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Submitted via e-mail to comments@osc.gov.on.ca and consultation-en-cours@lautorite.qc.ca

The Secretary
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Me Anne-Marie Beaudoin
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cc: British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Nova Scotia Securities Commission
Superintendent of Securities, Department of Justice and Public Safety, PEI
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

Proposed Amendments to National Instrument 45-106 – *Prospectus Exemptions*

Dear Sirs/Mesdames:

We are writing to you in response to the request of the Canadian Securities Administrators (the "CSA") for comments (the "Request for Comments") on the proposed amendments to National Instrument 45-106 – *Prospectus Exemptions* ("NI 45-106") published on August 13, 2015 relating to reports of exempt distribution (the "Proposed Amendments"). Capitalized terms used but not otherwise defined in this comment letter have the meanings ascribed to them in the Request for Comments.

Our comments in this letter should be read in conjunction with our comments on the proposed amendments to National Instrument 13-101 – *System for Electronic Document Analysis and Retrieval (SEDAR)* and Multilateral Instrument 13-102 – *System Fees for SEDAR and NRD* published by the CSA on June 30, 2015 (the "NI 13-101 Proposed Amendments"), which are set out in our comment letter dated August 31, 2015.

General Comments

While we commend the CSA for working cooperatively to develop a uniform report of exempt distribution across all provinces and territories, we have significant concerns with the Proposed Report. We believe that, if adopted, the Proposed Report will have a significant chilling effect on private placements in Canada. In short, we believe that the Proposed Report would make it less attractive for issuers to raise money using the Canadian exempt market and more difficult for Canadian institutional investors to access highly desirable foreign securities on a private placement basis.

Proposed Report Should Not Be Publicly Available

We are very concerned that the CSA's proposal to make the Proposed Report and any associated offering memoranda[1] publicly available on the System for Electronic Document Analysis and Retrieval ("SEDAR") will discourage issuers from accessing the Canadian exempt market.

Securities legislation has always drawn a distinction between the obligations placed on, and the information required to be disclosed by, issuers that have distributed their securities to the public and those that have not. Certain issuers, for one reason or another, have made the decision to remain private, distributing their securities only to those persons to whom they may be lawfully distributed without the need for a prospectus. They have elected not to subject themselves to the continuous and periodic disclosure requirements mandated by securities laws but, for that reason, they are able to distribute their securities only to a limited subset of potential investors.

The net effect of the Proposed Amendments and the NI 13-101 Proposed Amendments will be to require private issuers to disclose to Canadian securities regulators and to the public information about their assets, employees, directors, officers, shareholders and any other information typically included in an offering memorandum, including historical financial performance and business strategy. A simple search on SEDAR would give the issuer's competitors, customers and suppliers access to highly-sensitive and confidential information that has no business in the public realm. We do not believe private companies should be required to disclose this information – to securities regulators or the public – merely because they have used the exempt market to distribute securities to a limited group of investors (i.e., accredited investors).

In our view, the purpose of exempt trade reporting is to allow securities regulators to monitor compliance with prospectus and registration exemptions. The Proposed Report should not be used as a fishing expedition or information gathering exercise about the affairs of companies that have every right to operate – within the confines of the law – as private entities.

We have highlighted below under the heading "Specific Issues with the Proposed Report" the particular disclosure requirements that should be eliminated from the Proposed Report. In addition to eliminating these disclosure items, we strongly recommend that the Proposed Report

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[1] The NI 13-101 Proposed Amendments are unclear as to whether issuers are required to file an offering memorandum as a public document on SEDAR even if they are relying on an exemption other than section 2.9 of NI 45-106. In either case, we do not believe it is appropriate for any offering memorandum used in connection with a private placement to be made public under any circumstances.

and any associated offering memoranda be kept private in all circumstances. We fear that any other outcome will create a strong incentive to avoid the Canadian exempt market.

We understand that the NI 13-101 Proposed Amendments were derived in part from the CSA's desire to eliminate paper filings, and that SEDAR is the only available country-wide portal capable of accepting these filings electronically. We would urge the CSA to accelerate its long-term plan for an integrated, country-wide electronic filing portal along the lines of what the Ontario Securities Commission and the British Columbia Securities Commission (the "BCSC") currently have in place, rather than adopting the Proposed Amendments and the NI 13-101 Proposed Amendments.

Proposed Report is Too Onerous

We are concerned that the Proposed Report has become so onerous to complete that many issuers and underwriters will simply refuse to extend offerings into Canada. The consequences of this will be particularly felt by Canadian institutional investors, whose access to foreign securities will be significantly reduced.

