

CANADA



1 Current market of Crowdfunding platforms in Canada

Crowdfunding is divided into Non-Equity and Equity Crowdfunding platforms in Canada¹. Non-Equity platforms, as its name implies, do not involve the issuance of securities and are not regulated by Canadian securities laws. In contrast, equity Crowdfunding platforms involve the issuance of securities and consist of peer-to-peer (P2P) lending platforms and equity platforms.

1.1.1 Non-Equity Crowdfunding

There are three types of Non-Equity Crowdfunding Models that operate on Crowdfunding platforms in Canada, the Donation Model, the Rewards Model and the Pre-Purchase Model. A directory of various Non-Equity Crowdfunding platforms is publicly available on the website of the National Crowdfunding Association of Canada.²

1.1.2 Donation Model

The Donation Model is where an individual or entity donates or makes a financial contribution to a project or cause without any expectation of receiving a financial return on that contribution. An individual is motivated to make a donation based on their personal desire to support a project or campaign that is in some way meaningful or important to them. The Donation Model has its roots in philanthropy and is commonly used by on-line charities.

1.1.3 Reward or Perk Model

The Reward Model is where an individual or entity makes a financial contribution to a project or cause in return for a reward or perk. The types of rewards or perks offered by a project sponsor or entrepreneur vary considerably and are often quite imaginative and interesting and may not necessarily involve something tangible. For example, a film project could reward contributors with special recognition in the film credits or provide branded merchandise depending on the amount they contribute.

1.1.4 Pre-Purchase Model

The Pre-Purchase Model is where an individual or entity provides an up-front payment in exchange for a pre-order of a product. This model provides validation of a need or want for a product by providing a project sponsor or entrepreneur with up-front capital often at a discount to the anticipated retail price.

¹ The information in this note is current as of October 14, 2013.

² See <http://www.ncfacanada.org/canadian-crowdfunding-directory>.

1.2 Equity Crowdfunding

Equity Crowdfunding in Canada consists of P2P Lending and Equity Crowdfunding platforms.

1.2.1 Peer-to-Peer Lending Model

P2P lending involves matching borrowers with lenders where individuals or entities lend money to an individual, company or project in return for the repayment of the principal amount of the loan plus interest on their original investment. P2P lending is considered a 'security' under Canadian securities law, therefore, lenders are considered to be investors. Accordingly, any P2P portal would be a regulated entity under applicable Canadian securities law.

Canadian securities laws do not have an express prospectus or registration exemption to permit the operation of an on-line P2P lending platform. Therefore, in order for a P2P lending platform to operate in Canada, it would have to obtain exemptive relief from the prospectus and registration requirements from the various Canadian securities regulatory authorities as one company did in 2009.³ This company operated a P2P lending platform for accredited investors only. This company has since changed its business model and is no longer engaged in P2P lending. We are not aware of any other P2P lending platform operating in Canada.

1.2.2 Equity Crowdfunding Models

1.2.2.1 Regulation of securities in Canada

Canada consists of 10 provinces and three territories and the regulation of securities is within the jurisdiction of the provinces and territories and not the federal government of Canada as a matter of constitutional law. Therefore, Canada does not presently have a national securities regulator or any national securities legislation, although plans are in place to create a national securities regulatory authority.⁴ The Ontario Securities Commission (the **OSC**) is the largest securities commission in Canada while other significant provincial securities regulators are the British Columbia Securities Commission (**BCSC**), the Alberta Securities Commission and the Autorité des marchés financiers (Québec).

Although there are 13 jurisdictions in Canada, the various provincial and territorial securities regulators work together through an umbrella organization called the Canadian Securities Administrators (**CSA**). Through the CSA, Canada's provincial and territorial securities regulators promulgate national and multilateral instruments, guidelines, notices and other regulatory pronouncements in order to improve, coordinate and harmonize the regulation of the capital

³ See the exemptive relief order provided to Communitylend Inc. on the website of the Ontario Securities Commission at: http://www.osc.gov.on.ca/en/SecuritiesLaw_ord_20090911_215_communitylend.jsp.

