April 11, 2014

denise.weeres@asc.ca

Denise Weeres
Manager, Legal, Corporate Finance
Alberta Securities Commission
250 – 5th Street SW
Calgary, Alberta T2P 0R4

and

consultation-en-cours@lautorite.qc.ca

Me Anne-Marie Beaudoin
Directrice du sécretariat
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3

Re: CSA Proposed Amendments Relating to the Offering Memorandum Exemption

Dear Madams:

I am writing to comment on the proposed amendments to NI 45-106, in particular the proposed annual investment limits for non-accredited investors.
The proposed CSA contribution limits for exempt market investors under the OM exemption would be a step backwards from the NI 31-103 regime that was implemented just 3 years ago. This is due to the lack of relevant and substantive (post 31-103) quantitative data that demonstrates that the exempt market in its current form is broken, these investor contribution limits should not be imposed. There is no concrete data currently in existence that conclusively demonstrates that the Exempt Market investments are any riskier than other product categories. This suggests these proposed rules are singling out the Exempt Market based on historical bias rather than facts.

The ultimate, and noble, goal of reducing frauds and investor losses in the Exempt Market is one that should be pursued collaboratively with industry participants, and with constructive solutions. A blanket policy of reducing the amount that anyone can invest is not collaborative or constructive. Fraudsters will still cheat people out of their money (in all registration categories), however innocent in appearance, and sound investment issuers that enrich small business and their investors will lose out. This is punishing all actors for the bad actions of a few.

More beneficial would be a collaborative, industry-wide approach to seek solutions from all Exempt Market participants and their regulators to generate policies and solutions to reduce fraud and investor losses. It is in the interest of all of us that frauds and losses are minimized.

1. **Investor Protection Mechanisms already in place**

- In the case where the trade involves a registered Dealing Representative, who is supervised by a registered Exempt Market Dealer, placing any limits on how much can be invested undermines the very principals of KYC, KYP, and suitability obligations which are "cornerstones of (the CSA's) investor protection regime" put in place under NI 31-103.[1]

- A large enough "filter" already exists to ensure investors are adequately protected:

[1] CSA Staff Notice 31-336 *Guidance for Portfolio Managers, Exempt market Dealers and Other Registrants on the Know-Your -Client, Know-Your-Product and Suitability Obligations*. January 9, 2014. P 1.

- Trade is conducted through a Dealing Representative (registered with a provincial securities regulator) with the "cornerstones of (the CSA's) investor protection regime" being KYC, KYP, and suitability obligations in place under NI 31-103.[2]
- If client and DR agree on a "suitable" transaction, then the trade goes to a regulatory approved Chief Compliance Officer (CCO) to ensure they agree with the suitability of the trade
- Assuming the CCO approves the trade and the issuer closes on investor funds, the trade proceeds and a record of this trade is filed with regulators.
- If regulators do not agree with the trade's suitability, they have varying enforcement options available depending on the regularity and severity of the transgressions.
- This additional limit gives the perception that $30,000 is an acceptable loss for investors and places a stigma on our products.

2. **Diversification Issues**

- "Diversification is an important factor to consider when assessing suitability of investments" yet these proposed annual contribution limits will not allow for proper diversification for many clients.[3]
    - Given the ongoing costs of an investor, many issuers in the exempt market will only accept subscriptions of $25,000 or more. Assuming exempt market product is suitable, how could a Dealing Representative diversify a client's exempt market portfolio if they were capped to dealing with $30,000 contribution room a year?
    - The proposed contribution amounts limit the flexibility needed to build a holistic portfolio based on investor suitability.
    - If regulators are concerned with proper diversification, particularly in regards to those "few issuer groups raising the majority of the funds under the OM Exemption (with their) 'in-house' exempt market dealers" perhaps suitability practices should be looked into closer.[4]

3. **Lack of substantive evidence regarding 'investor complaints.'**

- "The ASC has received numerous complains from investors that have invested significant amounts under the OM Exemption and incurred significant losses"[5]
    - However, the ASC has failed to truly quantify this statement by providing a breakdown of the underlying data for this vague statement which is the basis for their argument to "limit the risks associated with an investment by a retail investor in illiquid securities"[6]

---

[2] CSA Staff Notice 31-336 *Guidance for Portfolio Managers, Exempt market Dealers and Other Registrants on the Know-Your -Client, Know-Your-Product and Suitability Obligations*. January 9, 2014. P 1.
[3] CSA Staff Notice 31-336 *Guidance for Portfolio Managers, Exempt market Dealers and Other Registrants on the Know-Your -Client, Know-Your-Product and Suitability Obligations*. January 9, 2014. P 14.
[4] *Multilateral CSA Notice of Publication and Request for Comment Proposed Amendments to National Instrument 45-106 Prospectus and Registrant Exemptions Relating to the Offering Memorandum Exemption and in Alberta, New Brunswick and Saskatchewan, Reports of Exempt Distribution*. March 20, 2014. Annex B. p 1-3.
[5] *Multilateral CSA Notice of Publication and Request for Comment Proposed Amendments to National Instrument 45-106 Prospectus and Registrant Exemptions Relating to the Offering Memorandum Exemption and in Alberta, New Brunswick and Saskatchewan, Reports of Exempt Distribution*. March 20, 2014. Annex B. p 2.

