

# New “Start-up” Crowdfunding Exemptions Adopted in Some Canadian Jurisdictions



In a Nutshell



June 4, 2015

**This is the second of our nutshell series on regulatory developments affecting crowdfunding and other online financing portals.**

On May 14, 2015, the securities regulatory authorities of British Columbia, Saskatchewan, Manitoba, Québec, New Brunswick and Nova Scotia (the participating jurisdictions) announced that they were adopting substantially harmonized registration and prospectus exemptions (the start-up crowdfunding exemptions) to allow start-up and early-stage companies in these jurisdictions to raise up to \$500,000 per calendar year through online funding portals.

As explained in the related notice, Multilateral CSA Notice 45-316 Start-up Crowdfunding Registration and Prospectus Exemptions, the exemptions are being implemented by way of local blanket orders on or shortly after the publication of the CSA notice, and will be in effect until May 13, 2020.

The start-up crowdfunding exemptions consist of an exemption from the prospectus requirement (the start-up prospectus exemption) and an exemption from the dealer registration requirement (the start-up registration exemption).

## Start-Up Prospectus Exemption

The start-up prospectus exemption allows non-reporting issuers (but not reporting issuers) to issue eligible securities, subject to a number of conditions, including the following:

- The head office of the issuer must be located in a participating jurisdiction.
- The issuer must distribute its securities through an online funding portal that is either relying on the start-up registration exemption (discussed below) or is operated by a registered dealer. Registered dealers that operate funding portals must meet their existing registration obligations under securities legislation and also confirm that they will comply with certain conditions of the start-up registration exemption.
- The issuer must distribute its securities using a prescribed form of offering document that includes basic information about the issuer, its management and the distribution, including intended use of funds raised and the minimum offering amount.
- The issuer (and any other issuer in the “issuer group”) cannot raise more than \$250,000 per distribution and is limited to two start-up crowdfunding distributions per calendar year (but is able to make other distributions in reliance on other prospectus exemptions). No person may invest more than \$1,500 per start-up crowdfunding distribution (but with no limit on the number of distributions in which the investor may participate).
- The distribution cannot remain open for more than 90 days.
- The issuer must provide each investor with a contractual right to withdraw their offer to purchase securities within 48 hours of the purchaser’s subscription or notification to the purchaser that the offering document has been amended.
- None of the promoters, directors, officers and control persons (collectively, the principals) of the issuer group is a principal of the funding portal.

The eligible securities are subject to an indefinite hold period and can only be resold under another prospectus exemption, under a prospectus or four months after the issuer becomes a reporting issuer.

## Start-Up Registration Exemption

The conditions to the start-up registration exemption include the following:

- The funding portal must deliver a funding portal information form and individual information forms for each of its principals to a participating jurisdiction at least 30 days before facilitating its first start-up crowdfunding distribution in the jurisdiction.
- A participating regulator may extend the initial 30-day review period and may remove the registration exemption (at any time) by notifying the funding portal that it has determined that the business of the funding portal is prejudicial to the public interest because the principals or their past conduct demonstrate a lack of
  - integrity,
  - financial responsibility, or
  - relevant knowledge or expertise.
- The head office of the funding portal must be located in Canada (but, unlike the case for issuers, may be located in a non-participating jurisdiction, such as Ontario or Alberta).
- The majority of the funding portal's directors must be Canadian residents.
- The funding portal cannot provide advice to a purchaser or otherwise recommend or represent that an eligible security is suitable, or comment on the merits of the investment.
- The funding portal cannot receive a commission, fee or any other amount from a purchaser of securities.
- The funding portal must make the offering document and the risk warnings available online to purchasers, and must not allow a subscription until the purchaser has confirmed that he or she has read and understood these documents.
- The funding portal must receive payment for securities electronically through the funding portal's website.
- The funding portal must hold the purchasers' assets separate and apart from its own property, in trust for the purchasers and, in the case of cash, at a Canadian financial institution.
- The funding portal must maintain books and records at its head office to accurately record its financial affairs and client transactions, and to demonstrate the extent of the funding portal's compliance with the start-up crowdfunding exemption orders for a period of eight years from the date a record is created.
- The funding portal must either
  - release funds to the issuer after the minimum offering amount has been reached and the 48-hour right of withdrawal has elapsed, or
  - return the funds to purchasers if the minimum offering amount is not reached or if the start-up crowdfunding distribution is withdrawn by the issuer.

Although it may seem unusual to provide an exemption from the registration requirement, but then reimpose many registration-like requirements as conditions of the exemption, this approach arguably reduces the registration requirement to a very "light touch" regime and allows the portal to avoid many additional obligations that ordinarily apply to registered firms. On the other hand, this approach may also result in some uncertainty, such as whether a regulator's decision to remove the registration exemption is subject to the same "fitness for registration" criteria and protections as a decision to refuse, suspend or revoke a registration, and may result in some additional risks to investors, such as in relation to the portal's ability to handle investor funds.

Nevertheless, on balance, the approach reflected in the start-up crowdfunding exemptions represents an attempt to tailor a regulatory regime that is sensitive to concerns about regulatory burden and principles of proportionate regulation, and allows issuers and portals a measure of choice over the regulatory regime under which they wish to operate.

As explained in our first nutshell of this series, [Equity Crowdfunding Portals](#), we may soon see a number of different crowdfunding models operating in Canada, including the following:

- the start-up crowdfunding exemption model for relatively small offerings of up to \$500,000 per year (with an investor limit of \$1500 per investment)
- the 45-108 crowdfunding model as described in proposed Multilateral Instrument 45-108 Crowdfunding (MI 45-108) for offerings of up to \$1.5 million per year (with an investor limit of \$2,500 per investment)
- broader crowdfunding based on other prospectus exemptions, such as the offering memorandum exemption or the accredited investor exemption (with generally no issuer or investor limits)

In this regard, it is particularly welcome that the start-up crowdfunding exemption has been amended from the original March 2014 proposal to allow offerings to be made through portals operated by registered dealers. In view of this change, registered dealers that are subject to higher regulatory requirements may also add start-up crowdfunding offerings to their activities. This may make it easier for the remaining jurisdictions, such as Ontario and Alberta, to introduce a similar start-up prospectus exemption in the future.

At a time when there appears to be little apparent movement south of the border on the crowdfunding proposals published by the SEC in October 2013, the choice of models being made available to Canadian issuers and investors is very welcome.

Please contact a member of our [Regulatory Compliance Group](#) for guidance on any of the topics in this nutshell.

This nutshell is an overview only and it does not constitute legal advice. It is not intended to be a complete statement of the law or an opinion on any matter. No one should act upon the information in this nutshell without a thorough examination of the law as applied to the facts of a specific situation.

