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June 17, 2014

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Dear Sirs and Mesdames:

Re: Multilateral CSA Notice of Publication and Request for Comment

Proposed Amendments to National Instrument 45-106 (NI 45-106) Prospectus and Registration Exemptions Relating to the Offering Memorandum Exemption in Alberta, New Brunswick and Saskatchewan, Reports of Exempt Distribution

(CSA Request for Comment)

A. Introduction

Walton International Group Inc. (**Walton**) welcomes the opportunity to comment on the CSA Request for Comment. Walton is an issuer/promoter of exempt market investment products and Walton Capital Management Inc. (**WCMI**), an affiliate of Walton, is an exempt market dealer (**EMD**) that is registered in all Canadian provinces where it sells Walton's exempt products.

The exempt market plays a crucial role in capital raising in Canada and Walton supports a regulatory regime for the exempt market that provides adequate protection to investors, fair and efficient capital markets and promotes economic growth.

The slow growth of the economy in Canada and around the world has led governments to find ways to spark growth and investment. In particular, governments are focusing much of their efforts on promoting investments in businesses and economic activity. While banks and large investment houses play a significant role in the Canadian economy, they may have less interest in funding small and medium sized enterprises (**SMEs**).

As a result, many companies must seek alternative means to raise capital. The exempt market is integral to these businesses in order to meet their capital requirements. The CSA estimated the exempt market to be over $150 billion in 2011, compared to the public market, at over $60 billion. Clearly, the exempt markets are one of the main engines of growth for the Canadian economy, or, as was stated in an "Op-Ed" article on May 22, 2014 in the Financial Post (by Chuck Strahl, former member of parliament and federal cabinet minister), "the exempt market is the flagship of the Capital Markets in Canada".

Notwithstanding the above, in the CSA Request for Comment, the ASC and other jurisdictions are proposing adding a restriction in the offering memorandum prospectus exemption (**OM Exemption**) contained in Section 2.9 of NI 45-106 whereunder individual investors that qualify as eligible investors (but do not meet the accredited investor definition) will be prohibited from investing more than $30,000 in investments that utilize the OM Exemption in any 12 rolling month period (**$30,000 Restriction**). We have significant concerns over the proposed adoption of the $30,000 Restriction.

Concurrent with the issuance of the CSA Request for Comment, the Ontario Securities Commission published Proposed Amendments to National Instrument 45-106 *Prospectus and Registration Exemptions* (**NI 45-106**) and Companion Policy 45-106CP Prospectus and Registration Exemptions in connection with the proposed adoption of new prospectus exemptions, including an offering memorandum exemption (**OSC Request for Comment**). We will refer to the OSC Request for Comment below.

B. <u>Commentary on Certain Assumptions Regarding the Exempt Capital Markets</u>

In our experience, a number of general assumptions continue to be made about the exempt capital markets in Canada and certain participants in those markets. We are concerned that the CSA is adhering to some of these assumptions for the purposes of the changes proposed in the CSA Request for Comment. Before we provide specific comments on the CSA Request for Comment, we wish to discuss this further.

1. The Exempt Capital Markets are a "limited" part of the Canadian capital markets.

Many assume that the exempt capital markets in Canada take a backseat to the Canadian public markets in terms of size and impact on the Canadian economy. This assumption may arise from the more "public" nature of the public markets, which, of course, require its participants to provide ongoing and significant amounts of disclosure to the Canadian public.

However, as we indicated above, the CSA estimated that the Canadian exempt markets raised over $150 billion in 2011, compared to the amounts raised in the Canadian public markets in 2011, at over $60 billion.

In addition, in a recent article in the Canadian Business Law Journal "The IPO Market in Canada: What a Comparison with the United States tells us about a Global Problem" (Bryce C. Tingle, J. Ari Pandes and Michael Robinson (2013) 54:2013 Canadian Business Law Journal), it was stated that, between 1993 and 2000, there was an average of 42.6 IPOs on the TSX each year. From 2000 to 20011 the average was 18.2 IPOs in a year.

Not only are the exempt capital markets in Canada materially important to the Canadian economy (and potentially more important than the Canadian public markets), but it appears that Canadian capital raising entities are turning more to exempt markets and less to public markets for their capital needs.

While one can debate why this is occurring, it is clear that extreme care needs to be taken in the regulation of the Canadian exempt markets to ensure that any such regulation does not hamper these

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markets by imposing on them unreasonable and unnecessary restrictions that have a materially negative impact on them and the Canadian economy as a whole.

