospectus exemptions should be rolled out in a way that fosters investor trust in the producers of retail investor products, the intermediaries that distribute them, and the regulators who create and enforce the rules which govern them.

Subject to the serious reservations about these two aspects of the OM exemption, and with some relatively minor qualifications regarding the role of registrants and the desirability for retail investors to seek out professional financial advice, Advocis otherwise supports the OSC's efforts to expand Ontario's securities markets – especially with regard to a crowdfunding portal, the existing security holder exemption, and a family, friends, and business associates exemption. 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 <u>eskwarek@advocis.ca</u>.

Sincerely,

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and

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