Backgrounder

Ontario

Ontario Securities Commission

Commission des valeurs mobilières de l'Ontario

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FOR IMMEDIATE RELEASE

November 5, 2015

EXEMPT MARKET REVIEW

As part of its exempt market review, the Ontario Securities Commission (the OSC or we) is involved in several initiatives. On August 28, 2013, we published OSC Notice 45-712 *Progress Report on Review of Prospectus Exemptions to Facilitate Capital Raising* (the Progress Report). The Progress Report stated that the OSC was directing staff to undertake further work on developing four new capital raising prospectus exemptions for issuers other than investment funds, which included the following:

- a crowdfunding exemption along with regulatory requirements applicable to an online crowdfunding portal (collectively, the crowdfunding regime),
- an offering memorandum exemption (the OM exemption),
- a family, friends and business associates exemption (the FFBA exemption), and
- an exemption that would permit a reporting issuer to issue securities to its existing security holders in reliance on the issuer's continuous disclosure record (the ESH exemption).

The Progress Report also indicated that the OSC would work with other Canadian Securities Administrators (CSA) members to see if the existing rights offering exemption available across Canada could be streamlined to improve its efficiency and effectiveness for reporting issuers.

Finally, the Progress Report indicated that we intended to pursue further improvements to our data collection on exempt market activity, and planned to publish proposed amendments to Form 45-106F1 *Report of Exempt Distribution* (Form 45-106F1).

The purpose of this backgrounder is to provide an update on the current status of each of these initiatives.

1. New capital raising prospectus exemptions

Overview of new exemptions

On March 20, 2014, we published for comment rules that would introduce four new capital raising prospectus exemptions in Ontario:

- the ESH exemption,
- the FFBA exemption,
- the OM exemption, and
- the crowdfunding regime.

The ESH exemption came into force on February 11, 2015. It allows publicly listed issuers on specified Canadian exchanges to cost-effectively raise capital from their existing investors in reliance on the issuer's continuous disclosure record. The FFBA exemption came into force in Ontario on May 5, 2015. It allows issuers to raise capital from a broader network of close personal friends, family and close business associates.

We have worked closely with staff in other CSA jurisdictions in formulating the OM exemption and the crowdfunding regime. The securities regulatory authorities in Alberta, New Brunswick, Quebec and Saskatchewan published for comment proposed amendments to the OM exemption that were similar to the OM exemption that we published for comment. The securities regulatory authorities in Manitoba, New Brunswick, Nova Scotia, Quebec and Saskatchewan also published for comment the crowdfunding regime.

The comment period ended on June 18, 2014 and the participating CSA jurisdictions collectively received approximately 1,000 comment letters regarding the OM exemption and approximately 70 comment letters regarding the crowdfunding regime.

On October 29, 2015, we published final amendments that would introduce the OM exemption in Ontario and modify the OM exemption that exists in the other participating CSA jurisdictions. Subject to Ministerial approval, the amendments will come into force in Ontario on January 13, 2016. Today, we published final amendments that would introduce the crowdfunding regime in Ontario and the other participating CSA jurisdictions. Subject to Ministerial approval, the amendments will come into force on January 25, 2016.

The key elements of the OM exemption and the crowdfunding regime are described below.

<table>
<tr><th>Exemption</th><th>Description</th></tr>
<tr><td>OM exemption</td><td>

The OM exemption will allow businesses to raise capital based on an offering memorandum being made available to investors. The OM exemption will be available for a wide range of businesses at different stages of development.
The OM exemption incorporates important investor protection measures, including:

requirement that a comprehensive disclosure document, that is subject to statutory liability if it contains a misrepresentation, be delivered to investors at the point of sale,
investment limits for investors who are individuals, other than those who would qualify as accredited investors or investors who would qualify to invest under the FFBA exemption, as follows:

in the case of a purchaser that is not an eligible investor, $10,000 in a 12 month period,
in the case of a purchaser that is an eligible investor, $30,000 in a 12 month period, and
in the case of a purchaser that is an eligible investor and that receives advice from a portfolio manager, investment dealer or exempt market dealer that an investment above $30,000 is suitable, up to $100,000 in a 12 month period,

requirements to provide investors with audited annual financial statements, annual notice regarding the use of the proceeds raised under the exemption and notice in the event of a discontinuation of the issuer's business, a change in the issuer's industry or a change of control of the issuer, and
requirement for investors to sign a risk acknowledgement form highlighting the key risks associated with the investment, which includes schedules to be completed by individual investors that require them to confirm they are investing within the investment limits, where applicable.

