



June 18, 2014

VIA E-MAIL

British Columbia Securities Commission
P.O. Box 1042, Pacific Centre
701 West Georgia Street
Vancouver, British Columbia
V7Y 1L2

Attention:

Leslie Rose, Senior Legal Counsel, Corporate Finance
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Sarah Corrigan-Brown, Senior Legal Counsel, Capital Markets Regulation
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Dear Mesdames:

Re: BCN2014/03 Notice and Request for Comment on Start-Up Crowdfunding (the Proposed Exemption)

This comment letter is submitted by the Private Capital Markets Association of Canada (formerly, the Exempt Market Dealers Association of Canada) (**PCMA**) in response to the request for comments published by the British Columbia Securities Commission (the **BCSC**) dated March 20, 2014 in connection with the Proposed Exemption. We thank you for the opportunity to provide you with our comments.

PCMA's Town Hall Meetings

In order to educate and obtain feedback from various stakeholders involved or interested in the various proposed prospectus exemptions, including the Proposed Exemption, the PCMA held Town Hall meetings in May 2014 in Toronto, Calgary and Vancouver. Some of the feedback we received is reflected in this comment letter.



WHO IS THE PCMA?

The PCMA is a not-for-profit association founded in 2002 to be the national voice of exempt market dealers (**EMDs**), issuers and industry professionals in the private capital markets across Canada.

The PCMA plays a critical role in the private capital markets by:

- assisting its hundreds of dealer and issuer member firms and individuals to understand and implement their regulatory responsibilities;
- providing high-quality and in-depth educational opportunities to private capital markets professionals;
- encouraging the highest standards of business conduct amongst its membership across Canada;
- increasing public and industry awareness of the private capital markets in Canada;
- being the voice of the private capital market to securities regulators, government agencies, other industry associations and the public capital markets;
- providing valuable services and cost-saving opportunities to its member firms and individual dealing representatives; and
- connecting its members across Canada for business and professional networking.

Additional information about the PCMA is available on our website at: www.pcmacanada.com

WHO ARE EXEMPT MARKET DEALERS?

EMDs are fully registered dealers who engage in the business of trading in securities to qualified exempt market clients. EMDs are subject to full dealer registration and compliance requirements and are directly regulated by the provincial securities commissions. The regulatory framework for EMDs is set out in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103)* and it applies in every jurisdiction across Canada.

EMDs must satisfy substantially the same "Know-Your-Client" (**KYC**), "Know-Your-Product", (**KYP**) and trade suitability obligations as other registered dealers who are registered investment dealers and members of the Investment Industry Regulatory Organization of Canada and mutual fund dealers and members of the Mutual Fund Dealers Association of Canada. NI 31-103 sets out a comprehensive dealer regulatory framework (substantially the same for all categories of dealer) which requires EMDs to satisfy a number of regulatory obligations including:

- educational proficiency;
- capital and solvency standards;



- insurance;
- audited financial statements;
- KYC, KYP and trade suitability;
- compliance policies and procedures;
- books and records;
- trade confirmations and client statements;
- disclosure of conflicts of interest and referral arrangements;
- complaint handling;
- dispute resolution;
- maintenance of internal controls and supervision sufficient to manage risks associated with its business;
- prudent business practices requirements;
- registration obligations; and
- submission to regulatory oversight and dealer compliance reviews.

EMDs may focus on certain market sectors (*e.g.*, oil and gas, real estate, mining or minerals, technology, venture financing, etc.) or may have a broad cross-sector business model. EMD clients may be companies, institutional investors, accredited investors or investors who purchase exempt securities pursuant to an offering memorandum or another available prospectus exemption.

EMDs provide many valuable services to small and medium size enterprises, large businesses, investment funds, merchant banks, financiers, entrepreneurs, and individual investors, through their ability to participate in the promotion, distribution and trading of securities, as either a principal or agent.

PCMA's COMMENTS ON THE PROPOSED AMENDMENTS

Our answers to the questions you have asked in connection with the Proposed Exemption are set out below. We have reproduced the questions for ease of reference.

1. Is there a funding gap that prevents small and early-stage businesses from raising sufficient capital under our existing prospectus exemptions? If so, please describe where you think the gap exists and what causes it?

Yes, we believe there is a funding gap that prevents small and early-stage businesses (each being a **small business**) from raising sufficient capital under existing prospectus exemptions.

A small business would typically rely on the private issuer exemption and family, friends and business associates exemption under NI 45-106 to raise capital.

A small business is unlikely to raise capital under the offering memorandum exemption since the cost of compliance is too high, especially the cost of audited financial statements. The principals involved in a small business may not know an accredited investor or an accredited investor who would be interested in making an investment in a small business. There are many potential small businesses that do not get funded or fail since they cannot raise additional funding under existing prospectus exemptions. Accordingly, we believe the Proposed Exemption provides a low cost alternative for small businesses to raise capital from those investors who are not family, friends or business associates or an accredited investor.

