



June 18, 2014

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

Email: comments@osc.gov.on.ca

Dear Secretary,

RE: Introduction of Proposed Prospectus Exemptions and Proposed Reports of Exempt Distribution in Ontario – Comments on OSC's Proposed Amendments to National Instrument 45-106 – Appendix D – Crowdfunding

We are pleased to provide the attached comments from MaRS Discovery District ("MaRS") on the OSC's proposed amendments to National Instrument 45-106. Our comments focus on the proposed crowdfunding exemption and related questions.

We appreciate the opportunity to participate in the consultation process and would be pleased to address any questions you may have regarding our submission.

Yours truly,

A handwritten signature in black ink that reads "Treurnicht".

Ilse Treurnicht

CEO, MaRS Discovery District



Background

MaRS Discovery District is one of the world's largest urban innovation hubs, located in the heart of downtown Toronto. A registered charity, MaRS helps entrepreneurs in the ICT, Cleantech and Health sectors launch, grow and scale the innovative companies that are building our future — startup ventures with broad economic and societal impact.

MaRS equips innovators and organizations alike with the entrepreneurship skills required to compete in the 21st century, provides expert advice & market research, and makes connections to the talent, customers & capital that our ventures need to succeed.

During 2013, MaRS, which has 133 full-time and contract staff (not including volunteer advisors), served a client base of 1,000+ startup ventures in the above sectors. MaRS venture clients have created more than 6,500 jobs and, in the past three years alone, generated over \$500 million in revenue and raised over \$1 billion in capital. In 2013, more than 2,000 meetings, events and conferences were held at the MaRS Centre, attracting more than 100,000 attendees from the innovation and technology ecosystem.

In anticipation of submitting comments on the crowdfunding prospectus exemption to the Commission, MaRS consulted with its extensive network of entrepreneurs, investors, potential portals, MaRS VX and regulators. The following submission reflects the comments made by this community.

Funding and Innovation Gap

The funding gap for Canadian technology companies is well documented. According to the Canadian Venture Capital Association (“CVCA”) report on 2013 activity¹, the number of Canadian innovative companies that received VC financing was 452, up 2% from the 395 companies that received VC funding during the previous year. In terms of VC dollars invested, this translated into \$2 billion as of December 31, 2013, or an increase of 31% year-over-year.

Though Ontario, Quebec and B.C. are prominent in North American VC rankings (7th, 9th and 10th respectively), no progress was made on closing the gap between Canada and the United States on deal capitalization. The year-over-year change in North American market share for Ontario, Quebec and B.C. was -0.2%, +0.4% and +0.8% respectively. In contrast, VC raised in the United States rose to US\$29.4 billion from the US\$27.3 billion invested in 2012. Coincidentally, in this same report, the Investment Accelerator Fund (IAF) maintained its second place ranking in the category “Top Canadian VC Investors: Government & Other Fund Types.” The IAF has a 6% market share, according to the number of deals, which represents an increase of 1.7% year-over-year.

In their 2013 Report on Angel Investing Activity in Canada, “*Accelerating the Asset Class*”², the National Angel Capital Organization (NACO) reported that angel groups that are members of the NACO invested \$89 million in 199 deals, with approximately 78.5% in central Canada, 0.8% in the Maritimes and 20.5% in the West. The average round size was \$945,000, up from \$314,000 in 2012, with a median investment of \$6.1 million. Just under half (45%) of that money goes into ICT, followed by health (33%) and cleantech (13%).

¹ Canada's Venture Capital Market in 2013

² NACO's 2013 Report on Angel Investing Activity in Canada

According to a 2013 Industry Canada report, “*Key Small Business Statistics: August 2013*”³, in 2012 there were 10 million individuals employed by small- and medium-sized businesses (“SMEs”), or 89.9% of employees. For these employer businesses, more than 98% were classified as small- and medium-sized businesses of less than 500 employees (“SMEs”) and created, on average, approximately 100,000 jobs each year.

Industry Canada’s 2013 report titled “*Small Business Access to Financing: Request and Approval Rates, Interest Rate and Collateral Requirements (2000 – 10)*”⁴ looked at the demand and supply side of financing for SMEs. It stated that on average, 25% of SMEs per year request financing to support their operations. The two most common reasons cited by SMEs for seeking financing were to purchase fixed assets and to support working capital needs.