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<table>
<tr><th>Exemption</th><th>Description</th></tr>
<tr><td>Crowdfunding regime</td><td>

The crowdfunding regime will allow businesses to raise capital from a potentially large number of investors through an online portal registered with the securities regulatory authorities. Businesses could raise up to $1.5 million during a 12 month period. The crowdfunding regime is aimed primarily at start-ups and small- and medium-sized enterprises based in Canada.
The crowdfunding regime incorporates important investor protection measures, including:

investors will be subject to the following limits:

in the case of an investor that does not qualify as an accredited investor:

$2,500 per investment, and
in Ontario only, an annual limit of $10,000, and

in the case of an accredited investor:

$25,000 per investment,
in Ontario only, an annual limit of $50,000, and
in Ontario only, no investment limits for a permitted client (e.g., an individual with net financial assets exceeding $5 million).

requirements to provide investors with annual financial statements, annual notice regarding the use of the proceeds raised under the exemption and notice in the event of a discontinuation of the issuer's business, a change in the issuer's industry or a change of control of the issuer,
requirement for investors to sign a risk acknowledgement form highlighting the key risks associated with the investment and which requires investors to confirm that they have understood the risk warnings and the information in the crowdfunding offering document,
requirement that all investments be made through a single registered crowdfunding portal that is unrelated to the issuer,
funding portals must fulfill certain gatekeeper responsibilities prior to allowing an issuer access to its online platform, including reviewing the issuer's disclosure in the crowdfunding offering document and other permitted materials for completeness, accuracy and any misleading statements, and
funding portals must review information and obtain background checks on the issuer and its principals, and deny an issuer access to the funding portal in certain circumstances.

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For further information on the OM exemption, please see the Notice of Amendments published on October 29, 2015: https://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20151029_45-106_amendments.htm

For further information on the crowdfunding regime, please see the Notice of Amendments published on November 5, 2015: http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20151105_45-108_multilateral-crowdfunding.htm

Intermediaries in the exempt market

We have seen a number of intermediaries applying to register as dealers that plan to operate online platforms in reliance on the new prospectus exemptions in Ontario. These online platforms can vary from platforms that facilitate private placements to accredited investors, to platforms that offer secondary market trading and co-investing opportunities. We continue to support innovative technology developed by industry that can benefit both issuers and investors. We remind intermediaries that plan to operate an online portal in Ontario that they must comply with applicable securities legislation, including registration prior to conducting business in Ontario. It is important to remember that registration is a separate requirement and the availability of a prospectus exemption to distribute securities does not mean there is a corresponding registration exemption.

Compliance and oversight program
As a broader group of retail investors will be able to access the exempt market through the OM exemption and the crowdfunding regime, the OSC is developing a compliance and oversight program to monitor distributions under these new capital raising tools. This program will have three main elements:

- assessing compliance,
- enhancing awareness, and
- gathering data to support the first two activities.

2. Modification to existing rights offering prospectus exemption

On November 27, 2014, the CSA published proposed amendments intended to streamline the existing rights offering prospectus exemption for non-investment fund reporting issuers and reduce the time and cost that have been noted as barriers to the use of this exemption.

The comment period ended on February 25, 2015. Final amendments were published on September 24, 2015 and subject to Ministerial approval, will come into force on December 8, 2015.

The amendments address investor protection concerns as well as concerns regarding compliance. The amendments include:

- removing the current regulatory review process prior to the use of the exemption,
- increasing investor protection through the addition of civil liability for secondary market disclosure,
- introducing a user-friendly form of rights offering circular,
- introducing a new notice that reporting issuers must file on SEDAR and send to security holders informing them about how to access the rights offering circular electronically, and
- increasing the dilution limit from 25% to 100%.