We agree that investor protection is one of the fundamental requirements of modern securities regulation. We are, however, of the view that sufficient regulation is already in place (through the existence of NI 31-103 and NI 45-106) which, if utilized appropriately, will provide more than adequate protection to Canadian investors in the Canadian exempt markets.

2. Eligible Investors are "retail" investors requiring the protections normally afforded to "retail" investors.

It is clear from the CSA Request for Comment that the CSA considers "eligible investors", being the group of investors (in addition to accredited investors) that can invest through the OM Exemption, to be "retail" investors. We believe that the term "retail investors" is a term that is used frequently without appropriate definition. As a result, using the term "retail investors" to describe a particular grouping of investors can hide the true practical issue of whether such grouping requires the protections generally afforded to "retail investors".

We believe that the investors that require the most significant level of protection afforded by securities regulation are those that exist in the "lower" portions of the investing public in terms of income and assets. It is those investors that the primary rules of securities regulation – the prospectus and registration requirements – are meant for. Those are true retail investors.

While accurate statistics vary and are not easy to come by as it relates to the net worth of Canadians, statistics appear to indicate that, based on the income tests set out in the definition of "eligible" investor as contained in NI 45-106, eligible investors fall within the top 15% of wage earners in Canada.

We believe that this statistic affords some perspective as to who is being regulated by the CSA in connection with its proposed changes to the OM Exemption, including the $30,000 Restriction. Should not the top 15% of wage earners in Canada be able to decide for themselves, with minimal oversight from regulators, what to invest in? Our view is yes. Especially as retirees are living longer and the federal and provincial governments are urging Canadians to build their "nest eggs" appropriately in response to the uncertainty surrounding the ability of present day pensions to fund retirement lifestyles.

We are of the view that the disclosure provided by an OM, the protection afforded by the KYP, KYC and suitability requirements provided for in NI 31-103 and the proposed ongoing disclosure that will be required of entities using the OM Exemption, is more than adequate to protect "eligible" investors. The $30,000 Restriction will only serve to unduly and arbitrarily restrict the top 15% of investors from investing in a manner that they themselves feel is appropriate for them.

3. Exempt Capital Markets are materially more risky than the Public Capital Markets

We agree that the exempt markets have a level of risk that must be recognized and understood by investors. It is generally stated that this risk primarily arises from the illiquid nature of exempt markets. Exempt market issuers generally are not public entities and therefore the securities issued by them are not freely trading, that is, there are restrictions on when and to whom the securities can be sold by the investor that originally acquired the securities. As a result, the ability of the investor to sell the securities if there is a downturn in the markets or in the fortunes of the particular issuer or because the investor needs the money, is very limited.

However, we feel that it is more appropriate to characterize exempt market risk as constituting a different type of risk rather than a materially higher risk than public markets:

(a) securities of many public entities are not listed. Even though the securities of these unlisted entities

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are freely trading, there is no market over which they can be traded. In other words they are likely as illiquid as exempt market securities;

(b) securities of many (if not most) listed public entities are very thinly traded, in other words, they have very little liquidity; and

(c) it is generally retail investors that bear the brunt of losses as a result of illiquid or thinly traded public entity stocks (ie, sophisticated investors have better resources and sophistication to determine when to get out of a stock when there is a downturn and better access to facilities to do so quickly).

There have been many "spectacular" disasters in the public markets over the past many years (Nortel and Bre-X to name just two), in addition to down cycles in the public markets (for example, the bursting of the dot-com bubble from 1999 to 2001 and the financial crisis of 2008 and 2009), where billions of dollars have quickly disappeared from the public markets, including in connection with issuers that have widely traded stocks. We suggest that it is retail investors that disproportionately bear the losses that occur in those circumstances compared to institutional and other sophisticated investors. And yet, under Canadian securities laws, because these are publicly listed entities, their securities can be sold to individuals whose income and net worth fall significantly below those of "eligible" investors.

Our view is that exempt markets are no riskier to investors than public markets. As with public markets, the key to protection of investors in the exempt markets is not inflexible arbitrary rules, but flexible principles-based regulation focusing on the suitability of a particular investment for a particular investor.

4. The focus of the OM Exemption and Exempt Capital Markets in general should be on SMEs; Larger companies wishing to raise capital should do so in the Public Capital Markets

Based on the CSA Request for Comment, it appears that it is the CSA's view that the purpose of the exempt capital markets and, in particular, the OM Exemption, is to promote capital raising for SMEs.

