June 17, 2014

BY EMAIL

British Columbia Securities Commission
P.O. Box 10142, Pacific Centre
701 West Georgia Street
Vancouver, British Columbia V7Y 1L2

Attention: Leslie Rose, Senior Legal Counsel, Corporate Finance
Email: lrose@bcsc.bc.ca

and

Sarah Corrigall-Brown
Senior Legal Counsel, Capital Markets Regulation
Email: scorrigall-brown@bcsc.bc.ca

Dear Sirs/Mesdames:

Re: BC Notice 2014/03 – Notice and Request for Comment on Start-Up Crowdfunding (the "Notice")

The Canadian Advocacy Council[1] for Canadian CFA Institute[2] Societies (the CAC) appreciates the opportunity to comment on the Notice and wishes to provide some general comments and respond to the following specific questions set out in the Notice.

While we appreciate the efforts of the British Columbia Securities Commission to quickly examine alternatives to the existing prospectus exemption regime, it is important that the conditions of the proposed start-up exemption do not favour small issuers over investor protection and transparency in the capital markets. We have serious investor protection concerns with respect to the proposed exemption, particularly as a result of the lack of registration for the portals. Absent registration, we believe it will be difficult for regulators to monitor abuse of the exemption before investor harm occurs, and difficult to enforce the remaining proposed requirements.

[1]The CAC represents the 13,000 Canadian members of CFA Institute and its 12 Member Societies across Canada. The CAC membership includes portfolio managers, analysts and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. See the CAC's website at http://www.cfasociety.org/cac. Our Code of Ethics and Standards of Professional Conduct can be found at http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx.

[2] CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 119,000 members in 147 countries and territories, including 112,000 CFA charterholders, and 143 member societies. For more information, visit www.cfainstitute.org.

Issuers finding the exemption attractive will likely be those that have already been rejected by traditional lenders, and possibly used all available capital from family and friends. There is a high probability that the management of an issuer choosing to raise money through the start-up exemption will not have adequate experience and qualifications to run a business raising money from the public. They may not have any financial background or ability to assess the financial risks attributable to their business, or the ability or desire to maintain investor relations with numerous unsophisticated investors. If the exemption is adopted, investors may not exercise sufficient diligence with respect to a particular investment available on the portal, mistakenly believing that if the investment is permitted by the regulators, it must be safe. If the start-up exemption is adopted, strict monitoring and enforcement of transgressions will be extremely important.

It is unclear to us who would be held responsible for a misrepresentation in the materials related to the issuer presented to the investing public. As a result, investors may in fact be required to try to sue the issuer and/or the portal to recover any losses, which is unlikely given the cost and length of time associated with litigation. We understand that even a small claims case could cost upwards of $2500 if paralegal assistance is required, which would be greater than the proposed single investment limit. An issue brief prepared by the CFA Institute[3] suggests that portals be required to have internal processes to deal with client complaints, as well as join a mechanism for dispute resolution, for this reason.

The crowdfunding proposal obviously represents a departure from the current regulatory model, where selling securities to the public requires a prospectus or an exemption, which are only available in limited circumstances, usually to certain types of investors. Many market participants agree that crowdfunding investment decisions are based mostly on emotions. These two conditions combined could result in a precarious situation for investor protection, and we believe these facts need to be taken into account when finalizing any crowdfunding rules.

The exemption should also be reviewed at a pre-determined time shortly after its implementation to assess its impact on our markets.

We are of the view that it is important, to the extent possible, to harmonize the capital raising exemptions across all Canadian jurisdictions. It is becoming increasingly confusing for issuers, advisors, dealers and investors to determine whether or not a prospectus exemption is available to an issuer or purchaser in a particular province or territory, which has a negative impact on the efficiency of our markets. Given the small amounts of capital that can be raised by issuers and the individual limits placed on investors themselves, we do not think it will be economically feasible for issuers to raise capital based on the proposed crowdfunding exemption if the terms are different in various jurisdictions.

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[3] CFA Institute, *Issue Brief: Investment-Geared Crowdfunding* (CFA Institute), online: <https://www.cfainstitute.org/>. http://www.cfainstitute.org/ethics/Documents/issue-brief-crowdfunding.pdf

General

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?

We do not believe it is necessary to restrict the start-up exemption to issuers that have raised less than a certain amount since their formation. We do believe the total amount an issuer can raise under the exemption should be limited as suggested by other CSA jurisdictions, particularly because the crowdfunding exemption (for larger / more mature issuers) that has also been proposed by some other CSA members includes a cap.

Portal obligations

4. Do the requirements of the start-up crowdfunding exemption adequately protect investors?

Given the lack of portal registration, the "Important Risk Warnings" may take on additional importance for the start-up exemption. The language does not sufficiently emphasize all of the salient risks of investing in an issuer using this exemption. For example, while the language does indicate it may be difficult for an investor to sell the investment, unsophisticated investors might not realize that this means the money might never be available to them, even in a financial emergency. In addition, the warning should cover the lack of continuous disclosure materials. Not every investor will understand what is meant by the phrase which indicates they will not have the same legal rights as those granted when investing through a prospectus offering, and thus it may be helpful to explain some of those rights in plain language. Since it will also be particularly important for an investor to fully understand the nature of investing in a start-up business, it could be helpful to include some information on the portal in plain language which would make the risk of the investment apparent; i.e. a statement to the effect that X% of all small businesses fail within the first Y months (or acknowledging a similar statistic). As the portals can not provide investment advice, it could be helpful to emphasize the benefits of speaking to a qualified financial advisor, and wording could be added to the effect that more information about the investment and the suitability of the investment for the investor's individual circumstances could be provided by a registered adviser/dealer.