The amendments also repeal the exemption for non-reporting issuers.

For further information, please see the Notice of Amendments published on September 24, 2015:
https://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20150924_45-106_amd-rights-offerings.htm

3. Proposed report of exempt distribution

On March 20, 2014, we published two proposed new reports of exempt distribution for use in Ontario and certain other jurisdictions.

The comment period ended on June 18, 2014. We received several comments regarding the need to harmonize the report of exempt distribution across the CSA. The report of exempt distribution is now being considered as a separate CSA initiative and we are working with CSA members to harmonize exempt distribution reporting requirements. This initiative aims to:

- reduce the compliance burden for issuers and underwriters by having a harmonized report of exempt distribution, and
- provide securities regulators with the necessary information to facilitate more effective regulatory oversight of the exempt market and improve analysis for policy development purposes.

As part of this initiative, the CSA published for comment a proposed harmonized report of exempt distribution on August 13, 2015. The comment period ended on October 13, 2015 and we received 18 comment letters. We are currently reviewing the comments and working with the CSA to develop final amendments to the report of exempt distribution.

We continue to require issuers to file a Form 45-106F1 *Report of Exempt Distribution*, as is currently required for distributions in CSA jurisdictions other than British Columbia. In British Columbia, issuers are generally required to file Form 45-106F6 *British Columbia Report of Exempt Distribution*.

For further information, please see the Notice and Request for Comment published on August 13, 2015: https://www.osc.gov.on.ca/documents/en/Securities-Category4/rule_20150812_45-501_exempt-distribution.pdf

4. Exempt market activity in Ontario

The exempt market continues to be an important part of Ontario's capital markets. In 2014, non-investment fund issuers raised approximately $41 billion through prospectus-exempt distributions in Ontario through approximately 22,000 purchases made by Ontario residents. For these non-investment fund issuers:

- The accredited investor exemption was the most widely used prospectus exemption in Ontario. In 2014 it represented 92% of the capital raised, 74% of filings and almost two thirds of purchases.
- The minimum amount investment exemption was the second most used prospectus exemption by number of filings and amount raised.
- Although equity securities represented close to two thirds of purchases and filings, debt-related securities raised a larger proportion of capital (approximately 68%).
- While the majority of issuers that participate in the exempt market are non-financial issuers, on average financial issuers raised significantly more per offering from a smaller pool of investors. Examples of financial issuers include private equity firms, consumer credit securitization vehicles, banks, mortgage investment entities and insurance firms.
- Issuers in the energy and materials industry group were the most active group of non-financial issuers in the exempt market.
- Only about a quarter of the capital raised was by reporting issuers.
- Among filings by non-reporting issuers, only about half were from issuers that were headquartered in Canada.
- A large proportion of exempt market activity by number of filings and purchases involved issuers that raised under $1.5 million. However, these accounted for less than 2% of the total capital raised.

A more detailed overview of exempt market activity in Ontario can be found at Appendix A.