2. Will the start-up crowdfunding exemption address this funding gap? Why or why not?

Yes, the Proposed Exemption will address this funding gap. The cause of the funding gap includes the lack of an available prospectus exemption, geographic limitations, lack of knowledge that such investment opportunities are available, and other barriers. The Proposed Exemption involves selling securities on the internet in those participating jurisdictions thereby eliminating geographic limitations and providing the transparency and accessibility of investment opportunities that were previously unknown.

3. Although the start-up crowdfunding exemption is intended to assist start-up and early stage businesses, it is not restricted to those issuers. Should we restrict the exemption to issuers that have raised less than a certain amount since their formation? Should we limit the total amount an issuer can raise under this exemption?

Yes, the Proposed Exemption should be restricted to those issuers who have raised less than a certain amount of capital since their formation or an aggregate threshold amount. We believe this amount should not exceed \$500,000 (the **Threshold Amount**) and include all monies raised by the issuer through any other prospectus exemption, such as the private issuer exemption and the family, friends



and business associates exemption under Canadian securities law.

The PCMA believes raising more than the Threshold Amount would require additional disclosure and investor protection safeguards.

Portal obligations

4. Do the requirements of the Proposed Exemption adequately protect investors?

No, we do not believe the Proposed Exemption adequately protects investors for the reasons set out below.

(a) A funding portal does not have to be registered

The Proposed Exemption does not require a funding portal to be registered with any securities regulator. A funding portal is an important gate-keeper in the ecosystem of capital raising. Although the amounts that can be raised by an issuer (\$300,000) or invested by an investor in any offering (\$1,500) are relatively small under the Proposed Exemption, a funding portal must have some responsibility for fraud on its platform.

We are very concerned that unregulated non-equity or rewards-based crowdfunding portals will be actively involved in providing equity crowdfunding under the Proposed Exemption. We believe there is a significant difference between regulated and unregulated crowdfunding. We are concerned that the public will be confused if an unregulated funding portal is involved in equity crowdfunding. We believe this is no different than the prohibition against a restricted dealer being dually registered as an EMD as discussed in proposed Multilateral Instrument 45-108 *Crowdfunding (MI 45-108)*.

Accordingly, we believe a non-equity crowdfunding portal should be prohibited from selling securities on the internet unless it is registered with an applicable Canadian securities regulator. Otherwise, we believe the BCSC would be unintentionally inviting the potential for fraud and imposing no liability on the funding portal which we submit is potentially bad for investors and for the capital markets.

(b) Securities regulators will be seen as having approved an offering and Prescribed Individuals

The Proposed Exemption requires an issuer to pre-file its offering document with its principal regulator and for officers, directors and certain other prescribed individuals of an issuer (the **Prescribed Individuals**) to provide its principal regulator with certain background information in order

to allow its principal regulator to do background checks.

PCMA believes investors will incorrectly assume that a principal regulator's review of an issuer's offering document and related background checks will be interpreted as the regulator having 'approved' an offering and that the Prescribed Individuals are acceptable to the principal regulator. We believe this should be the responsibility of the funding portal and not the principal regulator.

Accordingly, the PCMA strongly believes the funding portal should be registered under the Proposed Exemption. Moreover, the PCMA does not believe any disclaimer by a principal regulator will relieve it of any perceived approval or liability in the eyes of the investing public. If the BCSC adopts the Proposed Exemption, the PCMA strongly recommends that the BCSC require the registration of the funding portal.

5. Should we require the portal to do due diligence on issuers and their principals? If so, what level of due diligence should we require?

Yes, the portals should be required to do due diligence on issuers and principals in the manner contemplated by MI 45-108.

6. Should we impose any additional conditions on portals that rely on this exemption?

As discussed in #4 above, the funding portal should be registered as a form of restricted dealer.

Limits on investing

7. Should we impose an investment limit based on a percentage of the investor's net assets or net income, instead of a fixed dollar amount? Would having this type of investment limit add complexity to the start-up crowdfunding exemption?

No, the investment limit should be based on a fixed dollar amount since an investment limit based on a percentage of an investor's net assets or net income would add complexity to the Proposed Exemption. We suggest that the investment limit could be revised after a period of time following implementation and a review of the investment limits of the Proposed Exemption.

8. Should we add a requirement that issuers give investors a “cooling-off” period similar to the two-day right of rescission under the offering memorandum exemption?

Yes, we believe investors should be given a “cooling-off” period similar to the two-day right of rescission under the offering memorandum exemption. This would provide an added layer of investor protection.

Other comments involving the Proposed Exemption

The Proposed Exemption states, among other things, that (a) an issuer cannot raise more than \$150,000 under each offering; (b) a distribution cannot remain open for more than 90 days; and (c) the exemption cannot be used more than twice in a calendar year. We are not clear why such restrictions exist since no explanation has been provided.

