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VIA EMAIL

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**Re: CSA Multilateral Notice and Request for Comment Proposed Order 45-539
Small Business Financing (the “Proposed Order”)**

The Canadian Advocacy Council of CFA Societies Canada¹ (the “CAC”) appreciates the opportunity to provide the following comments on the Proposed Order. While we are strongly supportive of the ASC and FCAA’s intent to foster capital formation and, more importantly, help smaller businesses raise capital and thrive, we have a number of specific concerns with respect to the Proposed Order.

More specifically, we would recommend consideration of the following three areas:

1. There does not appear to be a clearly communicated target issuer or investor base who will benefit from the proposed prospectus exemption;
2. The economic model upon which the prospectus exemption is based may not be viable; and
3. There may be unintended consequences of the securities offerings contemplated by the Proposed Order for retail investors.

We examine each of these concerns in more detail below.

We are unclear about who is intended to benefit from the proposed prospectus exemption and whether there is in fact a group of issuers or investors by or for which no other existing prospectus exemption could be utilized. For example, it is noted in the Proposed Order that “start-ups” could otherwise utilize the start-up crowdfunding exemption in Proposed National Instrument 45-110 *Start-up Crowdfunding Registration*

¹ The CAC is an advocacy council for CFA Societies Canada, representing the 12 CFA Institute Member Societies across Canada and over 18,000 Canadian CFA Charterholders. The council includes investment professionals across Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. Visit www.cfacanada.org to access the advocacy work of the CAC.

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors’ interests come first, markets function at their best, and economies grow. There are over 173,000 CFA Charterholders worldwide in over 160 markets. CFA Institute has nine offices worldwide and there are 159 local member societies. For more information, visit www.cfainstitute.org.

and Prospectus Exemptions (“NI 45-110”). It is proposed in NI 45-110 that the aggregate gross proceeds raised by an issuer group during the 12 months prior to the crowdfunding distribution cannot exceed \$1 million, and each purchaser would be limited to an investment of no more than \$2,500 (\$5,000 if the purchaser has received advice from a registered dealer that such investment is suitable). As a result, we are not certain whether issuers would be motivated to try to meet the myriad conditions of the new proposed exemption as an alternative. We would have expected that issuers would instead have traditionally turned to the “family, friends and business associates” exemptions in sections 2.5 and 2.6 of National Instrument 45-106 *Prospectus Exemptions (“NI 45-106”)*.

In addition to whether issuers would otherwise choose to rely on the proposed prospectus exemption, we query if the economic model of the exemption is viable. We believe that the small capital raising limits set out in the Proposed Order may not justify the time and expense of raising capital utilizing the exemption.

We do not believe the availability of this prospectus exemption will result in favourable outcomes for retail investors. We believe the small allowable investment amounts, by design or unintended outcome, will attract retail investors. Even with the required risk disclosures, investments in such companies will pose a risk to retail investors of a permanent loss of their capital. In a paper entitled “Equity Crowdfunding: High-Quality or Low Quality Entrepreneurs?²”, authors Danie Blaseg, Douglas Cumming and Michael Koetter argue in the context of equity crowdfunding in Germany that as a result of potential costs due to factors such as early public disclosure of activities and communication costs with a large number of investors, such crowdfunding attracts lower-quality entrepreneurs, and that entrepreneurs who access such smaller offerings are more likely to fail.

Despite the information that would be made available to them through the offering document (more on that below), retail investors do not have the luxury of a secondary market price to be able to determine if the price they are paying for securities in a private placement for a private issuer is reasonable.

The Proposed Order would require, if issuers raise more than \$1.5 million pursuant to the new prospectus exemption, the delivery of financial statements that have been audited or subject to a review engagement. Further, such statements could be based on Canadian GAAP applicable to private enterprises (“**ASPE**”), with some modifications.