APPENDIX A

2014 EXEMPT MARKET ACTIVITY

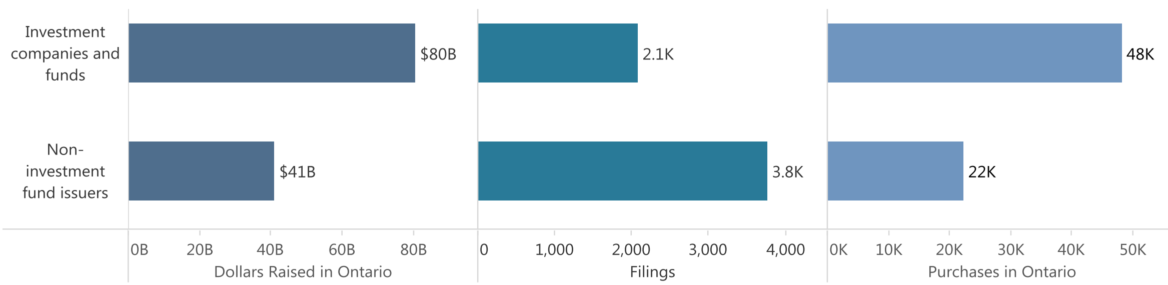
Overview

This appendix provides a snapshot of 2014 activity in Ontario's prospectus-exempt market (the exempt market). The data contained in this appendix is based on information collected from reports filed with the OSC on Form 45-106F1 *Report of Exempt Distributions* (Form 45-106F1),[1] which must be filed by issuers who rely on certain prospectus exemptions to distribute securities and includes information about the issuer and details of the distribution.[2] Prospectus exemptions are available to a wide range of issuers, including reporting and non-reporting issuers and issuers at varying stages of development, provided they meet the requirements of the exemption they are seeking to rely on.

2014 Exempt Market Activity in Ontario

During 2014, issuers raised a total of $121 billion through prospectus-exempt distributions in Ontario. Approximately 67% or $80 billion of this total represented gross flows to investment companies and funds.[3] The remaining $41 billion represented capital raised by non-investment fund issuers over 3,800 filings and involving 22,000 purchases by Ontario investors.[4]

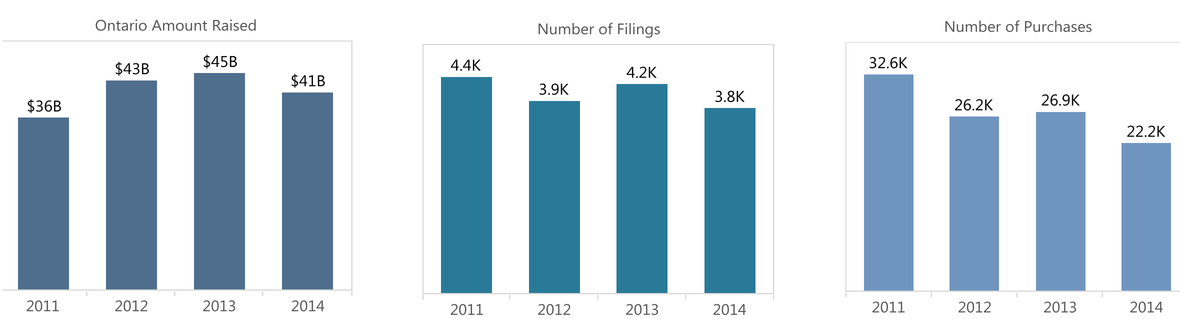
Figure 1



Comparison of Non-Investment Fund Flows with Previous Years

Overall activity for non-investment fund issuers in 2014 dropped slightly compared to the previous two years. We note that comparisons at this aggregate level are challenging given that both exogenous (e.g., local and foreign macro-economic climate) and endogenous (e.g., industry or policy specific) factors influence capital raising activity.

Figure 2



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1 The data only covers reports on Form 45-106F1 that were electronically submitted through the OSC's e-form from January 1, 2014 to August 31, 2015.

2 As only specified prospectus exemptions trigger a requirement to file a report, the data presented in this appendix does not capture all exempt market activity. See Part 6 of National Instrument 45-106 *Prospectus Exemptions* for more information on which exemptions must be reported on Form 45-106F1. We also note that this data reflects distributions to both individual and institutional investors under the applicable exemptions.

3 Issuers are only required to report gross inflows/sales and not redemptions. As most investment fund issuers are in continuous distribution and redemption throughout the year, the net flows or net sales for investment fund issuers will be lower than the amount indicated and could be negative if redemptions exceed sales over the same period.

4 The aggregated purchases figure only reflects total transactions by Ontario investors and does not represent the total number of unique investors that participated.

