



## **\*\* UPDATE\*\* Raising Money in Ontario** What's Up With Crowdfunding and Other Initiatives?



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In October, 2013 I advised that the Ontario Securities Commission (the “OSC”) had signalled its intention to propose new prospectus exemptions, including a ‘crowdfunding’ exemption, which will make it easier, particularly for start-ups and early-stage entities, to raise money through equity financing ([Focus on Corporate Finance, October 2013](#)). On March 20, 2014 the OSC followed-through by publishing draft legislation which would implement four new capital raising prospectus exemptions:

- crowdfunding
- offering memorandum
- family, friends and business associates
- existing security holders of listed companies

Certain details of these proposed exemptions, which will not be available to investment funds, are described below.

### **Equity Crowdfunding**

The new ‘crowdfunding’ exemption proposed by the OSC would permit Canadian entities (“issuers”) to raise capital from the public by the issuance of securities through an independent and regulated website called a “Portal”. This exemption is designed to enable an issuer to access a potentially large number of equity investors on a cost-effective basis via the Internet and social media, regardless of an investor’s financial

profile or investment sophistication, subject to certain requirements for the protection of investors.

To protect investors from potential losses, no investor will be permitted to invest more than \$2,500 in a single investment or \$10,000 in total investments under this exemption in a calendar year. The issuer will be required to give the investor a streamlined disclosure document that includes basic information about the issuer, the securities offered and the Portal. Investors will also be required to sign a specific risk acknowledgement form.

The disclosure document given to investors must include financial information about the issuer consisting of third party confirmation of the cash on hand if the issuer has not yet incurred any expenditures, unaudited financial statements which have been reviewed by an independent public accounting firm if the issuer has raised *less* than \$500,000 under prospectus exemptions and has spent *less* than \$150,000 since its formation, and audited financial statements if the issuer has raised *more* than \$500,000 under prospectus exemptions and has spent *more* than \$150,000 since its formation.

Marketing materials used by the issuer for the offering of securities will be limited to the streamlined disclosure document provided to investors, documents referenced therein, and any term sheet or summary, which can include a video. An issuer will be permitted to use social media or paper notice to direct potential investors to the Portal.

Although there is no limit on the number of investors to whom an issuer may sell, issuers will not be permitted to raise more than \$1.5 million in any 12 month period under the crowdfunding exemption. Offerings of securities must be completed within 90 days, must specify a minimum amount of funds to be raised in order to close the offering, and upon closing the issuer must have sufficient financial resources to complete the next milestone or carry out the activities as described in the issuer's written business plan.

An issuer which is not a reporting issuer (i.e. not a 'public entity') and which uses the crowdfunding exemption will thereafter be subject to new and ongoing disclosure requirements. Such issuers will be obliged to file with the OSC and provide to their investors, annually, audited financial statements if the issuer has exceeded the \$500,000 fundraising and \$150,000 expenditure thresholds described above or, otherwise, unaudited financial statements that have been reviewed by an independent public accounting firm together with disclosure of how the crowdfunding proceeds have been expended. Such non-reporting issuers will also have to notify their crowdfunding investors within 10 days of the occurrence of certain corporate events, including fundamental changes in the issuer's business and capital structure, corporate reorganizations, take-over bids, significant acquisitions and changes in directors and executive officers.

### **Portal Requirements**

The independent websites through which issuers will be required to conduct crowdfunding will be required to become registered with the OSC in the category of 'restricted dealer' and will be required to meet the same minimum capital, insurance, regulatory reporting, record-keeping and record-retention requirements as currently apply to exempt market dealers. Portals will also be required to conduct certain 'due diligence' and exercise an oversight function including:

- a. conducting background checks on issuers, directors, officers, promoters and controlling shareholders;
- b. understanding the structure, features and risks of the securities offered by the issuers through

the Portal;

- c. reviewing the information presented by the issuers on the Portal's website to confirm that the information adequately sets out the general features and structure of the securities, issuer-specific risks, parties involved, any identified conflicts of interest, and the intended use of funds;
- d. denying access to an issuer if it has reason to believe that the issuer or its offering is fraudulent; and
- e. providing investor education materials in plain language and obtaining a signed risk acknowledgement form from investors.

Portals are also prohibited from recommending or advising on specific securities offered through the Portal, may not generally solicit the purchase or sale of the securities offered on the Portal, and may not facilitate a resale market in securities issued under the crowdfunding exemption. The Portal will not be permitted to hold investor funds or securities. The Portal may accept securities of an issuer in payment of fees owing to the Portal provided that such securities represent less than 10% ownership interest in the issuer but the Portal must otherwise not invest in any issuer or underwrite the securities of an issuer.

### **Other Provinces**

Some other provinces have also proposed a variation of the crowdfunding exemption proposed by the OSC under which issuers would have no ongoing financial disclosure obligations and Portals would not be required to be registered however there would be an annual \$300,000 limit on funds raised.