The survey results determined that while larger enterprises generally received their funding, that:

1. Young businesses experienced greater difficulties accessing debt than older firms. This is likely because they have shorter track records, younger and less experienced management teams and higher default risks.
2. Canada's smallest businesses, youngest businesses and most R&D-intensive businesses appear to have faced greater challenges accessing debt. Key sources of capital for R&D-intensive businesses are retained earnings and the personal savings of business owners. These sources are far less predictable and cannot be relied upon long-term to support their ongoing needs. Access to financing for these businesses could be limited because of a higher rate of cash-burn and/or potentially higher default rates. It could also be that these businesses cannot satisfy the financial covenants of lenders or pledge sufficient collateral to secure loans.
3. The refusal to approve a business' request for financing becomes a concern when the refusal decision results in an under-allocation of financing to credit-worthy businesses or when certain categories of businesses are systematically denied access to capital. Such occurrences could signal a major, and potentially chronic, inefficiency in the small business financing market.

Challenges to Raising Capital for SMEs

In order for SMEs to grow, scale and achieve systemic success, they require capital; however, SMEs face significant challenges and barriers such as:

1. Identifying willing investors and accessing capital that will enable them to achieve their goals. SMEs traditionally have had limited opportunities outside of their family, friends and immediate community.
2. The cost of raising capital can be financially onerous, unless the SME is eligible for a prospectus exemption.
3. There are few central points where an SME or an investor can connect with each other.

MaRS recognizes that effective investing is not about providing capital to every business that requests it. The competitiveness of the small business sector depends on an efficient allocation of financial resources

³ Key Small Business Statistics: August 2013: <http://www.ic.gc.ca/eic/site/061.nsf/eng/02805.html>

⁴ Small Business Access to Financing: Request and Approval Rates, Interest Rate and Collateral Requirements (2000 – 10): <http://www.ic.gc.ca/eic/site/061.nsf/eng/02796.html>



and a healthy balance between capital demand and capital supply. If capital-raising standards are too loose, issuers could take on more debt or risk than what they could comfortably service when interest rates rise, the economy slows or unexpected issues impact their business plans. Similarly, if capital-raising standards are too stringent, issuers may not have the financial and human resources necessary to effectively pursue and raise their necessary capital.

Progressively more investors are using the Internet and social media to access information, make decisions that impact their investments and conduct their transactions. Similarly, SMEs are increasingly using the Internet to sell their products beyond their home base. There is no reason that either an SME should not be able to raise capital in the same manner or an investor use the Internet to access private equity initiatives.

Equity crowdfunding potentially offers a low-cost way of reaching a larger investor base. With many companies now being followed through social media, it is a logical extension that equity crowdfunding also be offered through a similar process.

Most of the discussions on crowdfunding have focused on improving access to capital, but we also believe that fostering the crowdfunding ecosystem could serve to stimulate and accelerate innovation by exposing more Canadians to local innovators and their businesses – raising awareness, inspiring others, catalyzing local support for great Canadian ideas, exposing existing Canadian companies to new local innovations and drawing new talent into the innovation mainstream. In addition to raising more capital for more Canadian businesses, a progressive and vibrant crowdfunding regime will also make Canada more attractive to innovators and their businesses from other jurisdictions – strengthening our ability to compete in the fast-moving global innovation economy.



Summary Recommendation

MaRS recognizes that equity crowdfunding is in its nascent stage and there is limited global experience with this type of capital raising; however, we believe the Ontario Securities Commission's (OSC) proposal regarding the crowdfunding prospectus exemption presents an opportunity to create a useful tool for small and medium enterprises, including social enterprises, to raise capital. This response incorporates certain recurring themes and, as such, we encourage the OSC to:

- 1) Ensure issuers have access to the largest pool of qualified investors by allowing accredited and non-accredited investors to participate.
- 2) Establish consistent (harmonized) rules across jurisdictions, wherever possible. This is of particular concern, since two crowdfunding models have been proposed: a) the startup crowdfunding exemption; and b) the integrated crowdfunding exemption.

These two proposals are significantly different from each other; therefore, if jurisdictions exclusively adopt opposing proposals, it will create a bifurcated crowdfunding regime, which will limit the success of crowdfunding in Canada. The appeal and success of crowdfunding is based on the accessibility, for an issuer, to a large number of people willing to invest in their idea or business. Restrictions imposed on the size of the crowd, or the jurisdictions in which an issuer can place their offerings, will result in both a) reduced pools of capital available to prospective issuers; and b) restricted deal flow presented to investors. Further, issuers, investors and the industry will bear the increased costs and confusion caused by the various models in terms of development, marketing, support and regulatory compliance.