⁴ On September 19, 2013, the Canadian Minister of Finance announced that the federal government has agreed in principle with the provinces of British Columbia and Ontario to move towards establishing a cooperative capital markets regulatory system. The proposed regulator will be a common regulator that will administer a single set of regulations designed to protect investors, support efficient capital markets and manage systemic risk. Although the other provinces and territories are not parties to the agreement in principle, the Canadian Minister of Finance has extended an invitation to all provinces and territories to participate.

markets in Canada. The CSA has published national Instrument involving prospectus exemptions that includes the offering memorandum (**OM**) exemption (the **OM exemption**)⁵ which is used by registered dealers to sell securities on the internet to the public which is discussed below.

1.2.2.2 Regulation of Equity Crowdfunding in Canada

There is no express Equity Crowdfunding prospectus and registration exemption in Canada but two proposed frameworks have been published by the Provinces of Ontario and Saskatchewan and are receiving serious consideration. However, some registered dealers in Canada have established websites where they sell securities to the public under the OM exemption. The OM exemption is available in all jurisdictions in Canada, except Ontario, and has been in place for many years.⁶ Some CSA members believe this prospectus exemption provides an existing securities framework for Equity Crowdfunding and existing registered dealers are taking advantage of it.⁷

The CSA members are still considering whether Equity Crowdfunding should occur under the OM exemption or a specific Equity Crowdfunding exemption as proposed by Ontario and Saskatchewan. Regardless, if a foreign entity desires to engage in Equity Crowdfunding today, it could do so in all jurisdictions in Canada except Ontario under the OM exemption as discussed below.

2 Current Regulation of Crowdfunding Platforms in Canada

2.1 Registration requirement for platforms

2.1.1 Across Canada – exempt market dealers

Offering securities for sale on the internet triggers registration under Canadian securities law. Crowdfunded offerings under the OM exemption must be conducted by a registered dealer under Canadian securities law. In Canada, there is a category of dealer called an ‘exempt market dealer’ (an EMD) that can act as a registered dealer in connection with Crowdfunded offering.⁸

An EMD is required to satisfy a number of regulatory obligations and requirements under Canadian securities law including its ‘know your product’ obligation, ‘know your client’ obligation and suitability obligation (which requires an EMD to ensure that an investment is a suitable investment for each investor). An EMD can act as an intermediary in any type of prospectus-exempt offering in

⁵ See section 2.9 of National Instrument 45-106 – *Prospectus and Registration Exemptions*.

⁶ For various policy reasons, Ontario has not adopted the OM exemption; however, it is currently under review.

⁷ Although some EMDs are also selling securities over the internet on their websites to accredited investors, (e.g., wealthy individuals and large institutional and government investors), many do not view the accredited investor prospectus exemption which is available across Canada as true Equity Crowdfunding since it does not involve selling securities to the public. According to OSC statistics, accredited investors only comprise approximately 4% of the Ontario and Canadian population.

⁸ Although an ‘investment dealer’ under Canadian securities law can also sell securities on the internet under the OM exemption, we are not aware of any such investment dealers who are engaged in such activities.



Canada where it is registered provided that the prospectus exemption relied upon is available in that jurisdiction.

2.1.2 Ontario's Equity Crowdfunding proposal

In Ontario, the OSC has published an Equity Crowdfunding framework in December 2012 (the **Ontario Proposal**).^{9,10} The OSC Proposal states that an Equity Crowdfunding platform operating in Ontario would have to register in the appropriate category of dealer or advisor category since the activities of platforms will generally be considered registerable trading or advising activity under Ontario securities law. The Ontario Proposal does not set out the registration requirements for a platform; however, it will likely be a type of 'restricted dealer' which means it will not be subject to all of the registration requirements of an EMD. For example, it is unlikely that a portal will be required to assess whether a Crowdfunded investment is suitable for an investor which is required by an EMD as a matter of law.