Although the obligation to prepare and file a report of exempt distribution rests with the issuer or the underwriter, in practice the report is often prepared by law firms on behalf of their issuer or underwriter clients. The law firm will generally prepare as much of the report as possible by reviewing the offering memorandum. This is done in order to minimize the amount of information that needs to be obtained directly from the issuer or the underwriter. Currently, Form 45-106F1 can often be prepared by a law firm without going back to the issuer or underwriter to obtain any information at all, other than information regarding the purchasers. The Proposed Report will make it impossible for a law firm to prepare and file a report on its client's behalf without reaching out to multiple people to obtain the required information.

By way of example only, a law firm preparing the Proposed Report on behalf of an underwriter in connection with the distribution of a foreign security to Canadian institutional investors would have to contact:

- the issuer in order to obtain: (a) its reporting issuer status in any "designated foreign jurisdictions", (b) any previous legal names, (c) its legal entity identifier (or confirm that it does not have one), (d) its NAICS industry code, (e) the number of people it employs, (f) its date of formation and financial year-end, if not disclosed in offering memorandum, (g) the CUSIP number for the securities and a list of all exchanges on which they trade, if not disclosed in the offering memorandum, (h) the size of its assets or its net asset value[2], (i) information about its directors, officers, control persons and promoters, including their

[2] For U.S. and Canadian reporting issuers, this could be obtained by looking at the issuer's most recent financials if they have been publicly filed at that time. Depending on the time of year in which the distribution occurs, the financial statements may not yet be publicly available, which means that this information would have to be obtained from the issuer. For non-Canadian and non-U.S. companies, this information would almost certainly have to be obtained from the issuer.

residential addresses[3], and (j) in the case of investment funds, information about "redemptions relating to the distribution" (whatever that means);

- the underwriter in order to confirm its relationship with the issuer (i.e., whether it is an insider or "connected" to the issuer or investment fund manager, etc.); and

- the trust company, trust corporation or registered advisor to persuade them to voluntarily provide beneficial owner information, notwithstanding that they are under no legal or contractual obligation to provide it, and may be contractually obligated to the beneficial owner to not provide it.

The consequences are that the cost of preparing and filing a report will increase materially. This acts as a financial disincentive to selling into Canada. More importantly, however, scarce internal human resources of the issuer and the underwriter must now be devoted to obtaining the requested information, creating a further disincentive. This is particularly true when you consider that foreign securities offerings are often extended into Canada at the request of Canadian institutional investors seeking access to asset classes not available in the Canadian market. Issuers and underwriters will agree to extend such offerings into Canada if it can be done at minimal expense and inconvenience. In our experience, they would not agree to extend such offerings into Canada if the post-trade reporting regime becomes too burdensome or if they are required to disclose to Canadian securities regulators – and possibly to the public – information regarding the issuer's directors, officers, shareholders, employees, assets and investments that is not otherwise publicly available.

For smaller issuers, which do not have the luxury of having their lawyers complete the Proposed Report, the process will be even more onerous by tying up scare internal resources. Worse, the cost of completing the Proposed Report and the loss of confidentiality will discourage smaller private issuers from accessing the capital they require to build their businesses.

The CSA's desire for more information about the exempt market should not become an impediment to accessing that market. We do not believe the Proposed Report strikes the right balance between effective oversight and market efficiency. Consider, for example, the U.S. exempt trade reporting requirements in comparable circumstances. We understand that a private company (whether domestic or foreign) carrying out a private placement to "qualified institutional buyers" or "accredited investors" in the United States does not have to file any post-trade report of any kind if the private placement is carried out pursuant to Section 4(a)(2) or Rule 144A of the Securities Act of 1933, as amended (the "U.S. Securities Act"). An issuer may, but is not required to, rely on the safe harbor provided by Regulation D of the U.S. Securities Act, thereby triggering a Form D filing within 15 days of the first sale. Form D does not require that an issuer file any offering memoranda used in connection with the private placement and it requires far less disclosure than the Proposed Report. In our view, Canada should strive to have a post-trade reporting regime for its exempt market that is not materially more onerous than that

[3] We acknowledge that this information would not be required if all of the purchasers are "permitted clients" or if the issuer is a "foreign public issuer" or a reporting issuer in Canada (or a wholly-owned subsidiary thereof).

of its neighbour to the south – the world's largest capital market – in order to maintain its international competitiveness.

Proposed Report Should Not Be Required if All Purchasers are Accredited Investors

If the CSA rejects our comments and nevertheless adopts the Proposed Report substantially in its present form, it should strongly consider introducing an exemption from the requirement to file the Proposed Report, in whole or in part, where the issuer is relying on the "accredited investor" prospectus exemption or where all of the purchasers are "permitted clients" as defined in National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("NI 31-103"). This will facilitate access to exempt-market securities, particularly foreign securities, for more sophisticated Canadian investors and is more consistent with the approach taken in the United States.