We agree that the exempt capital markets and the OM Exemption are crucial for the growth of SMEs across Canada. It appears to us however that the CSA sees the primary purpose for the exempt capital markets to be the provision of early to next stage capital for SMEs and that entities of larger size should look to raise capital in the public markets.

We disagree that entities that are not SME's should, through regulation, be pushed to "go public" and raise their capital in the public markets and, indeed, we do not agree that it should be seen by regulators that it is part of their mandate to do so.

It should be up to the directors/management/shareholders of each issuer to determine whether they wish for their particular entity to go public. Neither government nor the regulators should fashion regulation in a manner that pushes entities to the public capital markets in order to be able to raise capital for the proper growth of their businesses. Governments and regulators should be agnostic as to how and in which markets public or private companies raise their capital.

Reasons why issuers of any size may not wish to go public can include:

(a) the cost of raising capital in the public markets (especially in an IPO) can be very expensive (ie, multiples of the cost of raising similar amounts of capital in the exempt markets). This cost is borne by the securityholders;

(b) the time frame in which capital can be raised in the public markets (especially in an IPO) can be significantly longer than in which capital can be raised in the exempt markets;

(c) it can be difficult for issuers to attract the attention of registered dealers to sell their product in the public markets, not because the business of the issuer itself may not be profitable or desirable, but because the dealers:

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(i) determine that they cannot gain enough profit from selling the issuer's securities;

(ii) view the business of the issuer as too risky for the registered dealer; or

(iii) the business of the issuer or the securities of the issuer are not "plain vanilla common shares" and therefore are not as efficient or easy to sell as certain other issuers or securities;

(d) the ongoing costs and effort of compliance with being a reporting issuer in Canada is significant and continues to increase;

(e) the level of scrutiny by regulators into the businesses of reporting issuers in Canada is significant and continues to increase; and

(f) some management teams/shareholders, even of large companies, simply do not wish to, and choose not to, go public.

Many issuers find it appropriate to go public, and certain industries and businesses find that their business models are conducive to efficient operation in the public markets. However, many do not. Regulators should not place obstacles in the way of such issuers to raise funds in the exempt markets.

5. The Real Estate Industry is materially more risky than other industries that participate in the exempt markets and should be regulated in a more aggressive manner than other industries

In the OSC Request for Comment, the OSC indicates that it has concerns arising from the use of the exempt markets by non-reporting real estate issuers. We note that the OSC:

(a) states that it has "identified certain concerns with the sale of real estate securities by non-reporting issuers in the exempt market" – though it does not state what those concerns are;

(b) states that, "as phase two of the Exempt Market Review", it is proposing to develop tailored disclosure requirements for real estate issuers as it relates to the OM Exemption; and

(c) specifically <u>prohibits</u> the use of the proposed crowdfunding prospectus exemption by real estate issuers.

All industries have risks specific to those industries. We do not believe that the risks specific to the real estate industry are materially worse than risks that are specific to other industries. For example:

(i) the collapse of the "dot-com bubble" or "tech bubble" from 1999 to 2001 resulted in significant losses to investors in the capital markets. Many of the technology entities that raised funds during those times did so in the exempt markets. Many of those entities raised funds (and many are raising funds today) merely on the basis of proprietary ideas/concepts which had/have not been fully developed and/or had/have no short or even medium-term prospect for revenues, let alone profits. In addition, a number of capital raising institutions indicate that a new tech bubble is currently being formed; and

(ii) mining and oil and gas companies regularly raise significant funds, both private and public, for "exploration" plays which are considered to be very high risk investments. In its Exempt Market Review Staff Consultation Paper 45-710 (page 71), the OSC stated that the total capital raised in Ontario in 2011 by non-investment funds in the mining/oil and gas industry totaled approximately \$6.8 billion (25% of the total raised) compared to \$2.2 billion (8%) by the real estate industry. In 2010, these numbers were: mining/oil and gas - \$8 billion (30%) and real estate - \$1.5 billion (5.7%).

Is the OSC considering similar exempt market prohibitions for the high tech or mining/oil and gas industries? If not, why is the real estate industry being singled out when investment in other industries can be just as risky?

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C. The $30,000 Restriction

The CSA Request for Comment indicates that individual investors that qualify as eligible investors (but do not meet the accredited investor definition) will be prohibited from investing more than $30,000 in investments that utilize the OM Exemption in any 12 rolling month period (**$30,000 Restriction**). This is not just a restriction on investments in any one entity – this is a restriction on investors themselves that encompasses the entire exempt market in Canada that utilizes the OM Exemption.

