

Meet and Greet with Dentons – Crowdfunding Options for Start-Ups

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Overview

Agenda

1. Canadian Securities Law 101
2. Accredited Investor Exemption (2.3 of NI 45-106)
3. Offering Memorandum Exemption (2.9 of NI 45-106)
4. Crowdfunding Exemption (MI 45-108)
5. Start-Up Crowdfunding Exemption (CSA Notice 45-316)
6. Proposed Start-Up Business Prospectus Exemption (MI 45-109)
7. Dentons Start-Up Program

Equity Crowdfunding in Canada: A Legal Overview

Securities Law 101

- What is a Security?
 - Inclusive definition: shares, debentures, promissory notes, options, warrants, investment contracts, mortgages etc.
- Who Regulates?
 - No national securities regulator so we have 13 provincial / territorial regulators in Canada
 - Legislation and regulations in each province and territory
 - Harmonized through National Instruments, Multilateral Instruments, Staff Notices, Orders etc.
- Principal Objectives of Securities Regulation
 - Protect Investing Public
 - Promote Efficient Capital Markets
 - Need for harmonization
- Prospectus requirement
 - No trade in a security can be effected without a prospectus or a prospectus exemption
- Registration requirement
 - Entities in the business of trading/advising in securities must be registered in the appropriate category or be exempt from the registration requirement
 - Regulators take the position that portal operators are engaged in the business of trading and are required to be registered

Prospectus Exemptions Currently Available for Use in Canada

The Big Four:

1. Accredited Investor Exemption – (2.3 of NI 45-106) – Available across Canada
2. Offering Memorandum Exemption (2.9 of NI 45-106) – Available across Canada – With differences across certain provinces and territories
3. Crowdfunding Exemption (MI 45-108) – Available in Ontario, Manitoba, Quebec, New Brunswick and Nova Scotia
4. Start-Up Crowdfunding Exemption (CSA Notice 45-316) - BC, Saskatchewan, Manitoba, Quebec, New Brunswick and Nova Scotia

* The Proposed Start-Up Business Prospectus Exemption (MI 45-109) – Alberta and Nunavut (out for comment)

Accredited Investor Exemption 2.3 of NI 45-106

- **Accredited Investor:**
 - individuals who, alone or together with a spouse, own financial assets worth more than \$1MM before taxes but net of related liabilities.
 - an individual, who alone or together with a spouse, has net assets of at least \$5MM
 - an individual whose net income before taxes exceeded \$200,000 in both of the last two years and who expects to maintain at least the same level of income this year.
 - an individual whose net income before taxes, combined with that of a spouse, exceeded \$300,000 in both of the last two years and who expects to maintain at least the same level of income this year.
 - an individual who is or once was, a registered advisor or dealer other than a limited market dealer.
- **Risk Acknowledgement:** obtain executed risk forms from all individual investors who do not qualify under the highest asset threshold (\$5MM).
- **Verification of Representations:** issuers are required to confirm that individual investors are in fact accredited
- **Use of “offering materials” on a voluntary basis**
 - Documents and other materials (including videos, power point etc.) beyond a “term sheet” provided to an investor for an investment purposes may constitute an “Offering Memorandum”
 - Cannot contain a “misrepresentation” or the investor has rights of action for damages or rescission
 - Rights of action have to be disclosed in the offering memorandum
 - Offering memorandum has to be delivered to regulators within 10 days of the trade together with 45-106F1 and fee

Offering Memorandum Exemption 2.9 of NI 45-106

- The exemption allows reporting and non-reporting issuers to issue securities by providing prospective investors with **an offering memorandum** and a **risk acknowledgment form**
- **Form 45-106F2 Offering Memorandum for Non-Qualifying Issuers** contains disclosure about:
 - the company or the entity that is raising money;
 - the directors, management and promoters;
 - the securities offered;
 - the risks of the investment;
 - how the money will be used; and
 - financial statements (audited annual and unaudited interim).