We note that the Proposed Report appears to have been developed in the context of the new crowdfunding and family, friends and business associates ("FFBA") prospectus exemptions that permit issuers to distribute securities to retail investors without the benefit of a prospectus. We expect that these exemptions will be used primarily by junior or distressed issuers that are unable to obtain financing in any other way. We query whether the CSA's desire for more information about the exempt market stems from a concern that access to the exempt market has been broadened to potentially include less sophisticated investors. For example, the requirement to disclose all of an issuer's directors, officers, control persons and promoters may be relevant where a start-up issuer seeks to raise funds from retail investors so that the CSA can more easily locate the issuer's principals if they are found to have violated Canadian securities laws.

Distributions of securities to more sophisticated investors, however, do not give rise to the same investor protection concerns as do distributions through crowdfunding or in reliance upon the FFBA prospectus exemption.

We fear that failure to introduce an exemption along these lines will have a very negative impact on the institutional exempt market in Canada. Consider the relatively recent experience in British Columbia when the BCSC adopted Form 45-106F6, which is more onerous than the current Form 45-106F1 but less onerous than the Proposed Report. The reaction at the time from market participants was extremely negative. Institutional investors in British Columbia had to lobby the BCSC to grant blanket relief from the requirement to file the Form 45-106F6 (and instead file the current Form 45-106F1) where all of the purchasers in British Columbia were "permitted clients". To this day, our experience has been that foreign issuers and underwriters will only sell into British Columbia if they are able to do so in reliance on this exemption, which is just another way of saying that no one is prepared to undertake the time, effort and aggravation of preparing Form 45-106F6, nor do they believe the information requested therein is appropriate in the circumstances. Further, domestic issuers and investment funds who want to maintain the confidentiality of the information required in Form 45-106F6, of their own accord or at the request of institutional investors, have elected to not offer securities in British Columbia. Given that the Proposed Report is even more onerous than Form 45-106F6, we believe market participants will have an equally, if not more severe, adverse reaction to it.

Specific Issues with the Proposed Report

Without limiting the generality of our comments under the heading "General Comments" above, we have the following specific comments on the Proposed Report:

- *Instruction 4 – References to Purchaser*. The Proposed Report requires that, where a trust company, trust corporation or registered advisor has purchased securities on behalf of a fully-managed account, disclosure must be provided for both the registered holder and the beneficial owner of the securities. However, pursuant to subsections 2.3(2) and (4) of NI 45-106, trust companies and registered advisors purchasing pursuant to the accredited investor prospectus exemption are deemed to be purchasing the securities as principal. Therefore, the identity, level of sophistication and financial wherewithal of the beneficial owner is completely irrelevant for purposes of determining whether or not a prospectus exemption is available to the seller.

  There are also privacy concerns with respect to disclosing information regarding beneficial owners in these circumstances. The Proposed Report requires the issuer or underwriter to confirm that each individual listed in Schedule 2 to the report has been notified that their personal information will be disclosed to the CSA. They will not be able to make this certification because they have no relationship with the beneficial owners. This notice is typically provided in the offering document, but since no offering document is being delivered to the beneficial owners in these circumstances, the beneficial owners will not receive the notice and the issuer and underwriter will not be able to make the certification. Further, managed account agreements generally mandate that the advisor shall not disclose the identity of the beneficial holder(s) of the account. Any disclosure of the beneficial owner's personal information would be without their knowledge or consent, and in many cases contrary to the advisor's contractual obligations to the beneficial owner.

  In the Request for Comments, the CSA indicates that this information will be used in connection with the CSA's "oversight of registered advisors and to assist with our compliance functions". We assume that the CSA has other means and tools available to it to collection information directly from the registered advisors. It is not appropriate in our view to compel issuers, as a condition to accessing capital raising prospectus exemptions, to provide the necessary information for the CSA to ensure registered advisors are complying with applicable law.

  We also point out that issuers and underwriters have no ability to require the registered advisor to provide the necessary information. The trust company, trust corporation or registered advisor is under no legal or contractual obligation to provide this information to the issuer/underwriters, nor would they ever want to voluntarily reveal their client lists (for competitive reasons) or disclose their clients' personal information (for privacy reasons).

- *Items 4(b), (h) and 6(f) – Number of Employees and Size of Assets (Net Asset Value)*. For reporting issuers, this information will be available on SEDAR. It is inappropriate in our view to request this information from non-reporting issuers, as it is not relevant to

monitoring compliance with the prospectus exemptions and it may well be competitively sensitive.

- *Item 2 – Previous Legal Name of Issuer and Legal Entity Identifier Number*. It is unclear why this information is required, as it does not appear relevant to monitoring compliance with the prospectus exemptions.

- *Items 4(e) and 6(c) – Date of Formation and Financial Year-End*. For reporting issuers, this information will be available on SEDAR. It is inappropriate in our view to request this information from non-reporting issuers, as it is not relevant to monitoring compliance with the prospectus exemptions.

