Alberta Securities Commission
Autorité des marchés financiers
Financial and Consumer Affairs Authority of Saskatchewan

June 18, 2014

Re: Request for Comment on Proposed Amendments to NI 45-106.

Dear Sir or Madam,

Thank you for the opportunity to comment on the proposed changes to NI 45-106.

Exempt Experts believes the exempt market is a key part of an effective capital market, filing the gap between traditional bank financing and the public markets.

To this end, we think that the advisor/dealer oversight introduced in NI 31-103 should be given time to work. This structure, regulating the advisors rather than dictating investment limits, has been acknowledged by the regulators as an appropriate method of managing the public markets. Unless and until there is substantial evidence these regulations are not providing sufficient protection for exempt market investors, we believe investment limits are an unnecessary intrusion into the personal finance decisions of Canadians.

We have further addressed these points and others in the attached answers to the questions that you posed for comment.

We hope that you carefully consider them, and the other comments you receive, before making such drastic changes to an important component of the Canadian capital markets.

Feel free to contact the undersigned at 403.261.7500 with any comments or concerns.

Regards,

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CFO

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Comment 1

> *Under the current framework in Alberta, Québec and Saskatchewan, both individual and non-individual investors are subject to the $10,000 annual investment limit if they do not meet the definition of an eligible investor. Should non-individual investors, such as companies, be subject to the $10,000 limit if they do not qualify as an eligible investor? Please explain.*

We do not take a position on this item.

Comment 2

> *Are there circumstances where it would be suitable for an individual eligible investor who is not an accredited investor and not eligible to invest under the FFBA exemption to invest more than $30,000 per year under the OM Exemption? If so, please describe them.*

Given the broad range of circumstance of eligible investors, we believe that suitability and limits should be determined on an individual basis, by registered dealers completing thorough KYC procedures. Exempt market dealers and representatives are in the best position to understand their clients' financial goals, the options available in the marketplace and to provide advice on appropriate investment diversification.

While there are an infinite number of circumstances where investments beyond the $30,000 limit may be appropriate, a few example of such investors include:

- Young professionals with significant time prior to retirement. Their investment timelines provide for the ability to recoup potential losses and they can therefore afford to place more funds into higher-risk securities, such as the exempt market or public market equities.
- An investor with $800,000 in net investable assets and a $1,500,000 mortgage-free house. The proposed rules would limit this investor to $30,000 per year, ignoring the fact that they are clearly financially healthy and well positioned to assume the risk associated with an exempt market investment of more than $30,000.

Comment 3

> *Given the costs associated with doing so, how likely is it that an individual would create a corporation or other entity to circumvent the $30,000 cap?*

Effectively nil. The OSC, and other regulators, have repeatedly noted their difficulty in stopping investors from lying about their eligibility to invest in a product they would otherwise be locked out of. We expect regulators will continue to see the same issue if yet another hard cap is implemented.

Comment 4

> *Investors who do not qualify as eligible investors based on net income or net assets can qualify as eligible investors on the basis of advice from a registered investment dealer. In what circumstances do investors actually seek and receive advice from a registered investment dealer? Does this introduce any complications or difficulties?*

Most IIROC dealers, and certainly the IIROC dealers that non-eligible investors would use, do not typically sell exempt market products. Therefore, in order to qualify, an investor needs first to work with an EMD to find the product the wish to invest in, then take the proposed investment to an IIROC dealer (most likely their bank), and finally return to the EMD if approved by the IIROC dealer.

Even if an investor was to undertake such a cumbersome process, the IIROC dealer has no incentive to approve the investor; doing so would mean the investment and commission go to someone else. Instead, they are more likely to sell one of their own products to the investor.

In order for this rule to be useful, the Commissions should expand the rule to allow registered EMDs to give the required advice. As EMDs are the experts in the market, we believe they are better positioned to provide suitability advice to investors.

Comment 5

a)

> *The eligible investor definition includes persons that have a net income of $75,000 and persons that have net assets of $400,000. These income and asset thresholds currently apply equally to individual and non-individual investors, such as companies.*
>
> *Should the $75,000 income threshold only apply to individuals? If so, please explain.*

We do not take a position on this item.

b)

> *Should the net asset amount exclude the value of the principal residence for individual investors? If so, should the $400,000 net asset threshold be lowered as a result?*

No, the test should not exclude the value of the principal residence. Real estate, whether in rental properties or a personal residence, is an investment and should not be treated differently from any other type of investment. If the net asset test is to truly determine the financial position of an investor, it must include all assets, be it cash, bonds, precious metals, public stocks, private companies or antique cars. Regardless of the form that the investor chooses to hold them in, assets should be treated as assets.

c)

Should pensions be included in the net asset test under the OM Exemption? Please provide the basis for your answer.