In the CSA Request for Comment, the CSA sets out 16 specific questions or requests for comment that they wish responders to comment on. We will focus in this letter on our concerns with the $30,000 Restriction and, therefore, the comments in this section relate to those specific questions dealing with that restriction. We will respond to some of the other questions in Item D. below.

Our specific concerns and comments with respect to the $30,000 Restriction are as follows:

1. **Existing securities regulation currently provides adequate protection for the concerns the CSA raises in connection with the $30,000 Restriction. The $30,000 Restriction will result in substantially unfair and inappropriate suitability assessments for Canadian eligible investors.**

NI 31-103 contains requirements for registrants involved in the sale of securities (including EMDs) to conduct KYP research for each product it sells and KYC research for each client in order to determine whether a particular investment is suitable for the client. If the investment is not suitable, the registrant is required to take steps to indicate to the client that the investment is not suitable for the client. If the client still invests in the product, it does so with the knowledge that the investment is not suitable for it.

Prior to the adoption of NI 31-103, the CSA specifically "sold" NI 31-103 to the marketplace on the basis that it was "principles-based" regulation and not "rules-based" regulation. The process in the above paragraph was specifically meant to be flexible to allow the registrant to determine what is appropriate or not for a client based on that particular client's circumstances, without having to comply with specific strict rules which may or may not have an appropriate result for a specific client. Principles-based regulation recognizes that a client, with appropriate advice from a registrant, should, depending on his/her financial wherewithal, be able to determine for himself/herself what is appropriate for him/her to invest in. It is clear that a principles-based approach is more fair to an investor.

However, the $30,000 Restriction is a "rules-based" approach to regulation and is, in the context of the OM Exemption, a significant step backwards from the principles-based approach adopted by the CSA in NI 31-103. The $30,000 Restriction effectively amounts to the CSA dictating directly to "eligible investors" that are not accredited investors, what they can and cannot invest in, irrespective of whether such an investment would be suitable for them. So, if an eligible investor that is not an accredited investor determines that he/she wants to invest more than $30,000 in an OM offered product or acquire more than one OM investment that totals more than $30,000 and he/she and his/her advisor determine reasonably and appropriately (under NI 31-103) that such investments are suitable for him/her, the $30,000 Restriction would still prohibit the investment. This is not appropriate for a number of reasons, including:

(a) it constitutes the CSA adopting additional layers of regulation in circumstances where appropriate regulation is already in place to deal with the specific concern. This adds material cost to the capital market participants, including individual investors and does not add further protection and, in fact, can materially negatively impact investors and other market participants;

(b) it will result in inappropriate and unfair suitability assessments for many eligible investors that are not accredited investors;

(c) as indicated in B.2 above, "eligible investors" fall within the top 15% of investors in Canada from an income point of view. These investors should be able to determine for themselves, with an

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appropriately prepared offering memorandum and the appropriate assistance of a registrant, what they wish to invest in, especially when governments are urging Canadians to take their retirement savings into their own hands. The $30,000 Restriction will take away material tools available to investors to do this and will send a contradictory message to investors; and

(d) The rules-based regulation proposed by the CSA through the $30,000 Restriction perpetuates the inappropriate and incorrect view that government/regulators know better than individuals what is best for them and must protect individuals from themselves.

We understand that this point has recently been raised with staff at a securities commission and staff responded that NI 31-103 constitutes "registration" regulation while the OM constitutes "issuer" regulation. All experienced participants in the exempt capital marketplace will know that such a response is in no way an appropriate answer to the concerns raised in this Item, as both "registrant" and "issuer" regulation directly impact how issuers raise capital, and the protection of investors, in the exempt capital markets.

As the CSA has not adequately shown, through appropriate studies and research, the "dangers" to the market that must be remedied with the $30,000 Restriction, our view is that the adoption of the $30,000 Restriction could result in the CSA being in non-compliance with its second mandate, the obligation to foster fair and efficient capital markets.