2.1.3 Saskatchewan's Equity Crowdfunding proposal

In Saskatchewan, the Financial and Consumer Affairs Authority (the FCAA), the Saskatchewan securities regulatory authority, published a proposed Equity Crowdfunding framework for start-ups in July 2013¹¹ and followed up with a proposed Equity Crowdfunding prospectus exemption in October 2013.¹² The FCAA does not require an Equity Crowdfunding platform to be registered as a dealer or as an adviser under Saskatchewan securities law; however, it does require the platform operator and each promoter, director, officer and control person of the platform operator to file certain application forms 30 days before engaging in Crowdfunded offerings.

In order to rely on the Equity Crowdfunding exemption described in the Saskatchewan Proposal, the platform must ensure that:

1. it makes an Important Risk Warnings document and the offering document separately available to investors electronically online;
2. it does not allow the investment until the investor confirms online that they have read and understood the offering document and the Important Risk Warnings;
3. it does not release any funds until the minimum offering amount has been raised and until that time all funds received for the offering are held in trust for investors;

⁹ See OSC Staff Consultation Paper 45-710 *Considerations for New Capital Raising Prospectus Exemptions*.

¹⁰ In August 2013, the OSC published a progress report where it summarized its work and the public comments it received and confirmed its interest in continuing to develop an Equity Crowdfunding framework that seeks to balance investor protection without imposing excessive regulatory burdens on issuers and platforms.

¹¹ See "*Saskatchewan Begins Preliminary Exploration of Equity Crowdfunding*" on the FCAA's website at: <http://www.gov.sk.ca/news?newsId=e8941005-2be7-4c70-a443-b48e78b8edd0>.

¹² General Order 42-925 Saskatchewan Equity Crowdfunding Exemption.



4. when the offering is closed, the platform provides the issuer with the details of the investor (e.g., name address, e-mail etc.) within 15 days of the closing of the offering; and
5. issuers and investors have an address in Saskatchewan.

2.2 Payment services regulation

A platform that is registered as an EMD would be permitted to receive or hold investor funds in trust. This is what EMDs presently do when they engage in any type of private placement in Canada including a Crowdfunded offering under the OM exemption.

It is not clear whether a platform that may be registered as restricted dealer would also be permitted to receive or hold funds under the Ontario Proposal, however, it is expressly contemplated under the Saskatchewan Proposal.

2.3 Prospectus requirements

This section examines the OM exemption and the proposed Equity Crowdfunding prospectus exemptions being considered by Ontario and Saskatchewan.

2.3.1 OM exemption – available across Canada except Ontario

There are two models of the OM exemption in Canada; the ‘British Columbia model’ and the ‘Alberta model’. The British Columbia model is followed by the provinces of British Columbia, New Brunswick, Nova Scotia and Newfoundland and Labrador, while the Alberta model is followed by the provinces of Alberta, Manitoba, Prince Edward Island, Québec, Saskatchewan and the Northwest Territories, Nunavut and the Yukon.¹³

Under both models, a purchaser purchases a security as principal and at the same time, or before the purchaser signs the agreement to purchase a security, the issuer: (a) delivers a prescribed form of OM to the purchaser; (b) obtains a signed risk acknowledgement form from the purchaser; and (c) satisfies such other requirements as discussed below. Under both models, issuers can sell securities to the public with no limit on the amount of capital that can be raised by an issuer or invested by an investor, except the Alberta model only permits investors to invest up to \$10,000 unless they are an “eligible investor”¹⁴ and if so, then there is no investment limit.

¹³ Ontario is presently considering adopting the Alberta model of the OM exemption but considering additional investor protection measures.