Yes, they should be included in the test.

Corporate pensions and RRSP are merely different means of achieving the same end: saving for retirement. This is widely recognized, including in our tax system, where RRSP contribution limits are reduced based on pension contributions. To disallow pensions from the net asset test limits an investors' choices based solely on their employer.

Simply, if having a $400,000 RRSP (which is probably managed personally) makes an investor better able to handle the risks of the exempt market, it is illogical to suggest that having a $400,000 pension (which is probably professionally managed) is somehow different.

Comment 6

The FCAA would appreciate feedback on whether lawyers and public accountants should continue to be considered "eligibility advisers" in Saskatchewan for purposes of the OM Exemption? Please provide the basis for your opinion.

Yes, professional accountants and lawyers should continue to be considered eligibility advisors in Saskatchewan. Further, this rule should be expanded to other provinces.

While these professionals do not have the level of education in the capital markets required of dealers, they also do not need it to provide the level of advice being sought. The advisors are not being asked to complete a full KYP assessment on the investment. Instead, they are ensuring that the individual understand the investment and its risks, understands their own personal financial situation, and understands how that situation is and could be impacted by the investment. The vast majority of professional accountants and lawyers are equipped to provide this level of advice, and those who are not would be bound by their respective professional Codes of Ethics to decline such an engagement.

Additionally, the inclusion of professional accountants and lawyers as eligibility advisors provides investors with access to a set of completely independent advisors who have no financial stake in approving or disapproving a given investment.

Comment 7

a)

How common is it for an issuer that relies on the OM Exemption to make annual financial statements available to security holders?

How is this done? Are they delivered?

It is still uncommon to see issuers provide ongoing financial statements; however, the proportion of issuers offering them has increased since NI 31-103, as many EMDs will not sell products that don't promise ongoing financial reporting.

When they are prepared, we have seen a fairly even split between mailed and online delivery, with a trend towards online delivery to reduce costs.

b)

Are those financial statements typically audited?

Historically, most ongoing financial statements we have seen in our practice have not been audited or otherwise prepared by independent external accountants. However, this has also been changing since NI 31-103, as many issuers are promising audited or reviewed financial statements to increase the likelihood of having their offering carried by third-party EMDs.

c)

If the financial statements are not typically audited, is there an auditor involved and, if so, what standard of engagement is typically applied?

Answered in Comment #7b.

d)

Do issuers that prepared financial statements in accordance with IFRS for inclusion in their OMs typically continue to prepare financial statements in accordance with IFRS or do they transition to generally accepted accounting principles for private enterprises (ASPE)?

Issuers that prepare complete financial statements, as opposed to basic statements with no notes, generally continue to prepare their statements in compliance with IFRS. We cannot comment on issuers that prepare just the basic statements, as such statements generally do not disclose the basis of presentation.

e)

Is it common for security holders to request annual financial statements? Do they request audited financial statements?

In the current environment, both in light of NI 31-103 and the media coverage the failure of certain issuers, many EMDs are requiring ongoing financial reporting as a condition of sale; as a result investors now have wider access to deals where ongoing disclosure will be available.

In older deals, it is our observation that investors generally only request financial statements after they have reason to believe their investment is in trouble (i.e. an interest payment had been missed or there had been media coverage).

f)

What do you estimate as the annual cost of preparing the proposed audited annual financial statements?

We expect a typical inactive issuer (i.e. Land banking) would incur costs of $15,000-$20,000, while active small businesses would incur costs of at least $25,000, with costs increasing drastically based on the complexity of the issuer's business and the size of the deal.

g)

Do you anticipate that issuers will mail annual financial statements to security holders or place them on a website?

Based on the trends discussed above, we expect that most issuers would either email the statements or place them on a website.

h)

What do you estimate as the cost of making annual financial statements available to security holders?

Based on the trend towards online reporting, we expect there would be minimal cost (<$500) involved in making the statements available to investors. If mailing was required, our experience suggests there would be a cost of about $4-5 per investor.

