

OSC STAFF NOTICE 45-707

OSC BROADENING SCOPE OF REVIEW OF PROSPECTUS EXEMPTIONS

June 7, 2012

Introduction

On November 10, 2011, CSA staff announced that they are reviewing the \$150,000 minimum amount and the accredited investor prospectus exemptions contained in National Instrument 45-106 *Prospectus and Registration Exemptions* (NI 45-106). In light of feedback received from stakeholders to date, OSC staff are broadening the scope of our review to consider whether the OSC should introduce new prospectus exemptions that may assist capital raising for business enterprises while protecting the interests of investors. For instance, we heard from some stakeholders that we should consider prospectus exemptions based on a number of factors, such as the financial resources of a purchaser relative to the size of the investment and the availability of disclosure regarding the investment.

Different capital raising exemptions currently exist in the exempt market across CSA jurisdictions, and as a result, different feedback was received across CSA jurisdictions during consultations on the exempt market. In conducting the broader review, we will continue to work with staff in other CSA jurisdictions.

No decisions regarding changes to the exempt market regulatory regime have been made at this point. In deciding whether changes are necessary or appropriate, we will be governed by our regulatory mandate of:

- protecting investors from unfair, improper or fraudulent practices, and
- fostering fair and efficient capital markets, and confidence in those markets.

Significance of exempt market

The exempt market in Canada has become increasingly important for investors and issuers. The total amount of capital raised through exempt distributions reported to the OSC in 2011 was approximately \$142.9 billion. Approximately \$86.5 billion of that amount was raised in Ontario. In 2011, approximately \$72.8 billion was raised under the accredited investor prospectus exemption in Ontario. The minimum amount prospectus exemption was less used, but in 2011, approximately \$3.9 billion was raised under this exemption in Ontario.

We want the exempt market to be an effective mechanism for raising capital for business enterprises, particularly small and medium-sized businesses. However, we need to strike a balance between investor protection and efficient capital raising. In doing so, we need to consider in what circumstances investors do not require the

protections afforded by a prospectus offering, including prospectus level disclosure, the provision of statutory rights where there is a misrepresentation and the involvement of a registrant.

CSA consultation

On November 10, 2011, CSA staff published CSA Staff Consultation Note 45-401 *Review of Minimum Amount and Accredited Investor Exemptions*. The consultation note provided summary information regarding the two prospectus exemptions being reviewed and set out a number of specific consultation questions. The comment period closed on February 29, 2012 and 108 comment letters were received.

As part of the consultation process, OSC staff met with over 300 individuals. We held four public consultation sessions in February 2012, which were attended in total by approximately 200 individuals. We also consulted with our Investor Advisory Panel, Securities Advisory Committee, Small Business Advisory Committee and Continuous Disclosure Advisory Committee. In addition, we met with several interested stakeholder groups, including investor representatives, industry members, registrants, other regulators and legal and other advisors.

Key themes from feedback received

A wide range of views were expressed in both the written comment letters and in our consultation sessions. Some of the themes raised with OSC staff were:

- **Diversity of the exempt market.** There are different segments of the exempt market: capital raising traditionally associated with business enterprises, as well as a capital management component, including investments in pooled or hedge funds. There is a wide range of products being sold in the exempt market. A “one size fits all” regulatory approach may not be appropriate or sufficient.
- **Access to the exempt market by issuers.** Many stakeholders expressed concern that any changes to the exempt market regime might restrict access to capital by businesses. Some suggested that access to a broader range of investors through the exempt market may provide better support for small and medium-sized businesses.
- **Access to the exempt market by investors.** Some stakeholders supported “democratization” of the exempt market so that more individuals, rather than simply high net worth or high income individuals, would be able to make investments on a prospectus-exempt basis. Other stakeholders expressed investor protection concerns with broader investor participation in the exempt market given that no disclosure is currently mandated and registrant involvement is not always required.