Principles-based regulation (which Walton supports) is one that requires more cooperation among the various participants in the registration marketplace and necessarily will involve a longer period of time for it to achieve the required results. As stated in the article "Principles-Based Securities Regulation" by Christie Ford, Assistant Professor at the University of British Columbia Faculty of Law:

> "…principles-based regulation also requires a relationship between regulator and regulatee that is generally trusting and collaborative, not adversarial or cat-and-mouse."

and

> "The transition to a principles-based approach could be challenging for regulated entities and public companies. As the FSA recognized in an early document, 'Changes in the manner of expression of requirements may impose a burden on businesses … substantive changes … need to be accompanied by reasonable lead times for adjustments to systems and procedures.'"

This was all part of the discussion that occurred among the regulators and the market participants in the time leading up to the adoption of NI 31-103 and was part of the expectation of the participants when NI 31-103 was adopted.

The above items (a) to (d) would not be concerns if the CSA would just allow the principles based-rules set out in NI 31-103 to operate. NI 31-103 has only been in full operation for less than 4 years since the full regulation has been in effect. That is not adequate time for the market to adjust to it. It is an innovative and effective regulation that responds appropriately to all the needs of the Canadian marketplace. Rather than put in place inflexible rules, the CSA should focus on appropriate guidance to, and work with, the marketplace as it relates to the operation of NI 31-103. Regulators have the power to deal with obvious and blatant breaches of those rules. Issuers and dealers that are complying with the rules should not be punished because others are not in compliance. We request that the CSA let the current system work.

2. **The $30,000 Restriction is an arbitrary number. Securities commissions should be required to undertake further research in support of the restriction before they place a material restriction on investing that can have a materially negative impact on markets and the economy.**

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In the CSA Request for Comment, the only argument or rational that the CSA states to support the adoption of the $30,000 Restriction is that it will "limit the risks associated with an investment by a retail investor in illiquid securities". In the CSA Request for Comment, the CSA states that they chose the $30,000 amount because, based on the Alberta Securities Commission's (**ASC**) records over a two year period, the median total annual amount of investments made by eligible investors under the OM Exemption in Alberta was "less than $30,000". No further explanation, detailed rational, study or statistical information is provided, including (i) what damage has occurred, or is proposed to occur, to the market from the OM Exemption, (ii) why limiting "the risks associated with an investment by a retail investors in illiquid securities" is actually required, (iii) what the substantive reason is for the methodology used by the CSA to get to the $30,000 amount, (iv) why $30,000 is an appropriate amount, or (v) what negative impact the implementation of the $30,000 Restriction will have on the exempt capital markets. In other words, the CSA has not adequately demonstrated why such restriction is necessary.

The CSA's dual mandate is the protection of investors and fostering fair and efficient capital markets. Our view is that, if the CSA wishes to adopt such a restriction that could materially negatively impact the use of the OM Exemption and exempt capital markets, in order for the CSA to reasonably demonstrate that it has exercised its regulatory powers and responsibilities appropriately, it needs to appropriately demonstrate (through studies and other statistical information beyond that stated in the CSA Request for Comment) to the other participants in the marketplace why such a restriction is required and, if so, why $30,000 is the appropriate amount and what impact such restriction will have on the exempt capital market. Otherwise, such restriction and amount can only be seen as an arbitrary exercise of the regulatory powers of the CSA. The participants in the capital markets are entitled to such studies in order for them to appropriately respond to the CSA's proposals.

For example, in Annex B to the CSA Request for Comment, it is stated that the average investment size for investors in Alberta in 2011 and 2012 was over $45,000. Why choose median over average? Also, one specific clarification needed is whether the median calculation referred to above is in connection with all investments by an investor irrespective of the number of entities it invested in, or is it only on an entity by entity basis. Without commenting generally on the appropriateness of the methodology used by the CSA, if it is the latter, how could that be seen as an appropriate number as it would not take into account all investments by the investor in all issuers under the OM Exemption each year? The actual median number using the former would always be higher and would be a more accurate representation of how much individuals invest in the exempt market under the OM Exemption. This is just one item of many that the CSA would need to research to appropriately demonstrate why this restriction is necessary and why $30,000 would be an appropriate amount.

We understand that, at a recent meeting with the ASC on this matter, one of the justifications given by ASC staff for the $30,000 Restriction was that the use of the OM Exemption and the amount of capital that has been raised in Alberta under the OM Exemption in the past few years, was more than what the ASC had anticipated or intended at the time the current OM Exemption was adopted by the ASC. We find that a surprising statement for a number of reasons:

(a) We understood that the ASC and ASC staff were aware, at the time that the OM exemption was adopted in Alberta, that the exemption could open up the exempt capital markets in the manner that it has and yet staff and the ASC determined that it should adopt the OM Exemption; and

(b) It is not up to securities regulators to limit the capital markets. Clearly, as discussed in B.1 above, Canadian capital raising entities are increasingly turning to exempt markets rather than the public markets for their capital needs. We believe that, before the CSA tries to limit these markets, it and the relevant governments should determine why this is occurring and whether it should indeed limit those markets.