Comment 8

> *Under the Proposed Amendments, issuers relying on the OM Exemption would be required to deliver annual financial statements until the issuer either becomes a reporting issuer or ceases to carry on business. Are there other situations when it would be appropriate to no longer require ongoing annual financial statements for such issuers? If so, please describe them*

No, we believe that a requirement for ongoing financial statements is a great move towards protecting investors and would not suggest any other exceptions.

Comment 9

> *How do issuers relying on the OM Exemption typically communicate with their security holders? Do they maintain websites?*

Historically, we have seen a fairly even split between mailed and online delivery of investor updates, with a trend towards online delivery to reduce costs. Online delivery is normally done through email; however, some issuers do maintain active investor website.

Comment 10

> *Should issuers be permitted to cease providing annual financial statements to their security holders after proceeds of a distribution are fully spent? If so, is there a period of time after which it is reasonable to assume that the proceeds of a distribution under the OM Exemption will have been fully spent?*

No, issuers should not be permitted to stop providing annual financial statements once proceeds have been spent.

Despite the fact that the funds have been spent, a company could still enter into transactions that put investors at risk and that the investors should be informed about. For instance, if an issuer has mortgaged its land to pay for ongoing costs, the investors should be made aware of that even though their money has all been spent. Annual financial statements force issuers to provide regular updates on such activities as they would show up in properly prepared financial statements.

Comment 11

> *Should non-individual investors (e.g., companies or trusts) be required to sign a risk acknowledgment form? Please explain.*

Yes.

Exempt Experts believes strongly in creating a fair and transparent exempt market. Part of that is openly acknowledging the risks inherent in our market, specifically illiquidity and reduced disclosure. We think that all investors should be informed of those risks and that having them sign a risk acknowledgement form is an ideal way for them to signify their understanding of the risks.

Comment 12

> *Should "permitted clients", as defined in National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Obligations be required to sign a risk acknowledgement form? Please explain.*

Answered in Comment #11.

Comment 13

> *Should non-redeemable investment funds continue to be permitted to use the OM Exemption?*

We do not believe that there are any classes of issuers that should be statutorily banned from using the OM exemption. While there may be industries where a prospectus is the better option, due to complexity or other factors, we believe that decision should be left to the individual issuers and their respective counsel.

Comment 14

> *Are there certain types of issuers that should be excluded from using the OM Exemption?*

Answered in Comment #13.

Comment 15

> *Should issuers that are related to registrants that are involved in the sale of the issuer's securities under the OM Exemption be permitted to continue using the OM Exemption?*

We believe that related party sales should be allowed, subject to appropriate disclosure of the conflict of interest; this would be similar to the situation for first-party IIROC dealers. Dealers and representatives selling related products would still be subject to KYC and KYP requirements, as well as providing suitability advice to their clients. As a result, regulators would be able to initiate disciplinary action against any dealer or representative failing properly serve their clients.

Comment 16

a)

> *Currently, most CSA jurisdictions that have an OM Exemption have adopted local blanket orders that permit an issuer to raise up to $500,000 under the OM Exemption without having to include audited financial statements in the OM. Further, the blanket orders permit the financial statements to be prepared in accordance with ASPE rather than IFRS.*
>
> *Should these blanket orders be continued or revoked? Please provide the basis for your answer.*

We have prepared numerous offerings under this blanket order and believe that it should be maintained in a slightly modified form.

First, we think that the ASPE part of the blanket order should be removed, with all issuers forced to prepare their statements under IFRS. Comparability is an important aspect of investor research and we believe it should trump the desire of some issuers to utilize ASPE for their financial reporting.

Second, the blanket order should be strengthened by limiting its use to companies which only have cash and share equity (i.e. no liabilities or income). This would limit its use to start-up companies and ensure that all offerings by active businesses are subject to an audit requirement. Audits of newly formed corporations add unnecessary costs to offerings, while providing no investor protection as there is nothing to audit.

Lastly, with the above changes in place, the $500,000 limit should be removed. The audited statements provide no more information than NTR or issuer prepared statements, yet issuers must pay thousands of dollars for them; costs which are inevitability passed on to investors through the lower returns caused by high issuance costs. Audits of brand new companies benefit no one except audit firms.

b)

If you believe the blanket orders should be continued, should the same threshold amount be used in determining which issuers are subject to an ongoing annual financial statement requirement or an audit requirement? Please provide the basis for your answer.

We believe that $500,000 is too low to require a full audit, as audit bills can easily exceed $25,000 if the company is question is an active business. We would suggest a financial statement review be required for all issuers, and audits required for those who have raised more than $1,000,000 through any combination of exemptions.