

Check Against Delivery



“Regulatory Vision for the Exempt Market”

Speech by Howard Wetston

Chair, Ontario Securities Commission

2013 EMDA Exempt Market Conference

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Good morning.

Thank you Brian for your kind introduction. I would like to congratulate you and the EMDA on the work you have done to bring together exempt market dealers, product issuers and professional advisors – and regulators – in a forum like this.

I would also like to thank those who are participating on the OSC’s recently formed Exempt Market Advisory Committee.

I have been asked to speak today on the regulatory vision for the exempt market.

The exempt market was generating a lot of attention even before we published our paper last December. This increased focus is certainly a reflection of the challenges small and medium-sized companies are facing in raising capital in this economic environment. This is of critical concern to you. It is also a critical concern to the OSC.

There is no question that small and medium-sized companies play a significant role in driving economic growth. We recognize that small and medium-sized companies account for more than half of Canada's GDP¹. In 2011, about \$28 billion was raised through the exempt market in Ontario by non-investment funds, out of a reported total distribution of about \$87 billion.

Yet small and medium-sized companies are struggling to raise the capital they need to grow. The OSC understands that capital and economic cycles come and go, and securities regulators have reviewed access to capital issues before. So what has changed in today's environment? Why are we revisiting the exempt market and why now? What is different this time?

1. Securities regulation and the economy

Let me start with some thoughts from the 1965 Kimber report on securities regulation in Ontario. You probably have never heard of the report, but it was instrumental in reforming securities legislation in this province and ultimately across Canada.

¹ Statistics Canada, Small, Medium and Large Businesses in the Canadian Economy: Measuring their Contribution to Gross Domestic Product in 2005, May 2011.

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The report recognized that the securities industry is central to the capital markets in an advanced economy, and that one of the strongest forces in raising capital is public confidence. While the purpose of securities legislation must be to protect the investing public, the report observed that securities legislation also affects your efficiency as dealers in performing your capital allocation function.

One of the enduring aspects of the Kimber report is its effort to balance the interests of issuers and investors. In the almost 50 years since the report was written, however, the balancing act has become much more complex.

The OSC, like many securities regulators around the world, is facing three key challenges:

- structural changes in our markets;
- financial innovation and complexity; and
- globalization.

This has given rise to new areas of focus: derivatives and bank reform, algorithmic trading, social media and cyber security, to name just a few.

We must respond to these issues on both the global level through our involvement in the International Organization of Securities Commissions (IOSCO), and at the local level, where the far-reaching effects of the

financial crisis continue to impact our markets, particularly in the area of capital raising.

Historically, securities regulators have focused on the public capital markets; that is, the public offering and sale of debt and equity securities. The exempt market has been viewed as an “exception” and our approach as regulators has been to determine when the public financing rules need not apply.

The exempt market is an integral part of the capital market, not an exception to it. We need to look at the capital markets as a whole.

There is a wide-spread perception that the current exempt market regime in Ontario has not kept pace with global market developments, including changes in investor demographics and the use of the Internet and social media.

The current approach is perceived to erect barriers and create inefficiencies. It is not clear that this regime best achieves the goals of facilitating financial intermediation and economic growth.

It is our duty as securities regulators to examine whether the rules in place are inhibiting or promoting the high-quality capital markets that our economy needs in order to grow.

Effective securities regulation must be balanced and, among other things, address three fundamental objectives:

1. Improve efficient access to capital for issuers;
2. Increase access to investment opportunities for investors; and
3. Provide appropriate protection to investors.

The traditional tools of securities regulation in setting “the rules of the game” – registration, enforcement, compliance and oversight – are as relevant and important as ever to fostering capital raising and investor protection.

But securities regulators also need to consider other policies that may be appropriate to meet the needs of today’s investors and the markets.

2. The OSC’s approach to the exempt market

Simply put, we agree that something needs to be done.

This view is reflected in our mandate to foster fair and efficient capital markets. And it is a key area of focus in our proposed Statement of Priorities, which was published for public comment on April 4.

