June 17, 2014

BY EMAIL

Autorité des marchés financiers
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Nova Scotia Securities Commission

Me Anne-Marie Beaudoin
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Dear Sirs/Mesdames:

Re: Multilateral CSA Notice of Publication and Request for Comment - Draft *Regulation 45-108 respecting Crowdfunding;* Draft *Policy Statement to Regulation 45-108 respecting Crowdfunding;* Draft Blanket Orders in Manitoba, Québec, New Brunswick and Nova Scotia on the Start-Up Crowdfunding Prospectus and Registration Exemption and Draft Amendments to General Order 45-925 – *Saskatchewan Equity Crowdfunding Exemption* (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.

As an introductory comment, 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

[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.

precarious situation for investor protection, and we believe these facts need to be taken into account when finalizing any crowdfunding rules.

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 either of the proposed crowdfunding exemptions if the terms are different in various jurisdictions.

Issuer qualification criteria

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

The Crowdfunding Exemption should be restricted to non-reporting issuers. If the new exemption is intended to address a funding gap for small and medium sized issuers, there should not be a need for those issuers already subject to an expensive continuous disclosure regime to raise money through this exemption. In addition, it could be confusing for people investing in more than one issuer through the portal if issuers have different reporting requirements. They may not understand the difference between the reporting obligations of a reporting issuer and a non-reporting issuer. As an example, if an investor purchases the securities of a reporting issuer through the portal as their first investment, they might come to expect every issuer in which they invest through the portal to have a robust continuous disclosure regime, which would not be the case for the investment they next make in a non-reporting issuer.

3. The Crowdfunding 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 agree that requiring a majority of the issuer's directors be resident in Canada will help the objective of ensuring the initiative is aimed at facilitating capital raising for Canadian issuers. It is important to continue to permit some of the directors to be non-residents to help ensure that each issuer can structure its internal affairs appropriately and encourage participation by the directors best suited for the particular issuer and industry.

Offering parameters

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

We think a limit of $1.5-$3 million could be sufficient for issuers to raise start-up capital while still offering some level of investor protection, however the appropriate limits will be industry specific (for example, technology start-ups are quite capital intensive). More information could be required in order to determine if the limits should vary depending on the industry classification of the issuer. In all circumstances, if the maximum limit is too low, it could set up an issuer for failure before it has even begun operations. If the maximum limit is too high, however, given the proposed $2,500 individual investor limit, an offering could result in an unworkable number of small investors, and the costs of communicating with such investors could be untenable.

Investment limits

7. The Crowdfunding 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?

We do not think that there should be separate investment limits for accredited investors who invest through the portal. Simply being an accredited investor is not in all cases a proxy for investor sophistication. Possessing investable assets above a certain threshold may not imply familiarity with investments, as the threshold could be reached through inheritances and lottery winnings, as examples. Neither an asset test nor an income test is sufficient to determine which investors have better access to information and are sophisticated enough not to require as much protection as others.

Other

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

The proposed requirements for registered portals and the caps on investment are important safeguards, but additional restrictions could be considered specifically to address concerns relating to investors with low financial literacy and/or minimal investment experience. Timely and effective enforcement will also be key to mitigating the risk of abuse and fraud. Staff should monitor, in particular, that the requisite financial reports are provided in a timely fashion and completed as required.

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[3]. 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) to whom these securities can be sold, and a description of the proposed hold periods.

In order to help mitigate the risk of fraud, issuers could be required to disclose information with respect to persons with signing authority over the financial accounts of the issuer (if it differs from the principals, directors, etc. for whom disclosure is otherwise required).

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.

With respect to disclosure requirements, unique obligations may be required in order to provide investors with tangible, relevant information on the issuer without requiring the issuer in all cases to provide expensive, audited financial statements. For example, the issuer could be required to post tax returns or assessments (redacted as needed to protect confidential information) as a method of confirming revenue (or the lack thereof).

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 that an investment in privately placed securities under the Crowdfunding Exemption is in fact in a client's best interests, which would materially enhance investor protection.

Additional portal obligations

14. 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?

Given the likelihood that investors purchasing securities in reliance on the crowdfunding

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

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. Due to the costs and time delays that such checks may entail, it may not be necessary to run international background checks on every resident Canadian.

Other

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

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[4]. 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.

Start-Up Exemption

As a general comment, we have serious investor protection concerns with respect to the proposed start-up exemption, particularly as a result of the lack of registration for the portals, and would prefer that the exemption be limited to the terms of the Crowdfunding Exemption. 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.

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.

[4] Ibid.

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 in order to recover any losses, which is unlikely to occur given the cost of 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 single investment limit. An issue brief prepared by the CFA Institute[5] 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 exemption should also be reviewed at a pre-determined time shortly after its implementation to assess its impact on our markets.

19. Considering that the Start-Up Exemption will be substantially harmonized amongst the Participating Jurisdictions, it is our intention to allow a portal established in one Participating Jurisdiction to post offerings from issuers established in another Participating Jurisdiction. Also, portals established in one Participating Jurisdiction would be allowed to open their offerings to investors from other Participating Jurisdictions. Do you see any problems with this approach?

If the Start-Up Exemption is adopted, we do not see any problems with this approach. Given the proposed individual investment limits, it will be important for issuers to be able to access investors in more than one Canadian jurisdiction.

20. One of the major differences between the Crowdfunding Exemption and the Start-Up Exemption is that there is no registration requirement for the portal under the Start-Up Exemption. Do you think there are appropriate safeguards to protect investors without the registration of the portal? If not, please indicate what requirements should be imposed to the portal in order to adequately protect investors.

We believe that registration of the portal for the Crowdfunding Exemption is one of the primary safeguards against fraud and abuse, and registration will assist the regulators in their monitoring and enforcement efforts. 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

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

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.

22. The Start-Up Exemption would prohibit an investor from investing more than $1,500 in a single investment under the exemption. Is this limit appropriate? Should there also be a limit on the dollar amount that may be invested on a yearly basis by an investor?

There should be a maximum limit on the amount one person can invest in a given year. 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.

23. Should there be minimal ongoing disclosure that issuers be required to provide to their security holders? If yes, what should it be?

We understand that the cost of preparing financial statements, either at the point of sale or on an ongoing basis, would 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.

24. We expect issuers using the Start-Up Exemption to maintain the information provided in the Issuer Information form and the Offering Document form updated throughout the distribution period. Should there be an obligation for issuers to further update that information outside the distribution period?

Please see our response to #23 above.

25. Should investors have the right to withdraw their subscription at least 48 hours prior to the disclosed offering deadline, as proposed under the Crowdfunding Exemption?

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.

27. Are there other requirements that should be imposed to protect investors, taking into account the stage of development of the issuers susceptible to issue securities under the exemption?

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.

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