The PCMA believes that: (a) an issuer should be able to raise up to the Threshold Amount in any offering; (b) the distribution should be able to remain open as long as an issuer likes, provided that there has not been a material adverse change in the business and affairs of an issuer and the offering document does not contain a misrepresentation; and (c) an issuer can use the Proposed Exemption as many times as it likes provided that it has not raised more than the Threshold Amount under any prospectus exemption, including the Proposed Exemption.

The PCMA also believes that the investment limits should be increased to \$2,500 since \$1,500 is too low to be meaningful. This would mean at least 200 investors would have to invest \$2,500 to invest up to the Threshold Amount. This is the same minimum number of investors that would have to invest under the Proposed Exemption under the proposed a \$300,000 investment limit.

The Proposed Exemption should clarify whether a transaction fee can be paid by the issuer to the portal. Although the funding portal can charge the issuer for its services, no commission can be paid to an agent in respect of the offering so clarification is required.

We assume a portal can enter into a referral arrangement with another individual for issuers and/or investors referred to the portal - we believe this should be confirmed and clarified.

There is a concern that each of the funding portal’s promoters, directors, officers and control persons be resident of Canada. We believe this may unduly restrict foreign portals from operating in Canada who may have the resources and expertise to develop a viable portal framework in the participating jurisdictions who adopt the Proposed Exemption.

PCMA believes that additional guidance should also be provided on what other offering document or marketing materials, if any, can be provided by an issuer to an investor on the funding portal. Furthermore, many issuers seek clarification of whether a funding portal can host a road show presentation by an issuer in each of the participating jurisdictions.

Individual information forms for Prescribed Individuals involving an issuer or portal asks certain prescribed questions. It is not clear what happens when an individual discloses that: (a) they have resigned or been dismissed for cause by an employer; (b) been convicted of an offence under any legislation; (c) he or she is not up-to-date with all of their financial commitments; or (d) been subject to any proceedings or any order resulting from proceedings under any securities legislation or derivatives legislation or both in any province, territory, state or country. It is not clear when such affirmative disclosure would prohibit such person from being involved in an offering or funding portal and clarification is required.

Improvements on offering memorandum exemption

9. The offering memorandum exemption is not widely used by small and early-stage businesses. We have heard that the costs of complying with the financial statement requirements in the offering memorandum form may be prohibitive and we welcome suggestions on ways to adjust those requirements. Are there other issues with the offering memorandum exemption that we should reconsider in order to make it a more useful exemption for small businesses?

(a) *Financial statement requirements*

We believe issuers that seek to raise capital under the offering memorandum exemption should be provided relief from the audited financial statement requirements. On December 20, 2012, the Canadian Securities Administrators (the **CSA**) (other than British Columbia and Ontario) published Multilateral CSA Notice 45-311 *Exemptions from Certain Financial Statement-Related Requirements in the Offering Memorandum Exemption to Facilitate Access to Capital by Small Businesses*. Each CSA member (other than British Columbia and Ontario) issued a harmonized interim local order (the **Order**) that provides an exemption from certain financial requirements set out in the offering memorandum. The Order remains in force until December 14, 2014.

The Order provides relief from the audited financial statement requirement and the requirement for issuers to prepare financial statements using Canadian GAAP applicable to publicly accountable enterprises provided that: (a) the issuer and related issuers raise no more than \$500,000; (b) no



investor invests more than \$2,000 in any 12-month period; (c) the issuer is not a reporting issuer, investment fund, mortgage investment entity or real estate issuer; (d) the issuer does not distribute complex securities; and (e) the offering memorandum contains a bold warning on the front page.

In February 2013, the BCSC published a Notice and Request for Comment on National Instrument 45-106 *Prospectus and Registration Exemptions Proposed Prospectus Exemption to Assist Capital Raising by Small Businesses* (the **BC Proposal**).

We are not aware of any report or follow-up communication by the BCSC in connection with the BC Proposal. We submit that the relief from certain financial statement requirements under the offering memorandum exemption as set out in the Order should be followed by the BCSC and similarly adopted as a local BC order.

(b) Other issues with the OM exemption

Issuers, dealers and other capital market participants require additional guidance on the non-financial disclosure requirements involving the OM exemption. We are very concerned with the different views that various CSA members have with the level, quality and extent of required disclosure among themselves but also within the corporate finance and enforcement branches of such CSA members. This needs to be clarified.

Moreover, the various prospectus exemptions (*i.e.*, the Proposed Exemption, the Equity Crowdfunding Exemption and the OM exemption) have different disclosure requirements yet the same prohibition against having a misrepresentation. It is not clear how the law involving a misrepresentation can be the same law but applied differently among three different prospectus exemptions (*i.e.*, the Proposed Exemption, the Equity Crowdfunding Exemption and the OM exemption) with three different disclosure requirements. We submit that additional clarification and guidance is required.



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We thank you for the opportunity to provide you with our comments on the Proposed Amendments and would be pleased to discuss this with you further upon request.

Yours very truly,

Private Capital Markets Association of Canada

"Brian Koscak"
Chair

"Geoffrey Ritchie"
Executive Director

cc: PCMA Canada, Board of Directors