

November 5, 2013

BY MAIL AND EMAIL

Saskatchewan Financial and Consumer Affairs Authority
Securities Division – Saskatchewan Equity Crowdfunding Exemption
Suite 601-1919 Saskatchewan Drive
Regina SK S4P 1C2

Dear Sirs/Mesdames:

Re: General Order 42-925 Saskatchewan Equity Crowdfunding Exemption (the “General Order”)

The Canadian Advocacy Council¹ for Canadian CFA Institute² Societies (the CAC) appreciates the opportunity to comment on the General Order.

As a general comment, the CAC is supportive of the efforts of the Saskatchewan Financial and Consumer Affairs Authority to proactively and quickly examine alternatives to the existing prospectus exemption regime. However, it is important that the conditions of the proposed crowdfunding exemption do not favour small issuers over investor protection and transparency in the capital markets. We have a number of investor protection concerns with respect to the use of crowdfunding that can only be addressed through strict monitoring and enforcement of the use of the exemption.

By its nature, the exemption involves the issuance of securities to a large, potentially unsophisticated group of investors with no other relationship to the issuer. We have commented previously on the Ontario Securities Commission Staff Consultation Paper 45-710 – Considerations for New Capital Raising Prospectus Exemptions. In our comment letter, we emphasized that there is an increased possibility that the management of an issuer choosing to raise money through crowdfunding will not have adequate

¹The 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 113,000 members in 140 countries and territories, including 102,000 CFA charterholders, and 137 member societies. For more information, visit <http://www.cfainstitute.org/>.

experience and qualifications to run a business. Under the proposed General Order, an issuer would only be permitted to raise a maximum of \$300,000 per year (\$150,000 in each of two offerings). It is likely that issuers that find the exemption attractive will be those that have already been rejected by banks and other traditional lenders, and possibly used all available capital from family and friends, or had financing declined by them. They may not have any financial background or ability to adequately access the financial risks attributed to their business. The General Order would not require issuers to provide financial statements or comment specifically on the financial condition of the business.

It would be helpful to know if there are statistics available with respect to the success of small businesses in the Province, and thus whether or not that information is material and should be provided to potential investors, as it could indicate a potential matching loss rate from a crowdfunding offering. In addition, \$150,000 per offering, in most cases, would not be enough money to start a new business or carry an existing business through a growth stage, so it would be helpful to know in more detail the type of fundraising the exemption is intended to encourage.

With respect to the maximum amount that can be invested by a person in any one offering made under the General Order, we are concerned that there is no maximum amount that any one person can invest in any given year, or any maximum based on an individual's net worth or annual income. While the loss from an investment in any one offering under the General Order is limited to \$1,500, there is nothing that would prevent an unsophisticated investor from investing all of their net worth or financial assets in a number of issuers through the crowdfunding exemption.

While the offering document form can be simpler than a prospectus or offering memorandum, there is still important information that should be added to the form currently contemplated. While financial statements may be too expensive to prepare for issuers relying on the exemption, they should at a minimum have to comment on the financial condition of the issuer, as well as provide a description of the ownership and capital structure of the issuer. We also believe that certain portions of the offering form should be able to be modified from the draft, notably the glossary in connection with terms that do not relate to the particular offering being made. Issuers should also be required to disclose whether they have previously tried to obtain financing from other sources and, if they were denied, a summary of the reasons therefor. They should also have to indicate whether they have declared bankruptcy or undergone a reorganization or similar procedure in the past, and when that occurred. Investors would also find helpful information such as the total amount of investment put up in the issuer by the owners/promoters, as well as a summary description of the total number of businesses owned or operated by the owners/promoters previously or concurrently with the issuer for which financing is being sought and their success rates.

Issuers should be required to update the information on the portal, at a minimum on an annual basis. Such information would be helpful to investors who purchase securities on the secondary market (if any). It could also be useful to investors and the regulators if the

issuers were required to disclose information such as the name, business address, resume and photograph of each person with signing authority over the financial accounts of the issuer.