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3. **The $30,000 Restriction will substantially reduce the capital available <u>to Canadian exempt market issuers</u> under the OM Exemption**

The OM Exemption has been crucial to capital raising for many start-ups and SMEs. The amount of capital available to start-ups and SMEs under the OM Exemption will be substantially reduced as a result of the $30,000 Restriction.

The CSA states that the OM Exemption is designed to facilitate early stage and small business financing. While the requirement to prepare and provide an offering memorandum is less expensive to an issuer than a prospectus, it still requires resources for the issuer to prepare one properly (which usually requires retaining legal counsel and an appropriate auditing firm). The significantly reduced amount of capital that will be available under the OM Exemption because of the adoption of the $30,000 Restriction, will result in a competition for those available funds. Those issuers that have more resources will be able to prepare "better" offering memoranda and be in a better position to attract investors, to access those funds and thereby "crowd out" those issuers that have less resources. This will result in those issuers that need the funds the most to be in a worse position, competitively, to attract those funds.

As a result, we are of the view that the $30,000 Restriction will significantly restrict the usefulness of the OM Exemption for SMEs.

4. **The $30,000 Restriction will substantially reduce the choices that would otherwise be available <u>to Canadian investors</u> under the OM exemption and thereby impact their ability to diversify their portfolios in an appropriate manner**

Appropriate diversification of an investment portfolio is the goal of most Canadian investors. For certain investors, investment in exempt market products, including alternative investments, may be a suitable and appropriate way for them to diversify their portfolios. The $30,000 Restriction will reduce the tools available for many investors to appropriately do that and it will do very little if anything at all, to reduce risk to the Canadian marketplace.

5. **The $30,000 Restriction will result in a material competitive disadvantage for EMDs compared to other participants in the Canadian capital markets**

The main participants in the Canadian capital markets, being securities dealers (**SD**s), mutual fund dealers (**MD**s) and insurance dealers (**ID**s) compete for the same groups of investors, including the group of investors that EMDs can sell to. However, EMDs can only sell to those investors that can avail themselves of prospectus exemptions. This primarily means that EMDs can only sell to those investors who qualify as "accredited investors" or "eligible investors".

While the $30,000 Restriction will have an impact on SDs, MFDs and EMDs, the SDs and MFDs can always still sell prospectus qualified securities and mutual funds to (i) persons that are not eligible investors or accredited investors, <u>and</u> (i) to eligible investors and accredited investors. In other words, SDs and MFDs (as well as IDs selling investment products) can sell their specific types of products to investors who are the sole target group of EMDs.

However, the converse is not true. The only groups that EMDs can sell to are, realistically, eligible investors and accredited investors. The $30,000 Restriction will substantially reduce the pool of capital that is currently available to EMDs under the OM Exemption and EMDs will be required to compete with more established and generally better funded groups such as SDs, MFDs and IDs, who will, because of their operations, usually have a larger (though not necessarily better) shelf of products available.

This will create a significant competitive disadvantage for EMDs compared to SDs, MFDs and IDs. We believe this is significantly unfair to EMDs and is unwarranted given the other points made elsewhere in

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this letter (ie, adequate rules are already in place to deal regulators concerns with the OM Exemption, etc).

This is compounded by the fact that the EMD industry is only a few years old and most EMDs are smaller, less financially strong organizations compared the other categories of registered dealers in investment product.

If the CSA wants to create an effective and protective EMD marketplace, it needs to put the EMDs on a more level playing field from an economic point of view. Implementing the $30,000 Restriction will negatively impact EMDs from this point of view.

6. **The $30,000 Restriction could (i) reduce the number of EMDs in the marketplace and reduce competition for the stronger EMDs and choice for investors, and (ii) make it harder for less well financed EMDs to afford appropriate compliance systems and personnel**

A further impact of the decrease in available capital in the exempt market because of the $30,000 Restriction and the resulting competitive disadvantage to EMDs as compared to other capital raising participants, is that smaller, less financially strong EMDs will have a harder time competing against larger and financially stronger EMDs for both clients and dealing representatives. This may result in many such EMDs having to shut down. This will lessen competition for the larger EMDs and lessen choice for investors in the EMD marketplace. This result is not efficient for the marketplace or for investors nor should lessening competition in the capital markets be one of the roles of the regulators.