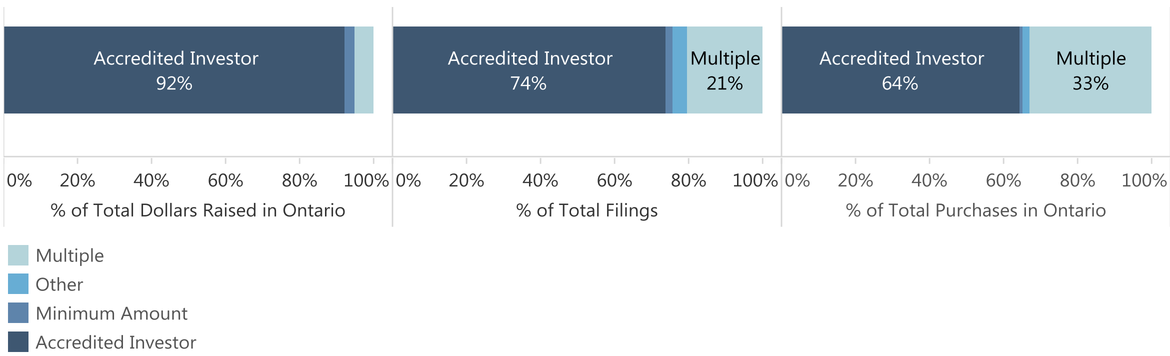
Non-Investment Fund Issuers

The following charts and tables provide a more detailed analysis of exempt market activity in 2014 by non-investment fund issuers.

Use of Exemptions

The accredited investor exemption remained the most relied upon prospectus exemption by capital raised (92%), filings (74%) and purchases (64%) in 2014.[5] The second most commonly used exemption by number of filings and amount raised was the minimum amount investment exemption. Approximately 21% of filings reported distributions made in reliance on more than one prospectus exemption and the majority (99%) of these filings included the accredited investor exemption in addition to other prospectus exemptions.

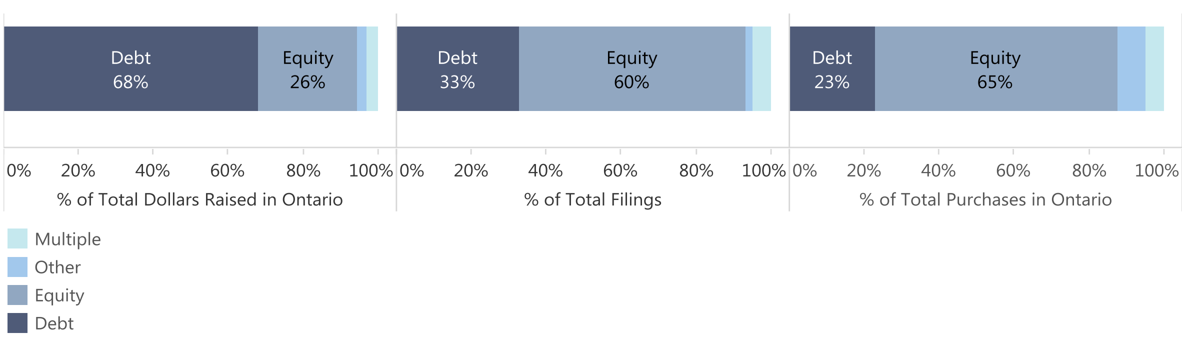
Figure 3



Types of Securities Distributed

Although equity securities represented close to two thirds of all purchases and filings, debt securities raised a larger proportion of capital (approximately 68%). Debt offerings are typically larger in size than equity offerings in both the private and public markets. Less than 5% of filings or amounts raised involved the distribution of warrants, subscription receipts or other types of securities.[6] Filings which reported the distribution of more than one type of security represented only 5% of filings.

Figure 4



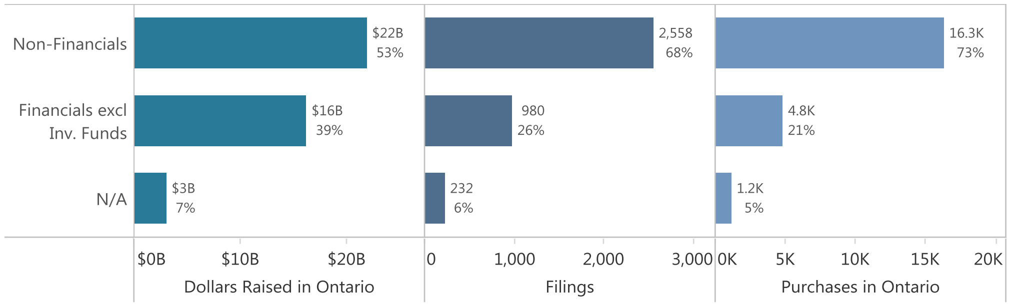
[5] This number is likely higher given that among filings that indicated the use of multiple exemptions, 99% of them relied on the accredited investor exemption in addition to other exemptions.