- 3) Minimize compliance costs to issuers and portals.



Crowdfunding Exemption

Issuer Qualification Criteria

Q1. Should the availability of the Crowdfunding Prospectus Exemption be restricted to non-reporting issuers?

NO. This exemption should be available to non-reporting and reporting issuers alike.

Q2. Is the proposed exclusion of real estate issuers that are not reporting issuers appropriate?

NO. If different types of issuers require specific disclosure documentation, this can be developed through consultation with the community in the review phase; however, if working out the specific disclosures necessary for the OSC to feel comfortable with real estate issuers using the exemption will take additional time to develop, we would recommend implementing the exemption for other issuers now and phasing in the real estate issuers at a future date.

Q3. 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?

YES. We believe it is consistent with your objectives and with the requirement only being a majority of the directors, which enables Canadian issuers to add global talent to their boards.

Offering Parameters

Q4. 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?

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

1. YES. The maximum raise amount of \$1.5 million is an appropriate limit on the amount that can be raised under the exemption by the issuer.
2. NO. The 12-month period prior to the issuer's current offering would be an unnecessary constraint.

Startup companies and their capital needs can be extremely unpredictable, both the upside (explosive growth) and downside (underestimated development, marketing, support and regulatory compliance costs for new product or service). Rather than imposing a 12-month limit on an issuer's capital raise, it would be acceptable to require a disclosure on the use of proceeds related to the expense of preparing for and undertaking a subsequent financing round.

3. MaRS is concerned that the current proposal has no mechanism in place to limit an issuer from placing its offering on only one portal and suggests the Commission clarify their view on this point.



Q5. 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? If so, should this be tied to a minimum percentage of the target offering being achieved?

YES. A 20% minimum capital raise is acceptable. An issuer should be able to extend their distribution every 90 days if: a) they have raised a minimum 20% of their capital; and b) the issuer provides any updates to their offering/terms, etc., if any.

Restrictions on Soliciting and Advertising

Q6. Are the proposed restrictions on general soliciting and advertising appropriate?

YES. The restrictions seem appropriate, but the OSC may want to review once a period of time has passed after the implementation of new exemptions to determine if any of the restrictions are too onerous or if others may be appropriate, based on experience of portals, issuers and investors.

Investment Limits

Q7. 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. Restricting an accredited investor to \$2,500 in a single investment and a maximum \$10,000 in total in one calendar year is unrealistic. The amounts are inconsistent with the proposed OM exemption where the Commission is willing to use an income and/or net worth test, but is unwilling to introduce such a test in this exemption. The Commission should harmonize the requirements across the proposed prospectus exemptions for accredited investors, including the income and/or net worth test, no investor limits and no KYC/KYP, and suitability obligations on the Portal.

Additionally, MaRS suggests that the proposal include language that limits the liability of a portal in the event that an investor invests in offerings featured on several independent portals and exceeds their \$10,000 annual investment limit.

Statutory or Contractual Rights in the Event of a Misrepresentation

Q8. 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? What impact would this standard of liability have on the length and complexity of offering documents?

YES. This is an appropriate standard for liability. It is up to the issuer and portal to: a) ensure that any investor resides in the jurisdiction in which the issuer and portal are allowed to conduct transactions; and b) comply with current regulatory regimes, which are adequate.

Provision of Ongoing Disclosure

Q9. How should the disclosure documents best be made accessible to investors? To whom should they be made accessible?

MaRS believes that giving the investors the choice of accessing disclosure documents online in a password-protected area of the company's website or on the portal would be the most cost-effective approach for issuers. The documents should be accessible by the investors and issuers, and portals should be encouraged to enable access to the documents by the investors' advisor at the request of an investor.

Q10. 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? Are financial statements without this level of assurance adequate for investors? Would an audit or review be too costly for non-reporting issuers?

YES. The purpose of the crowdfunding proposal is to help alleviate the funding gap and accompanying regulatory concerns faced by startups and small businesses in connection with raising capital in relatively low dollar amounts.

MaRS appreciates the OSC's requirements for ongoing disclosure, as detailed elsewhere in the Ontario Securities Act (the "Act"); however, we believe the proposal as set out in this exemption extends beyond similar requirements elsewhere in the Act. MaRS suggests that the OSC harmonize this requirement by stating all non-reporting issuers provide financial statements that are either audited or reviewed by an independent public accounting firm as set forth in the Business Corporation Act of Ontario. This standard is adequate and does not impose new regulations by the Commission.