- **Existing criteria for accredited investor status.** Some stakeholders believe the current financial thresholds for individuals to qualify for accredited investor status are appropriate. Other stakeholders do not think net income or financial assets are an adequate proxy for sophistication. Other stakeholders questioned whether the monetary criteria should be adjusted for inflation. Some stakeholders have suggested that individuals who do not meet the current financial thresholds should nonetheless be able to invest in the exempt market if they have certain attributes of sophistication such as investment or work experience or education, or are relying on the advice of a registrant.
- **Existing minimum purchase amount.** Many stakeholders questioned the rationale for the existing minimum amount prospectus exemption. They felt that it had the effect of causing investors to invest \$150,000 in one investment when an investment in smaller amounts or a more diversified approach would have been more appropriate. We also heard that the ability to invest a lump sum of \$150,000 does not indicate that an investor is sophisticated or able to withstand the loss of that investment. Some stakeholders indicated that a limit on the maximum amount invested, expressed either as a dollar amount or a percentage of the investor's assets or net income, would be more appropriate than the current minimum amount prospectus exemption.
- **Other options.** There were a number of views on whether there should be prospectus exemptions based on the provision of disclosure to investors and, if so, what form that disclosure should take. Some stakeholders suggested that Ontario should adopt an offering memorandum prospectus exemption, which would allow a broader range of investors to participate in the exempt market on the condition that a minimum level of disclosure is provided to investors. That exemption currently exists in some CSA jurisdictions. Some stakeholders supported more rigorous risk disclosure to enhance investor protection. In addition, there were different views on whether the availability of a prospectus exemption should be contingent on the involvement of a registrant who is subject to know-your-client (or KYC), know-your-product (or KYP) and suitability obligations.
- **Harmonization.** Some commenters encouraged CSA members to renew their efforts to harmonize the current prospectus exemptions that exist in National Instrument 45-106 *Prospectus and Registration Exemptions*. We received feedback that exemptions, which are not totally harmonized across Canada, add undue complexity for investors and costs for issuers.

This is not an exhaustive list of all the comments staff received. We are currently considering all of the comments provided to us by stakeholders, which will inform the next phase of this initiative. We will publish a summary of the comment letters we have received in response to our request for comment on the minimum amount and accredited investor prospectus exemptions.

Next steps for OSC staff

In light of feedback received from stakeholders, we are broadening the scope of our review to consider the exempt market regulatory regime more generally. We will continue to assess whether the existing minimum amount and accredited investor prospectus exemptions remain appropriate or whether changes should be made. We will also consider whether the OSC should introduce other prospectus exemptions to facilitate capital raising for business enterprises. Because this latter consideration was not part of the review of the minimum amount and accredited investor prospectus exemptions, we are giving market participants an opportunity to address that issue before our review of the exempt market is completed.

During this fiscal year, OSC staff will:

- **Publish a second consultation note.** We will publish a second consultation note which will seek further feedback on the exempt market regulatory regime. That consultation note will explore whether the OSC should adopt any new prospectus exemptions and, if so, under what circumstances or terms.
- **Hold further public consultation sessions.** We will hold further public consultation sessions following the publication of the second consultation note. In addition, we will actively reach out to investors and meet with other stakeholders to obtain their feedback.
- **Consider the experience of the other CSA jurisdictions with prospectus exemptions not currently available in Ontario.** Other CSA jurisdictions currently have a form of offering memorandum prospectus exemption and a “friends and family” prospectus exemption, neither of which are currently available in Ontario. On April 26, 2012, CSA staff published Multilateral CSA Staff Notice 45-309 *Guidance for Preparing and Filing an Offering Memorandum under National Instrument 45-106 Prospectus and Registration Exemptions*. The staff notice summarizes common deficiencies in offering memoranda prepared in accordance with Form 45-106F2 *Offering Memorandum for Non-Qualifying Issuers* and provides guidance to improve compliance with the disclosure requirements.
- **Consider developments in other jurisdictions relevant to capital raising in the exempt market.** We will consider the securities regulatory regime for capital raising in the exempt market in other jurisdictions. In particular, we will consider developments in the U.S. with respect to capital raising contained in the *Jumpstart Our Business Startups Act* (or the JOBS Act).

- **Establish an ad hoc advisory committee.** We will establish an ad hoc advisory committee to communicate views to us on possible regulatory approaches to the exempt market. The committee will be comprised of investors, issuer representatives, registrants and legal and other advisors. A separate news release will be published inviting interested stakeholders to apply for membership on this committee.

As noted above, we will publish a summary of the comment letters received on CSA Staff Consultation Note 45-401 *Review of Minimum Amount and Accredited Investor Exemptions*.

Questions

Please refer any questions to:

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