¹⁴ An “eligible investor” means, among other things, a person whose: (a) net assets, alone or with a spouse, in the case of an individual, exceed \$400,000, (b) net income before taxes exceeded \$75,000 in each of the two most recent calendar years and who reasonably expects to exceed that income level in the current calendar year, or net income before taxes, alone or (c) with a spouse, in the case of an individual, exceeded \$125,000 in each of the two most recent calendar years and who reasonably expects to exceed that income level in the current calendar year.

Generally, reliance on the OM exemption is subject to the following requirements:

- *Commission and finder's fee*: no commission or finder's fee may be paid to any person, other than a registered dealer, in connection with a distribution to a purchaser in the Northwest Territories, Nunavut, Saskatchewan and Yukon. It is permitted in the other jurisdictions.
- *Prescribed form of OM*: an OM must be in compliance with the prescribed form requirements, as set out in Form 45-106 F2 - *Offering Memorandum for Non-Qualifying Issuers*, which describes the form requirements for private issuers. There is a separate form for public issuers.
- *Audited financial statements* – issuer are required to include audited financial statements and interim financial statements for the most recently completed interim period that ended more than 60 days before the date of the OM, subject to a number of requirements.¹⁵
- *Cancellation right and holding funds in trust*: an OM must provide the purchaser with a contractual right to cancel the agreement to purchase the security if the securities legislation where the purchaser is resident does not provide a comparable right by delivering a notice to the issuer not later than midnight on the second business day after the purchaser signs the agreement to purchase the security. Accordingly, the issuer must: (a) hold in trust all consideration received from the purchaser in connection with a distribution of a security until midnight on the second business day after the purchaser signs the agreement to purchase the security; and (b) return all consideration to the purchaser promptly if the purchaser exercises the right to cancel the agreement to purchase the security.
- *Statutory rights of action*: the OM must contain a prescribed contractual right of action against the issuer for rescission or damages if the securities legislation where the purchaser is resident does not provide a statutory right of action in the event of a misrepresentation in an OM delivered to a purchaser.
- *Certificate*: the OM must contain a certificate page that states the OM does not contain a misrepresentation which must be signed by individuals holding certain titles within an issuer, which varies depending on the type of legal entity that is offering the securities. This certificate must be true at the date the certificate is signed and delivered to a purchaser. If a certificate ceases to be true after it is delivered to a purchaser, the issuer cannot accept an agreement to purchase the security from a purchaser unless: (a) the purchaser receives an updated OM; (b) the updated OM contains a newly dated and signed certificate; and (c) the purchaser re-signs the agreement to purchase the security.

¹⁵ On December 20, 2012, the CSA members (other than British Columbia and Ontario) published Multilateral CSA Notice 45-311 Exemptions from Certain Financial Statement-Related Requirements in the Offering Memorandum Exemption to Facilitate Access to Capital by Small Businesses. Each CSA member (other than British Columbia and Ontario) issued a harmonized interim local order (the **Order**) that provides an exemption from certain financial requirements set out in the OM exemption. The Order remains in force until December 14, 2014. The Order provides relief from the audited financial statement requirement and the requirement for issuers to prepare financial statements using Canadian GAAP applicable to publicly accountable enterprises provided that: (a) the issuer and related issuers raise no more than \$500,000; (b) no investor invests more than \$2,000 in any 12-month period; (c) the issuer is not a reporting issuer, investment fund, mortgage investment entity or real estate issuer; (d) the issuer does not distribute complex securities; and (e) the OM contains a bold warning on the front page.

In February 2013, the BCSC published a Notice and Request for comment on National Instrument 45-106 *Prospectus and Registration Exemptions Proposed Prospectus Exemption to Assist Capital Raising by Small Businesses* (the **BC Proposal**). The BC Proposal is the same as the Order except that it requires an issuer to identify the use of the exemption in a report of trade and it is not yet legal. Unlike the Order it is only a request for comment which comment period has closed and there has been no further update by the BCSC on this matter. The BC Proposal can be found on the BCSC's website at: http://www.bcsc.bc.ca/policy.aspx?id=16540_



- *Risk acknowledgement form*: a risk acknowledgement form must be in the required form and an issuer relying on it must retain the signed risk acknowledgment for eight years after the distribution.
- *Filing the OM and any update OM*: the issuer must file a copy of an OM delivered to a purchaser and any update of a previously filed OM with the securities regulatory authority on or before the 10th day after the distribution of the OM or updated OM.