In order to help inform investment decisions, the portals could be required to disclose their process for allowing issuers to use their services, as well as information about the success/failure of issuers that have previously raised money through that portal.

Consideration could also be given to providing guidance on permitted communication between issuers and investors and among potential investors themselves on the portal. Portals should have visibility on the information being shared amongst potential investors, some of whom may in reality be paid promoters.

We support the CSA initiative that is underway with respect to potentially imposing a statutory best interest duty on registrants, and strongly support imposing such a duty on registered dealers providing advice to clients, including exempt market dealers providing advice on privately placed securities. Retail investors rely primarily on their advisers to let them know if an investment is appropriate for their level of risk tolerance. Even though it is proposed that investors sign a risk acknowledgement form, investors assume that their advisers are looking out for their best interests. If such a standard were formally implemented, it would help to ensure for those clients that consult a professional that an investment in privately placed securities under the start-up exemption is in fact in a client's best interests, which would materially enhance investor protection.

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?

Given the likelihood that investors purchasing securities in reliance on the crowdfunding exemption will not have extensive investment experience, it is very important for portals to have the primary due diligence responsibility relating to the issuers "listed" on the portal, including the responsibility to compete domestic background checks. To the extent any directors, officers, promoters or control persons are non-residents of Canada, international background checks should also be required.

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

Absent registration, clear expectations must be set for the portals to minimize misconduct, including record keeping requirements relating to the securities issued and the security holders, as well as requirements relating to conflict of interest (i.e. prohibiting investments in the issuer by the portals). The portals should have some regulatory responsibility for ensuring the integrity of the issuers utilizing their services, beyond simply commercial pressures they may face from the investing public. Portals could also be required to provide more robust information about themselves to the regulators, such as with respect to their financial condition.

Although issuers could be expected to seek additional financing, many commentators have noted a "Series A crunch", referring to the problems faced by start-ups when attempting to secure the next level of financing once the initial seed capital is obtained[4]. We believe that any difficulty in achieving the next level of financing might make it even more difficult for investors to dispose of their securities due to the expected lack of any secondary market. As a result, the terms of the exemption should address the resale market, specifically, whether portals are responsible or permitted to maintain a secondary market, as well as specifically advise investors on the portal (who may not be familiar with the resale requirements in other forms of private placements) with respect to the meaning of an

[4] Ross S Weinstein, "Crowdfunding in the U.S. and Abroad: What to Expect When You're Expecting" (2013) 46 Cornell Int'l LJ 427.

indefinite hold period and to whom these securities can be sold in a private placement.

The founders of the issuer could be required to escrow their existing securities for a period of time, in order to ensure they retain a substantial stake in the issuer. The resulting ownership structure after completion of the capital raising through the exemption should be disclosed through the portal.

The portals could be required to assist issuers in providing registrar and transfer agent type functions to help issuers monitor and communicate with their security holders, particularly as it relates to social media communications.

When the exemption is utilized by start-up or smaller companies in the growth phase, it is likely that the capital raising sought by the exemption will not be isolated financing, and companies will likely seek additional funds through alternative methods concurrently or shortly thereafter[5]. Investors may not be cognizant of the fact that each additional financing will dilute their investment, and thus the risk warning (or other warning prominently displayed by the portal) should specifically address the risk of dilution due to additional financings, whether through the portal or otherwise. Issuers should be required to notify investors through the portal of any additional financings.

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?

Instead of imposing a limit based on net assets or net income, we believe that investors should be required to turn their mind to the percentage of the investor's net assets or net income (excluding their principal residence) being placed in one investment. We are concerned that placing a hard limit might result in unintentionally providing asset allocation advice to investors. Instead, investors could self-certify in the risk acknowledgement form whether or not the amount of the investment was greater than a fixed percentage (e.g. 10%) of their net assets/income. Such a requirement would not add to the complexity of the exemption but would require investors and their advisors to consider the risk they are assuming, with a view to the investor's own personal financial circumstances. We note that there is currently nothing in the proposed exemption that would prevent an unsophisticated investor from investing all of their financial assets in a number of issuers through the start-up 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?

[5] Ibid.

The "cooling off period" is an important investor safeguard, particularly with respect to investments that could be made on the basis of social media pressure / emotional response as might be expected with start-up issuers raising funds under the start-up exemption.

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?

We understand that the cost of preparing financial statements that are not otherwise required to be prepared (for corporate law reasons or otherwise) could be prohibitive. However, we do think issuers could comment on their financial condition, as well as provide updates to investors on the ownership and capital structure of the issuer, at minimal cost.

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at chair@cfaadvocacy.ca on this or any other issue in future.

(Signed) *Ada Litvinov*

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Chair, Canadian Advocacy Council