Q11. 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? Is the dollar amount specified for each parameter appropriate?

YES. The thresholds appear appropriate; however, it may be more appropriate to require smaller issuers to provide Notice to Reader compiled annual financial statements versus requiring a Review engagement, which is considerably more expensive. Most SMEs provide Notice to Reader financials used in preparation of their tax returns to their shareholders.

Additionally, MaRS suggests the Commission consider including the practice of angels and VCs, and let investors decide what they need on an annual basis. Generally, audit requirements are waived in the first couple of years, as the investors would prefer that company funds be spent on product development, marketing and sales instead of a costly engagement or audit.

Other

Q12. Are there other requirements that should be imposed to protect investors?

MaRS suggests the Commission conduct a follow-up review on the mechanisms for right of action with respect to crowdfunding, in keeping with the scale and intention of the crowdfunding proposal.

In theory, this is the appropriate standard of investor protection. In reality, this standard of investor protection offers the retail investor an investment of \$2,500 or less, and little or no protection. A small



investor will probably not have the capacity to conduct adequate due diligence in a timely fashion to avail themselves of this protection, and the cost of follow-up courses of action, for the most part, would exceed the cost of the investment. The unintentional result of implementing the existing format for statutory rights would be that the Commission does not provide credible investor protection in the event of a misrepresentation on an equity crowdfunding initiative. Since the Commission has taken a significant leap forward in proposing the crowdfunding prospectus exemption in response to the changing Internet and social media environment, MaRS suggests the Commission review the right of action in relation to the crowdfunding prospectus.

General Registrant Obligations

Q13. 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?

YES. The proposed amounts appear reasonable.

Additional Portal Obligations

Q14. 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?

NO. The requirement is too costly for the portal to conduct on every director, executive officer, promoter and control person. Additionally, international background checks can significantly delay the time to launch an offering on a portal.

MaRS suggests that an international background check be completed on any director, executive officer, promoter and control person who either: a) resides outside of Canada at the time of the application; or b) subsequently resides outside of Canada at the time the issuer with which they are associated wishes to extend the distribution an additional 90 days.

Prohibited Activities

Q15. 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? 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?

YES. The issuer should be permitted to pay the portal fees in either cash or securities or a combination thereof. This would mirror standard industry practices for those assisting issuers to raise capital and the 10% threshold would appear appropriate for the equity portion of the portal's compensation from an issuer. The fact that a portal is receiving equity for all or a portion of its fees should be clearly disclosed to potential investors so they can consider any potential conflict of interest.

Q16. The Crowdfunding Portal Requirements restrict portals from holding, handling or dealing with client funds. Is this requirement appropriate? How will this impact the portal's business operations? Should alternatives be considered?



It is probably best to introduce this new exemption with restrictions in place; however, it should be clarified that a portal may hold and handle that portion of client funds that represents their portal fee from the issuer. In early days, cash flow will be important for portals to ensure their ability to serve issuers and investors, and the requirements should enable them to be paid up front from proceeds, as the issuer is receiving the cash from investors without delay or having to implement operations staff to bill and collect amounts from issuers.

MaRS suggests the Commission conduct a follow-up review of this requirement, as there are perceived issues of allowing a portal to provide only partial service to their clients. Clients may look to a portal to provide end-to-end service, from vetting and posting new issues to acting as a single point of access for ongoing disclosure to accepting funds/shares for distribution.

Other

Q17. Are there other requirements that should be imposed on portals to protect the interests of investors?

NO. The requirements appear appropriate and should remain light in order to ensure that portals can launch and develop self-sustaining business models in the market.

Q18. Will the regulatory framework applicable to portals permit a portal to appropriately carry on business?

YES. The framework appears to enable portals to carry on business; however, it would be useful for the OSC to review the impact of the framework on portal operations and profitability at some point in the future to determine if any elements of the framework require adjustment and ensure that portals can operate effectively and thrive in the market.

Activity Fees

Q1. Are the proposed activity fees appropriate? Do they address the objectives and concerns by which were guided?

YES. Generally the fees are appropriate; however, MaRS is not sure that they should apply to crowdfunding exemption where maximum capital raise will be \$1.5 million, as many SMEs will target smaller amounts than that and issuers will already be paying fees to the portal for their services. If a fee is absolutely a requirement of the OSC, perhaps \$100 would be more appropriate than \$500.

Q2. Should we consider any other activity fees for exempt market activities?

NO. None at the current time.