[6] *Multilateral CSA Notice of Publication and Request for Comment Proposed Amendments to National Instrument 45-106 Prospectus and Registrant Exemptions Relating to the Offering Memorandum Exemption and in Alberta, New Brunswick and Saskatchewan, Reports of Exempt Distribution*. March 20, 2014. P. 3.

- There was no indication that these complaints were related to sales made by a registrant under NI 31-103
  - If they were, does the ASC have evidence of enforcement actions taken against these registrants?
  - The lack of press releases from the ASC regarding disciplinary actions taken against dealing representatives suggests that these complaints stem from the well documented losses that occurred before and were very much the basis for implementation of NI 31-103, an instrument that cost tax payers millions of dollars to create.
  - Accordingly there is no evidence that the post NI 31-103 exempt market, including the existing OM exemption parameters are not working.

4. **Encourages mechanical 'Tick Box' versus client focused behavior**

- Regulators indicate that a "mechanical 'tick box' approach is not sufficient" for constructing an investor portfolio yet that is the very approach they are taking here[7]
  - For example, how can regulators apply the same thresholds to an investor with an income of $75,000 and an investor with more than double that income (eg. $199,999)?
  - How can an arbitrary contribution room be imposed on everyone base on income and net worth without knowledge of the investor's sophistication, time limes and risk tolerance?

5. **Annual contribution room not pragmatic**

- What happens when an existing "retail" exempt market investor has a successful exit where the proceeds exceed $30,000? How will this contribution room be managed?
  - Are regulators prepared to subsequently restrict them to investing $30,000 (which may be less than the principal they originally invested) in order "to limit the risks associated with an investment by (them) in illiquid securities" after they just had success with an investment of that very nature?[8]
  - Dealing Representatives would have a transactional focus with the contribution limits as opposed to the client focus of the suitability process.
  - Who would track and take action when investors have exceeded their annual contribution limits? EMDs or individual DRs would have no current means to ensure with 100% accuracy if the client has staying within the contribution limit over the last 12 month period.
  - Regulators would force investors back into the public markets they fled to the exempt market from when they are trading at an all-time high?

6. **Increases costs and risks**

- The OM Exemption, which is generally used by Exempt Market Dealers and their Dealing Representatives is "designed to facilitate early stage and small business financing" yet the costs associated with the current EMD regulatory regime, coupled with regulators attitudes that losses are unacceptable make funding riskier small business very problematic in its current form.

---

[7] CSA Staff Notice 31-336 *Guidance for Portfolio Managers, Exempt market Dealers and Other Registrants on the Know-Your -Client, Know-Your-Product and Suitability Obligations.* January 9, 2014. P 9.

[8] *Multilateral CSA Notice of Publication and Request for Comment Proposed Amendments to National Instrument 45-106 Prospectus and Registrant Exemptions Relating to the Offering Memorandum Exemption and in Alberta, New Brunswick and Saskatchewan, Reports of Exempt Distribution.* March 20, 2014. P. 3.

Adding these arbitrary contribution limits would even further reduce financing for new enterprises as;

- Eligible investors wanting to take "suitable" SME investment risks would be capped at investing $30,000 per annum.
- Those that do not qualify for Eligible Investor status wanting to take these "suitable" SME investment risks would be capped at investing $10,000 per annum.
- Many existing Dealing Representatives, particularly those who are long term client focused, would leave the industry due to having their ability to earn a living "capped" given the time, complexity, and liability involved with working in the exempt market
- EMDs would have additional costs of dual (conflicting) compliance regimes of suitability on one hand and contribution limits on the other.
- EMDs would be less willing to undertake fundraising efforts for enterprises that have a risk of undercapitalization as their ability to raise funds would be inhibited.

7. **Is the Change within the Securities Commission's scope of Powers?**

- The policy may not withstand a court challenge. It is unclear whether the securities regulators have the authority to dictate caps on the amount of funds investors are able to put into a particular asset type. Such a policy may in fact be unconstitutional, as it takes away investor rights. In addition, setting limits on a particular product category could be considered giving investment advice, which is not in the mandate or powers of the Securities Commissions.[9] Should there be a court challenge of this limit, and should the regulators lose, it would further erode and undermine public confidence in the securities regulators.

This submission is being made on my own behalf.

If you would like further elaboration on my comments, please feel free to contact me at mike.moore@pinnaclewealth.ca

Regards,

Michael Moore

CC:

Cora Pettipas
Vice President, National Exempt Market Association
cora@nemaonline.ca

[9] About the ASC. Under category "Who we are" under sub category "What the ASC can and cannot do." http://www.albertasecurities.com/about/Pages/default.aspx