Even if some of these smaller, less well financed EMDs are able to continue operating, they could have less resources available for systems such as compliance. While compliance systems are crucial for the protection of investors, those systems, including the cost of experienced compliance personnel, are costly. The less resources that an EMD has available to it could result in that EMD not having as robust a compliance system as better financed EMDs and afford less protection for their clients.

7. **The $30,000 Restriction will create a disincentive for dealers to sell OM exempt product <u>which will lessen the availability of capital for issuers and choice for investors</u> and could result in OMs being sold by issuers <u>without the benefit of registered dealers thereby adding investor risk to the capital markets</u>.**

The CSA states that the OM Exemption is designed to facilitate early stage and small business financing. As indicated in Item B.4. above, it can practically be difficult for new and smaller issuers to attract the attention of registered dealers to sell their product. This may not be because the business of the issuer itself may not be profitable or desirable, but because the dealers have determined that they cannot gain enough profit from selling the issuer's securities.

The adoption of the $30,000 Restriction will make it even more difficult for SMEs to attract the attention of registered dealers to sell their product as the dealers ability to profit will be lessened (because of the limit on purchases that clients can make in the OM exempt market as a whole) and may not adequately offset the costs and time involved in the due diligence required to sell the product.

This will result in some issuers not being able to raise sufficient capital to fund their businesses through the OM exemption and therefore abandon or not undertake an offering. This, in turn, will artificially lessen investment opportunity for investors.

This could also result in issuers attempting to sell their own product through the OM offering (assuming they don't trip the "business trigger" under NI 31-103), without the use of a registered dealer, which is a result that actually <u>adds investor risk</u> to the marketplace. While NI 31-103 does contemplate the sale of exempt securities by issuers without the use of a registered dealer provided the "business trigger" is not tripped, we suggest that the CSA should not be putting rules in place that practically result in the

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promotion of sales without the use of a registered dealer. This would not be a concern if the $30,000 Restriction is not adopted. We suggest that the CSA consider the alternatives in this circumstance and consider which it better for the marketplace: (i) no limit but sales through a registered dealer – which we indicate elsewhere will add very little or no risk to the marketplace, or (ii) a limit which will promote sales to eligible investors without a registered dealer?

8. The $30,000 Restriction could lead to inappropriate behavior by some EMDs and Dealing Representatives in relation to commissions and suitability for clients.

With the $30,000 Restriction, the amount that each eligible investor (that is not an accredited investor) can invest in the OM market in any 12 rolling month period will be restricted to $30,000. This will naturally restrict the amount of commissions that a dealing representative in an EMD can earn from any one such client. This could result in some less experienced or less compliance minded dealing representatives to influence such clients to invest in an OM product that has a greater benefit (ie, commissions) to that dealing representative but may be less suitable for the client (but still suitable) than another product that has a lower commission.

While blatant examples of this behavior should be able to be caught by the compliance personnel of EMDs, it may be difficult for compliance personnel to notice such behavior in more subtle situations, especially if the compliance resources of the EMD are already strained.

9. The $30,000 Restriction creates a significant practical problem for some eligible investors as to which OM exempt product they should invest in and could result in such investors investing in less suitable product.

The $30,000 Restriction prohibits eligible investors that are not accredited investors from investing in more than $30,000 under the OM Exemption in any 12 rolling month period. The practical result of the 12 rolling month requirement is that investors that wish to invest the full $30,000 amount in any such 12 month period in OM offerings may:

(a) place the full amount in a product that it finds suitable and desirable and then miss out on a better opportunity that may come out a number of months later but which is no longer available after the end of the 12 rolling month period; or

(b) place less than the full $30,000 in a more suitable and desirable product in the beginning of the 12 month period because the investor hopes to find another suitable product later on which never materializes.

This could actually result in investors investing in less suitable product than they would have if they could invest more than $30,000. This will not lead to fair and efficient markets and it is, we submit, not in the mandate of the CSA to implement regulation that could harm investors in this manner.

10. The $30,000 Restriction will favor exempt market issuers that issue RRSP eligible securities or securities with other tax incentives over such issuers that do not issue such securities. It will also favor such issuers that issue such securities in the first 60 days of the calendar year over those that do not.