### **Offering Memorandum Exemption**

The 'offering memorandum' ("OM") exemption proposed by the OSC is based on, but not identical to, the OM exemption currently available in Alberta, Quebec and some other provinces and the territories under section 2.9(2) of National Instrument 45-106 ("NI 45-106"). The OSC has indicated that it expects that the new OM exemption will assist issuers that

are moving beyond the early stages of development and will provide new opportunities for exempt market dealers to assist issuers in their capital-raising efforts.

The OM exemption will allow an issuer, subject to certain conditions and restrictions, to issue securities (excluding certain complex securities) to investors who have signed a risk acknowledgement form and to whom the issuer has provided a specific form of offering memorandum which includes audited financial statements. If the investor is an 'eligible investor', but not an accredited investor, they may purchase no more than \$30,000 of securities under the OM exemption in any calendar year. If the investor does not meet the 'eligible investor' qualifications they may purchase no more than \$10,000 of securities under the OM exemption in any calendar year. An 'eligible investor' is an investor which satisfies certain minimum financial requirements (which are less stringent than those of an 'accredited investor') or who has received advice from an 'eligibility adviser'. For example, an individual is an eligible investor if their net income before taxes exceeded \$75,000, or when combined with their spouse, \$125,000, in each of the two most recent calendar years and who reasonably expects to exceed that income level in the current calendar year, or whose net assets, alone or together with that of their spouse, exceeds \$250,000 excluding their primary residence. In the case of an investor which is not an individual (i.e. a corporation or other entity), such an investor would be an eligible investor if they had net assets of at least \$400,000. An investor which does not meet any of the aforementioned financial qualifications for an 'eligible investor' would nevertheless qualify as an 'eligible investor' if they are advised by an eligibility advisor in respect to the purchase of the security offered by the issuer. An eligibility adviser is a person registered as an investment dealer and who is authorized to give advice relative to the security sold by the issuer.

There is no limit on the size of an offering or as to how long an offering may remain open under the OM exemption.

If an issuer which is not a reporting issuer uses the OM exemption it will trigger certain new and ongoing disclosure requirements. Such non-reporting issuers must thereafter make available to their investors and

file with the OSC on an annual basis audited annual financial statements within 120 days of the year-end together with a notice that describes how the proceeds of the OM exemption offering have been used. A non-reporting issuer will also have to give notice to its investors within 10 days of the occurrence of certain corporate events, including fundamental changes in the issuer's business and capital structure, corporate reorganizations, take-over bids, significant acquisitions and changes in directors and executive officers.

### **Family, Friends and Business Associates**

The family, friends and business associates ("FFBA") exemption proposed by the OSC is designed to facilitate early stage entities in raising capital from family members, close personal friends and close business associates of management, founders and controlling shareholders and is substantially similar to the exemption that has been available in other provinces under s.2.5 of NI 45-106. The FFBA exemption would allow access to a larger scope of potential investors than is currently permitted in Ontario under the 'founder, control person and family' exemption in s.2.7 of NI 45-106 and, unlike the existing 'private issuer exemption' which permits the sale of securities to similar types of investors but has a 50 security holder limit, there would be no numerical limit under the FFBA exemption. It is proposed to eliminate the 'founder, control person and family' exemption in s.2.7 of NI 45-106 when the FFBA exemption is implemented.

Investors under this exemption will be required to sign a risk acknowledgement form in which they will also identify their particular relationship to management personnel, the founder or controlling shareholder of the issuer, as applicable. The FFBA exemption will not be available for the issuance of certain novel or complex securities.

### **Existing Security Holders**

The OSC has proposed a new prospectus exemption which would enable issuers whose securities are listed on any of the Toronto Stock Exchange, TSX Venture Exchange or the Canadian Securities Exchange to sell to existing security holders securities of the class

listed on the exchange. This proposed exemption is designed to make it easier and more cost-effective for listed issuers to access the capital markets while providing a greater opportunity for 'retail' (i.e. non-accredited) security holders to participate in primary offerings by listed issuers. All existing security holders must be given the opportunity to purchase, on a pro-rata basis, the securities offered under this exemption. An issuer may not use this exemption to issue more than 100% of the outstanding securities of the same class. To be eligible to use this exemption an issuer must have been a reporting issuer for at least 12 months or, alternatively, must have become a reporting issuer via a prospectus offering.

### **Related Matters**

Issuers utilizing any of the four proposed exemptions will be required to electronically file with the OSC a new and more detailed form of report than Form 45-106F1 which is currently required to be filed in connection with certain exemptions under NI 45-106.

Although the OSC has not proposed at this time any changes to the existing rights offering exemption it is continuing to work with other members of the Canadian Securities Administrators ("CSA") to explore ways in which the rights offering exemption can be streamlined to improve its efficiency and effectiveness.

Also, the CSA, which includes the OSC, has recently published for comment proposed amendments to NI 45-106 which would, among other things, remove the availability of the minimum amount (\$150,000) exemption for individuals and which would allow portfolio managers of fully-managed accounts to purchase investment fund securities under the accredited investor exemption.

### **Comment Period/Implementation**

The OSC will accept comments on the proposed prospectus exemptions until June 18, 2014. If, following the comment period, the OSC decides to proceed to implement the proposed prospectus exemptions without any further material amendments and comment process, the new prospectus exemptions could take effect in the latter half of 2014.

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