We believe that there have been demonstrated issues when ASPE is utilized, for example, potential for stale information with respect to valuation data. We recognize that the cost and time required to prepare and provide financial statements and obtain assurance in a review or audit engagement can be material for a small business. We have concerns about the lack of financial information that is provided to investors if the “issuer group” raises no more than \$1,500,000 under the proposed exemption in a 12-

² Daniel Blaseg, Douglas Cumming and Michael Koetter, “Equity Crowdfunding: High-Quality or Low-Quality Entrepreneurs?” (2021) 45(3) *Entrepreneurship Theory and Practice* 505.
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month period. We would be supportive of some form of financial information being provided, such as through an expansion of Form 45-539F1 Small Business Offering Document, so that an investor can exercise diligence, independence, and thoroughness in analyzing their investment decision.

It is unclear in the Proposed Order who would be permitted to perform the required financial review. We believe it is important that the requirement specify that the certified public accountant performing the review engagement be independent.

We recognize the higher level of assurance provided to investors through audited financial statements. While reviewed financial statements do provide for a lower level of cost and time for the issuer, which can be very helpful for a small business, we hold the perspective that the delivery of audited financial statements be a prerequisite to higher offering and investment limits.

The proposed prospectus exemption would require the use of a streamlined offering document as set out in Form 45-539F1. The current form of offering document proposed is quite comprehensive, and we support the required level of disclosure. However, since such documents are not generally reviewed by regulators in advance of their use, the fact that a prescribed form of document is used may lull retail investors into a false sense of security that the offering has been vetted by regulators. As CFA charterholders with investment decision-making roles, we have seen that the fees, organizational description, risks and security attributes that are set out in offering documents tend to be complex and difficult for readers to understand. We continue to support clear and prominent fee and conflict disclosures upfront on the face pages of an offering document as an important investor protection mechanism, as well as “plain language” requirements throughout.

We note that the exemption may be of interest to issuers that are capital pool companies and are ‘SPAC-like’ in nature. These pooled vehicles provide a way for retail investors to access private market opportunities otherwise unavailable to them. Retail investors may be attracted to the optionality of accessing a popular, private deal that would be otherwise unavailable for investment. A concern frequently raised with respect to such issuers, however, is that those persons working for the issuer to search for investments utilize all available cash to do so, often overpaying for a private asset and ultimately diluting equity ownership by offering other investors PIPE investments.

Finally, the Proposed Order has some inconsistencies in language with what has been proposed in the Proposed Amendments to NI 45-106 and Proposed Changes to Companion Policy 45-106CP *Prospectus Exemptions* Relating to the Offering Memorandum Prospectus Exemption in September 2020 (the “**OM Proposals**”). For example, the OM Proposals would define a “collective investment vehicle” as “an issuer whose primary purpose is to invest money provided by its security holders in a portfolio of securities”. While that term would include investment funds (in jurisdictions where investment funds can utilize the Offering Memorandum exemption), the Proposed Order instead references that the new exemption may be used by “some businesses that act as a vehicle for collective investment”, including opportunity development cooperatives.

We believe that the terms should be harmonized across prospectus exemptions wherever possible.

While we are of the view that innovative prospectus exemptions can provide tangible benefits to issuers through additional avenues for capital raising and to investors through diversification opportunities outside of the traditional stock markets, we have concerns in this case that the potential loss of investor protections may outweigh the benefits of the proposed prospectus exemption, particularly given its lack of differentiation from other existing or already-proposed prospectus exemptions, including NI 45-110. Given the issues with the Proposed Order, we would recommend that the implementing jurisdictions adopt an accountability framework for regularized review of issuer usage and investor outcomes from this prospectus exemption, with an initial public report 2 years following the implementation date of the Proposed Order.

Concluding Remarks

While we strongly support efforts to ease capital raising for start-up businesses, we are concerned that the Proposed Order would introduce a prospectus exemption that may not be utilized by issuers, is based on an unsustainable economic model and that could result in unintended consequences for retail investors. We recommend that the implementing jurisdictions closely monitor the usage of this exemption via public reporting on issuer usage and investor outcomes.

We thank you for the opportunity to provide these comments and would be happy to address any questions you may have. Please feel free to contact us at cac@cfacanada.org on this or any other issue in future.

(Signed) *The Canadian Advocacy Council of
CFA Societies Canada*

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