Offering Memorandum Exemption 2.9 NI 45-106

- Concept of “**eligible investor**” in most provinces except for BC
- An “**eligible investor**” includes:
 - a person whose:
 - i. net assets, alone or with a spouse, in the case of an individual, exceed \$400,000;
 - ii. net income before taxes exceeded \$75,000 in each of the 2 most recent calendar years and who reasonable expect to exceed that income level in the current calendar year;
 - iii. net income before taxes, alone or with a spouse, in the case of an individual, exceeded \$125,000 in each of the 2 most recent calendar years and who reasonable expect to exceed that income level in the current calendar year;
 - an accredited investor;
 - family, friends and business associates; or
 - a person that has obtained advice regarding the suitability of the investment and, if the person is resident in a jurisdiction of Canada, that advice has been obtained from an eligibility adviser.

Offering Memorandum Exemption 2.9 NI 45-106

Key features in Ontario

- (a) Investment limits:
 - Non-eligible investors – \$10,000 acquisition cost for all securities acquired under the OM exemption in preceding 12 month period
 - Eligible investors - \$30,000 acquisition cost for all securities acquired under the OM exemption in preceding 12 months; and
 - Eligible investors - \$100,000 for all securities acquired under the OM exemption in preceding 12 months if the individual receives advice from a portfolio manager, investment dealer or exempt market dealer that the investment above \$30,000 is suitable
- (b) Disclosure of audited annual financial statements and use of proceeds for reporting issuers. Disclosure of notice of key events in Ontario
- (c) Marketing materials – Must be incorporated by reference in OM
- (d) Can't be used for derivatives or structured finance products
- (e) Can't be used by investment funds

Crowdfunding Exemption – MI 45-108

- Eligible Securities:
 - Common Share, Non-convertible Preference Share, Convertible Security, Unit of a Limited Partnership, Flow-through Share
- Eligible Issuers:
 - The proposed exemption would be made **available to reporting and non-reporting issuers, including registered dealers**
 - However, investment funds, issuers without a written business plan (“blind pools”) and issuers whose directors are not residents of Canada would be **excluded** from using the exemption
 - Issuers incorporated or organized in Canada and having their head office and a majority of directors in Canada
- Documentation Requirements:
 - Issuers would be required to present to investors an offering document, Form 45-108F1, disclosing basic information about its company, its capital structure, management and the distribution, including how the business intends to use the funds raised, the minimum offering amount and information about the funding portal being used
 - Financial statements, which must be audited if the issuer has completed a financial year
 - Rights of action in the event of a misrepresentation

Crowdfunding Exemption – MI 45-108

- Investment Limits:
 - The proposed exemption would cap the amount an issuer could raise at **\$1.5 million during a 12 month period**
 - Investors who do not qualify as accredited investors would be limited to **\$2,500 in a single investment** and **\$10,000 in a calendar year in Ontario**
 - **Investors who do qualify as accredited investors may invest up to \$25,000 per investment and, in Ontario \$50,000 unless a permitted client**
- Advertising and Solicitation:
 - Issuers may not advertise a distribution of securities though it may inform a prospective purchaser of its intention to distribute securities and refer the person to the applicable portal
- Continuous Disclosure:
 - Issuers will have to continue to provide certain information about the business post closing
 - Reporting issuers must observe continuous disclosure obligations
 - Non-reporting issuers must make annual financial statements “reasonably available” within 120 days after year end and maintain certain books and records for 8 years from closing date
 - **Ontario – must also advise of certain issuer events such as a discontinuation of business, a change of industry or change of control**

Crowdfunding Exemption – MI 45-108

- Portal Requirements:
 - Available to fully registered dealers, exempt market dealers and restricted dealers
 - Restricted dealers cannot rely on other exemptions or provide recommendations or advice to purchasers
 - Required to conduct background checks on the issuer and its key individuals
 - Obligation to terminate a distribution if it appears that the business is not being conducted with integrity
 - Portal must disclose all compensation, fees and costs charged to the issuer or purchaser
- Commission or Fees:
 - None payable other than to funding portal