Many investors prefer to invest a portion of their annual investment cash in RRSP eligible securities and/or in other securities that issue securities with other tax incentives (ie, flow-through securities). This, the $30,000 Restriction and the fact that most tax beneficial investments occur in the first 60 days of the calendar year will result in a "rush for capital" in the first 60 days of the calendar year by exempt market issuers that issue such securities under the OM Exemption.

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This will mean that exempt issuers that do not issue securities with tax incentives may also have to complete their OM offerings during that time period. They will have to compete with such tax beneficial issuers for a share of their capital. This could put them at a competitive disadvantage for that capital.

This will also prejudice issuers that issue securities on a regular basis over the course of the year or those that simply need to raise capital at a time other than the first 60 days of the calendar year.

This will not lead to fair and efficient capital markets. It is not in the mandate of, and it is inappropriate for, the CSA to implement regulation that favors capital raising by one type of exempt market issuer over another.

D. Other Comments on the Proposed OM Exemption

Below are responses to some of the specific requests for comment contained in the CSA Request for Comment. The numbering below corresponds to the number in the CSA Request for Comment, though some portions of the questions have been removed for brevity.

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.

Yes, there are many circumstances where it would be suitable for such an eligible investor to invest more than $30,000 a year under the OM Exemption. It would be impossible to describe all circumstances where this would be the case as suitability is different for each individual investor. That is why the KYP, KYC and suitability obligations contained in NI 31-103 were created in a principles-based manner. It was recognized that the concept of suitability could not be enshrined in a set of specific rules. This very question (set out in the CSA Request for Comment) demonstrates why the $30,000 Restriction will be unfair to many investors and why such a rules based approach will not work. No matter how many specific rules are put in place, there will always be circumstances where the rule will create unfair results. The CSA should not adopt the $30,000 Restriction and should allow NI 31-103 to operate in the manner it was intended to operate and in the manner the CSA advised the capital industry it would operate.

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

No. We do not understand why any particular issuer should be excluded from using the OM Exemption. We suggest that in order for you to receive appropriate and useful answers to this question you should be more specific in what concerns you may have. Also please see our comments in Item B.5 above.

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

Yes. As we are sure you are aware, in the OSC Request for Comment, the OSC is proposing to include a restriction in its proposed offering memorandum exemption that would prohibit dealers from selling securities of related issuers under the proposed OM exemption. Walton has provided a full and detailed response in this regard as to why such restriction should not be included in the OSC's proposed OM exemption. Rather than repeat that answer here, we have included for your review our response to the OSC on this matter.

E. Other Comments on other Parts of the OSC Request for Comment

Proposed Annual Audited Financial Statement Obligation for OM Issuers:

We are concerned with the requirement to provide annual audited financial statements within 120 days from the end of the issuer's financial year end. We recognize that 120 days from the end of the issuer's

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financial year end is the deadline required for "venture issuers" under securities legislation but note that many provincial corporate statutes, including the *Business Corporations Act* (Alberta) only require corporations to table at their annual shareholder meetings annual financial statements for a period that ends not more than six months (180 days) after the corporation's year end.

We believe it is not appropriate to elevate users of the OM Exemption to the filing requirements of venture issuers in this regard and propose that the 180 days provided in the corporate statutes is a more suitable deadline.

Also, given the deadlines for the preparation of audited financial statements for public entities, it may make sense to have a later deadline for non-reporting OM issuers, to stagger the timing for the resources needed from auditors to prepare audits for the financial statements for those entities.

F. Conclusion

As indicated above, we are of the view that the CSA members that are referenced on the CSA Request for Comment should not adopt the $30,000 Restriction in connection with the OM Exemption. Adoption of the $30,000 Restriction will:

(a) add further layers of regulation when the current regulation is adequate to deal with the regulatory concerns;

(b) significantly limit the effectiveness of the OM Exemption as a capital raising tool for start-ups and SMEs;

(c) significantly limit the effectiveness of the principles-based regulation previously provided in NI 31-103 is it relates to the exempt capital markets;

(d) limit and prevent investors from investing in products that may be suitable for them or that may result in an appropriate diversification of their portfolios;

(e) create a competitive disadvantage for EMDs;

(f) favour certain exempt issuers over others; and

(g) create further disharmony in the Canadian exempt markets.

We request that the CSA not adopt the $30,000 Restriction.

Please do not hesitate to contact us if you have any questions.

Yours truly,

WALTON INTERNATIONAL GROUP INC.

Mark McKenna
President

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