We appreciate that the proposal not to require portals to register with the Saskatchewan Financial and Consumer Affairs Authority is intended to streamline regulation and reduce the costs to issuers in connection with the exemption. However, it is unclear to us how, absent registration, the regulators would be able to quickly enforce sanctions on such portals in the event the terms of the exemption are not met or the portals engage in inappropriate activities. Absent registration, there should be clear expectations set for the portals to minimize misconduct, including record keeping requirements, requirements to segregate investor funds at a regulated bank or trust company while an offering is open, requirements relating to conflicts of interest (i.e. not permitting portals or their operators to have an interest in the issuers raising money through those portals), and minimum insurance requirements to deal with any loss of investor funds while held through the portal prior to release to the issuers. In addition, the portals should retain some responsibility for mitigating the risk of fraud that can be facilitated by the anonymity of the internet. Portals should keep any available financial information and risk factors about the issuer, and can be used to help ensure issuers and investors do not exceed the maximum amount they are permitted to raise and invest, respectively. Portals should also be responsible for determining that all necessary anti-money laundering obligations have been satisfied. The information provided to the regulator in the proposed issuer and portal information form is much less onerous than the requirements relating to personal information forms for prospectus filings or exchange listings, and thus the portal must have some responsibility for ensuring the integrity of the issuers utilizing their services. Consideration should also be given to requiring the portals to provide additional information to the regulators, such as their credit rating (if any) and financial condition.

If the portals are owned by banks or other large institutions, it will be important that they be required to institute ethical walls to ensure that other divisions do not have priority access to issuer information.

We support the requirement to require investors to acknowledge reading the “Important Risk Warnings” document; however, the document does not sufficiently emphasize all of the salient risks of investing in an issuer using the crowdfunding exemption. For example, the wording suggesting that it will be difficult to “cash in” on the investment might not clearly communicate that the investment is illiquid and that there are resale restrictions, and that money may not be able to be taken out of the investment even in a financial emergency situation. The warnings should also cover the lack of continuous disclosure materials. We also do not believe that every investor will understand what is meant by the phrase indicating they do not have the same legal rights as those granted when investing through a prospectus offering. As a result, it might be helpful to explain the top 2 or 3 legal rights that are not available to an investor in a private placement of this nature. It is also important for investors to fully understand the nature of investing in a start-up/small business, and thus an acknowledgment to the effect that X% of all small

businesses fail within the first Y months, and therefore the investor has a X% chance of losing his or her investment within that time period (or acknowledging a similar available statistic). As the portals will not be permitted to provide any investment advice, we think it is important to emphasize the benefit that investors would receive from speaking to a qualified financial adviser, 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 can be provided by an adviser.

The investor should also have to certify that they have not exceeded their investment limit in the offering (through the use of nominees, etc.). As noted above, we believe there should be a limit on the number of such offerings that any one investor can participate in during a 12 month period, and thus a certification could be added to verify that such limits have not been breached. Also, the investor should authorize the collection of personal information taken and used in the information provided to the issuer and the regulator. Another statement should indicate that the investor understands he/she could lose his/her whole investment and that the investor can bear the financial loss.

In addition, while the crowdfunding exemption is meant to be used only by investors and issuers with an address in Saskatchewan, it is conceivable that issuers with a head office and/or substantial connection to another jurisdiction with nominal operations, or simply a mailing address, in Saskatchewan could try to make use of the exemption to sell to Saskatchewan residents.

While it might be addressed in the upcoming guide for issuers and portals, it is currently unclear how the communication chain is intended to operate between investors, the portals and the issuers. For example, the guide should provide clear instructions on how the status of the offering and the amount accepted for investment is communicated to investors. Similarly, the guide should prescribe the type of communication that will be provided if an offering is oversubscribed, or can not proceed because it does not attain the minimum amount or is terminated for any other reason. Additional guidance would also be helpful on whether it is anticipated investors would be able to communicate with one another through the portal. In addition, consideration should be given to requiring portals to disclose their process for allowing issuers to use their service, as well as information regarding the success of issuers that have raised money through the portal or the number of issuers that have subsequently become insolvent. Issuers will likely also require assistance in the event there is a need to communicate with their security holders, and the portals could be required to provide or arrange for registry and transfer agent type functions to assist issuers with communication and investor relation functions.

It will be very important for the regulatory authorities to monitor the portals and the issuers using the General Order. Timely and effective enforcement will be important to mitigate the potential risk of abuse and fraud. It may be helpful to consider out-of-the box requirements to help ensure issuers have sufficient capital to run a business,

including requiring senior management to post collateral and/or require issuers to post a certified summary of their tax returns.

We believe it is important that, to the extent possible, the capital raising exemptions be harmonized across all Canadian jurisdictions. Harmonizing the exemptions would simplify the capital raising process for issuers, and would help issuers and prospective investors more easily confirm eligibility for participation in an exempt offering that occurs in more than one jurisdiction. Rather than instituting a crowdfunding exemption on a jurisdiction by jurisdiction basis, we believe it would be more advantageous to go forward with an exemption on the same terms as those agreed to in other CSA jurisdictions. As the exemption is intended to be available to raise only a small amount of capital, it would not seem economically feasible for issuers to raise capital based on this exemption if the terms were different in various Canadian jurisdictions.

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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