As you are aware, the OSC is considering new exemptions with respect to capital raising. We have received about 100 comment letters – including those of the EMDA on the consultation paper we published last December.

Consultations

In addition to the written comment process, we engaged in extensive consultations. We hosted four public town halls that were attended by approximately 165 stakeholders. We also participated in town halls hosted by the Prospectors and Developers Association of Canada and by MaRS.

We consulted with over 40 interested stakeholder groups, including other regulators, crowdfunding portals and associations, industry groups, advisory committees and academics.

Online survey

We also conducted an online survey of approximately 1,500 Canadian investors to learn more about their needs and preferences, and to gauge their interest in greater access to investment opportunities in the exempt market generally and in small business in particular.

The comment period on the paper closed in March and we are assessing the feedback. The OSC is open to considering changes to our exempt market regulatory regime for alternative capital raising exemptions, such as an OM exemption.

We are also considering the issue of crowdfunding. I want to note that the Ontario government is also examining crowdfunding as mentioned by the Minister of Economic Development and Innovation in his speech at the

Technicity conference last fall.

Crowdfunding is one option that appears to be gaining momentum around the world following the approval of the U.S. JOBS Act in April 2012. As a result, we are looking at crowdfunding very closely. The issues are complex and it is a challenging task to find the right balance.

For example, the new exemption for crowdfunding under the JOBS Act is subject to SEC rulemaking. The deadline for the SEC to issue rules was December 31, 2012, but no rules have been published to date.

We are asking ourselves three key questions:

1. Would crowdfunding be an effective capital raising tool for companies?,
2. Are investors interested in these types of investment opportunities?,
and
3. Can we find ways to address investor protection concerns regarding the potentially high risk and illiquid nature of these types of investments?

Crowdfunding may not be the answer to all of the challenges facing small business, but it is something that we must examine.

We also recognize that the exempt market is one area where the CSA is not harmonized. Our objective is to attempt to harmonize Ontario's exempt

market regulatory regime, as appropriate, with other Canadian jurisdictions. The CSA has also agreed to explore ways to achieve the harmonization of these exemptions to the extent possible.

As I mentioned, we are considering the feedback we received from investors, issuers, dealers and other stakeholders. We are planning to publish a progress update on our review of possible new exemptions in late summer.

We have an obligation to ensure that any proposals reflect today's market realities: globalization, multiple markets, and industry incentives in developing and distributing products.

We need to consider the appropriate limits on both companies and investors. We also need to consider whether additional investor protection measures are warranted.

We have to get this right. It has to work for the individual in BC or Nova Scotia who wants to invest in his cousin's business in Ontario, and it has to work for the big pension fund that is responsible for providing income to thousands of retirees.

I also want to mention that we cannot do this alone. We are willing to consider the introduction of new tools in the exempt market, but to make it work, we need a commitment from industry to ensure that investors are protected. We view investor protection as a shared responsibility.

As you know, the OSC recently conducted a suitability sweep of portfolio managers and exempt market dealers. In particular, we found substantive and procedural issues at certain exempt market dealers with respect to Know Your Client and suitability obligations, as well as the sale of securities inappropriately to non-accredited investors.

We plan to publish a report of key findings and “best practice” guidance in the fall to assist registrants in meeting their compliance obligations. In our view, more work needs to be done by industry to, at a minimum, consistently meet existing requirements.

Conclusion

Ultimately, we all have a shared responsibility to support and facilitate robust and healthy capital markets in Ontario. We also share a common goal of contributing to the growth of Ontario’s economy.

It comes back to access by those who need capital and those who have money to invest.

Our job as a regulator is to create the framework and set the rules of the game to make Ontario’s capital markets fairer and more efficient, and provide an appropriate level of investor protection.

We do not want to stand in the way of capital formation, but we have a responsibility to ensure that capital formation occurs in a manner that reflects the important investor protections provided under securities law.

Thank you.