2.3.2 The Ontario Proposal

The key elements of the Ontario Proposal are set out below.

- *Qualification criteria* - the issuer, its parent (if applicable) and its principal operating subsidiary (if applicable) must be incorporated or organized under Canadian federal laws or the laws of a Canadian jurisdiction and the issuer must have its head office located in Canada. It applies to private and public companies except investment funds.
- *Limit on offering size* – the issuer cannot raise more than \$1.5 million in any 12-month period.
- *Limit on type of security* – the only securities that can be distributed under this exemption are common shares, non-convertible preferred shares, non-convertible debt securities that are linked only to a fixed or floating interest rate and securities convertible into common shares or non-convertible preferred shares.
- *Investment limits* – an investor cannot invest more than \$2,500 in a single investment or more than \$10,000 in total under this exemption in a calendar year.
- *Limits on advertising* – the issuer is not permitted to advertise an investment except through the funding portal or on the issuer's website. However, the issuer would be able to use social media to direct investors to the funding portal or the issuer's website.
- *Type of offering document* - an investor must be provided an 'information statement' (a type of offering document with prescribed disclosure) at the time of distribution consisting of: (a) *financing facts* – basic information about the offering; (b) *issuer facts* – basic information about the issuer; and (c) *registration facts* – basic information about the registrant or portal. The OSC states that the information statement is intended to provide more stream-lined than the disclosure under the OM exemption and would be akin to a summary in a long-form prospectus.
- *Risk factor disclosure* - the information statement must include a discussion of the principal risks facing the issuer's business.
- *Risk acknowledgement form* - a purchaser must sign a stand-alone risk acknowledgement form where they confirm they: (a) fall within the investment limitations under the exemption; (b) understand they can lose all their money; (c) can bear the loss of their entire investment; and (d) understand the illiquid nature of the investment.
- *Financial statements* – an issuer's financial statements: (a) must be audited if the issuer proposes to raise at least \$500,000 or if the issuer is a public company; and (b) may be unaudited if the issuer proposes to raise less than \$500,000 and is not a public company; only management-certified financial statements would be required in such circumstances.
- *Rights of action* – investors have a statutory right of action against an issuer for a misrepresentation in the information statement.
- *Report of trade* – it is contemplated that a report of trade will be required to be filed by an issuer with the OSC within 10 days of the trade. It is not clear whether a filing fee will be required to be paid at this time.
- *Resale restrictions* – securities distributed under this exemption are subject to a restricted resale period. The securities will not be free-trading shares where the issuer is not a public company, unless they can be sold under another prospectus exemption.
- *Ongoing disclosure requirement* – issuers must provide its securityholders with annual financial statements within 120 days from its fiscal year end.

- *Books and record requirement* - issuers must maintain books and records that are available for inspection by purchasers and OSC staff.

2.3.3 The Saskatchewan Proposal

On October 7, 2013, the FCAA published the Saskatchewan Proposal¹⁶ and has requested public feedback by November 6, 2013.¹⁷

The key features of the Saskatchewan Proposal are set out below.