- *Item 5 – Directors, Executive Officers, Control Persons and Promoters*. While we acknowledge the exemptions provided, we do not believe they go far enough and, in any event, we question why this information is required at all.

  The carve-out for "foreign public issuers" only applies to issuers that are reporting issuers (or equivalent) in certain designated foreign jurisdictions.[4] We do not see any reason for limiting the carve-out to these designated foreign jurisdictions. Practically speaking, this means that underwriters will not extend into Canada securities offerings of any foreign public issuer from a jurisdiction other than a "designated foreign jurisdiction", as they will be unwilling or unable to provide the information requested in the Proposed Report regarding directors, executive officers, control persons and promoters.

  For the reasons discussed elsewhere in this letter, we also do not believe it is appropriate for securities regulators to require private issuers to provide this information. They have elected to remain private for many reasons and disclosure of this type of information is inconsistent with the concept of an exempt market. The exempt market exists for good reasons – one of which must be to allow entities to remain private while still having access to capital from certain sources.

  It is also unclear why disclosure is required in respect of <u>every</u> executive officer of an issuer. An issuer may have dozens of executive officers; why do all of them have to be listed?

  In addition, the concept of promoter really only applies in the context of a public offering or if the offering memorandum exemption in section 2.9 of NI 45-106 is relied upon to make the distribution. In most exempt distributions, the fact that someone technically meets the definition of "promoter" will be of no consequence. It is unclear why the issuer or underwriter would have to conduct a "promoter analysis" solely for the purpose of preparing and filing the Proposed Report, when it was not necessary to do so in connection with the offering itself.

[4] We note there are no South American countries in the definition of "designated foreign jurisdiction" and the only Asian countries are Hong Kong, Japan and Singapore.

Finally, we do not understand why the CSA needs information about the number of securities held by the directors, executive officers, control persons and promoters and the aggregate consideration paid by them for those securities. The fact that these individuals may have paid less for their securities has no bearing whatsoever on the value of the securities being distributed and it is not appropriate to draw the inference that because they acquired the securities at a lower price, somehow the price being paid by purchasers in the distribution is unfair. These insiders could have acquired the securities when the company was in its infancy (i.e., founder shares) and the value of the company could be materially different at the time of the distribution. The securities could also have been acquired by the exercise of options that were priced years in advance of the distribution. It is not clear to us how this information assists the CSA in its oversight of the exempt market. We believe that for issuers to compile this information will be extremely onerous in practice and we see no reason why the CSA should be trying to enforce a particular view about the undesirability of "cheap stock" as a matter of corporate fiduciary norms under the guise of information needed to develop "policy" concerning the exempt market.

- *Items 6(b) – Type of Investment Fund.* For reporting issuers, this information will be available on SEDAR. It is inappropriate in our view to request this information from non-reporting issuers, as it is not relevant to monitoring compliance with the prospectus exemptions.

- *Item 7(g) – Net Proceeds to Investment Funds.* This entire section is very confusing. First, it is unclear why non-investment fund issuers located outside of Canada need only report distributions to purchasers in Canada (see Item 7(f)), whereas investment fund issuers need to disclose all purchasers (both Canadian and foreign). Second, it is unclear what is meant by the words "less the gross redemptions relating to such distribution" in the definition of "net proceeds". What is a redemption "relating to a distribution"? In our experience, there is no connection between the proceeds of a private placement and redemption, even if the events occur on the same day.

Recommendations

For the foregoing reasons, we strongly advise the CSA to implement the following changes to the post-trade reporting regime contemplated by the Proposed Amendments:

- Neither the Proposed Report nor any associated offering memoranda should be filed on SEDAR or made publicly available under any circumstances.

- As described above under the heading "Specific Issues with the Proposed Report", the problematic disclosure that we have identified should be eliminated to make it less onerous on issuers and underwriters to prepare and file the Proposed Report.

- If the CSA rejects our other recommendations and adopts the Proposed Report substantially in its present form, it should strongly consider eliminating the requirement to file the Proposed Report, in whole or in part, where all of the purchasers participating

in the offering are "accredited investors" as defined in NI 45-106 or "permitted clients" as defined in NI 31-103.

In closing, the exempt market exists, we believe, to promote two goals: one an issuer-oriented goal to permit issuers to raise money from sophisticated investors without becoming reporting issuers and otherwise complying with onerous rules involving retail securities offerings, and the other an investor-oriented goal to broaden the offerings otherwise available to sophisticated investors. The thrust of the Proposed Amendments would be to make the exempt market process sufficiently burdensome as to seriously undermine these objectives.

Thank you in advance for the opportunity to comment on the Proposed Amendments. If you have any questions regarding this comment letter, please do not hesitate to contact me.

Yours very truly,

(signed) Anthony Spadaro

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