The Start-Up Crowdfunding Exemption 45-316

- The participating jurisdictions are:
 - British Columbia, Saskatchewan, Manitoba, Quebec, New Brunswick and Nova Scotia
- The issuer can raise a **maximum of CAD\$250,000 per offering** and can only conduct **up to two offerings per year** (therefore, a maximum of \$500,000 in a year)
- An investor can **invest no more than CAD\$1,500 per offering**
- Investors must be provided with a contractual **right to withdraw within 48 hours** of their subscription
- The issuer **must be a non-reporting issuer (and cannot be an investment fund)**
- The issuer will not be required to provide investors with financial statements either at the point of sale or on an ongoing basis, but the issuer will be **required to produce:**
 - **Form 1 – Start-up Crowdfunding – Offering Document:** includes basic information about its company, its management and the distribution, including how the business intends to use the funds raised, and the minimum offering amount; must be made available to investors and filed with securities regulators no later than 30 days after the closing of the distribution
- The funding portal **must deliver a funding portal information form and individual information forms for each of its principals** to the regulators in the participating jurisdictions **30 days prior** to its first start-up crowdfunding distribution
- The funding portal's **head office must be located in Canada** and the majority of its **directors must be Canadian residents**
- The funding portal **cannot provide advice** to an investor, **cannot recommend a security** and **cannot receive a commission** or fee from an investor

Proposed Start-Up Businesses Prospectus Exemption – MI 45-109

- Alberta and Nunavut
- Out for comment until December 18, 2015
- Eligible Issuers:
 - Non-reporting issuers
 - Not available to investment funds
- Eligible Securities: (a) common shares; (b) non-convertible preference shares; (c) securities convertible into (a) or (b), (d) non-convertible debt securities linked to a fixed or floating rate; (e) LP units
- Investment limits:
 - No registered dealer - Cdn \$ 1,500 in a single investment and Cdn \$3,000 in issuer group over 12 months
 - Registered dealer and suitability advice provided, a purchaser can invest up to \$5,000 in a single investment and up to \$10,000 per issuer group in 12 months

Proposed Start-Up Businesses Prospectus Exemption – MI 45-109

- Lifetime limit - \$1M per issuer
- Risk acknowledgement form and offering document (financial statements not required)
- Contractual and statutory rights
- Maintain books and records for 8 years from the closing date
- File a start-up business report of exemption within 30 days of closing

Differences between Accredited Investor Exemption and Offering Memorandum Exemption

- Use of an “Offering Memorandum” is mandatory for OM exemption and must be in a prescribed form
- OM exemption provides access to a broader pool of investors as allows investments by non-accredited investors such as eligible investors as well as non-eligible investors
- Accredited investors can be used for all securities where OM exemption cannot be used by an investment fund or for derivatives or structured products
- Investment limits under OM exemption

Dentons Canada Startup Program

- Dentons Canada's Startup Program is designed for high-growth startups that are lean on cash.
- Our Startup Program package includes a suite of documents that are necessary to successfully launch a startup.
- The package is customizable to support the startup phased, seed and series A financings (and beyond).

Dentons Canada – Entrepreneurial Lawyers

Supporting Entrepreneurs

- We use technology innovations such as document automation to create efficiencies.
- We coach startups on record keeping and host a secure online portal for their key documents.
- Our Startup Program encourages startups to focus on product and business development with an efficient, well planned approach to legal matters.
- We are please to support NextLaw Labs is a business accelerator focused on investing in, developing and deploying new technologies to transform the practice of law.

Benefits associated with the Dentons Canada Startup Program

- Regular/alternative fee arrangements, including:
 - flat fee/capped fee
 - arrangements for legal services packages with companies in the incubator
- Reasonable deferrals
- Success fees
- Pricing transparency and flexibility
- Work in teams so that a professional with company knowledge is always available on a timely basis
- International reach, including Introductions to global network of VCs and advisors

Thank you

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