- *Saskatchewan investors only* – the exemption is only available to investors who have an address in Saskatchewan.
- *Investor investment limits* - investors can only purchase \$1,500 per offering with no annual investment limit.
- *Acknowledgement of risk* - investors must confirm online that they have read and understood a prescribed form of document called *Important Risk Warnings*.
- *Rights of action* - subject to certain limitation periods, investors have a right to sue for a misrepresentation in the issuer's advertising or sales materials or if a verbal statement was made in connection with the investment that contained a misrepresentation. Investors also have a right to cancel the subscription agreement and recover the purchase price if the investment is sold in breach of a decision of the FCAA or the Saskatchewan Securities Act.
- *Saskatchewan issuers only* - the exemption is only available to issuers who have an address in Saskatchewan.
- *Type of issuer* - any type of issuer can use the exemption except a public company or an investment fund.
- *Type of securities* - any type of security can be issued except derivatives. The trade can only involve a trade by the issuer in its own securities facilitated by the portal.
- *Form filing* - any issuer must file Form GO45-925F1 *Issuer Information* 10 days prior to beginning to trade.
- Maximum offering size - \$150,000.
- *Minimum offering size* - the minimum offering size must be set out in the offering document which must equal the amount needed to carry out the purpose for which the funds are sought. The minimum offering size may be reduced by any other amount available for the purpose set out in the offering document, as long as the offering document states that these other funds are unconditionally available to the issuer.
- *Offering period* – the offering period shall not exceed six months.
- *Annual limit* - the issuer and its promoters, directors, officers and control persons cannot use the exemption more than two times per calendar year.
- *Offering document* - the issuer must use an offering document following Form GO45-925F3 *Offering Document* to be made available to investors through the portal and file the offering document 10 business days prior to beginning to trade.
- *No other concurrent offering* – there can be no other concurrent offering by the issuer or other issuer for the same project
- *Background checks* – the FCAA will undertake background checks on individuals involved with the offering who must submit Form GO45-925F2 *Individual Information Form*.

¹⁶ General Order 42-925 Saskatchewan Equity Crowdfunding Exemption.

¹⁷ The stated purpose of the Saskatchewan Proposal is to help bridge the funding gap for start-ups and entrepreneurs while adequately protecting investors. If implemented, the FCAA stated the Saskatchewan Proposal would have a three-year sunset clause when it expires.



- *No payment of commissions* – no commission or other amounts can be paid to the issuer or its promoters, directors, officers, control persons, employees or agents with respect to the trade.
- *Report of trade and fees* - the issuer must file a report of trade in Form GO45-925F4 *Report of Trades* within 30 days after the offering closes. There are no filing fees payable to the FCAA.
- *Resale restrictions* – securities can only be resold under a prospectus exemption unless the issuer becomes a reporting issuer and if so, then subject to certain conditions.
- *Ongoing disclosure requirement* – there are no ongoing disclosure requirements except issuer are required to disclose how investors will be updated in their offering document.
- *All trades must be through portal* - in order to rely on the exemption, all trades must be carried out through the portal and payment for the securities must be made through the portal.

3 Possible regulation of Crowdfunding platforms under the AIFMD regime in Canada

Canada is not required to adopt the AIFMD since it is not part of the EU. However, to the extent that a Canadian-based portfolio advisor markets AIFs in the EEA, manages or sub-advises EEA domiciled AIFs, or is outside the safe harbour for “reverse solicitation” in a jurisdiction, it may need to comply with the local rules and requirements.

4 Conclusion

Canada currently permits Equity Crowdfunding under the OM exemption in all jurisdictions in Canada, except Ontario where it is presently unavailable, provided that it is undertaken by registered dealers such as an EMD. EMDs sell securities in the exempt market (*i.e.*, exempt from the prospectus requirement) and are much easier to become registered than a full investment dealer.

Both Ontario and Saskatchewan are considering adopting a specific Equity Crowdfunding framework. It is believed that Ontario is waiting for the United States to come out with its draft rules and regulations before finalizing any framework in Ontario, if at all, while many anticipate Saskatchewan will likely adopt its framework by the end of 2013.

The tension in Canada is that some CSA members believe the OM exemption should be used as our only Canada-wide Equity Crowdfunding exemption, while Ontario believes there should be a less burdensome framework. This is being debated among the CSA members. Saskatchewan is looking at the OM exemption, as are other CSA members as the preferred framework, but believes it needs a different approach for start-ups with its Saskatchewan Proposal.



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