[6] Warrants, options, subscription receipts, other rights and securities that do not represent an equity interest or debt obligation of the issuer are categorized in the "Other" category in Figure 4.

Financial Issuers vs Non-Financial Issuers

In close to 40% of filings, issuers selected "Other" for their industry category and provided a brief description of their business. These descriptions were reviewed to assign issuers across several broad industry categories as indicated in the charts below.[7] Non-financial issuers represent the bulk of issuers that participate in the exempt market, however, on average financial issuers raised significantly more per offering from a smaller pool of investors than their non-financial peers.

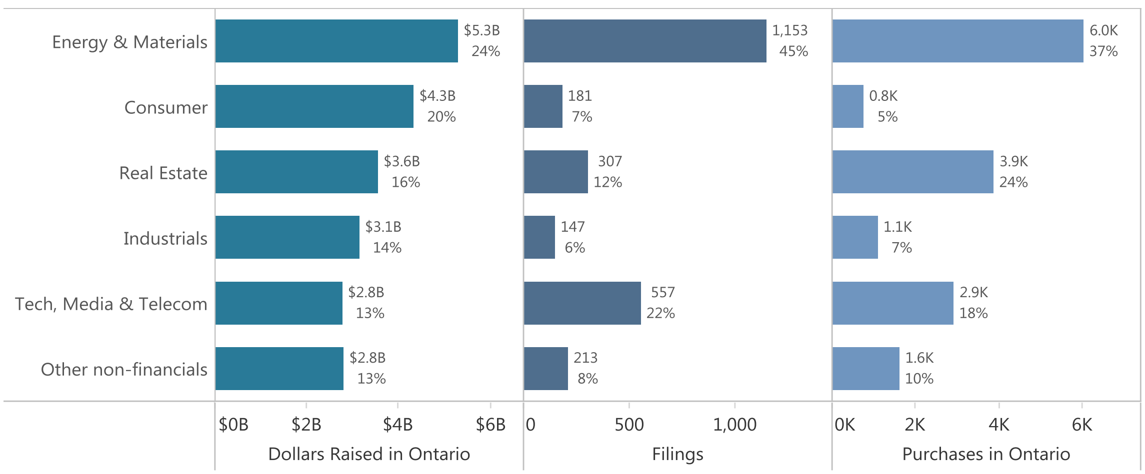
Figure 5



Non-Financial Industry Groups

Among non-financial issuers, issuers in the energy and materials group were the most active by amount raised, filings and number of purchases.

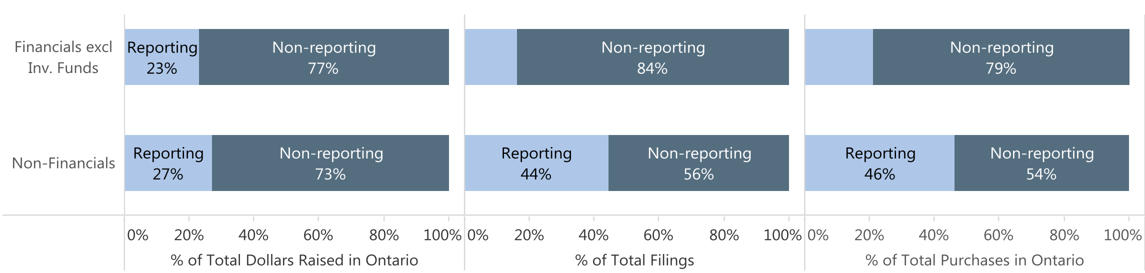
Figure 6



Reporting Issuer Status

Only about one quarter of capital raised by non-investment fund issuers in 2014 was raised by reporting issuers. Non-reporting issuers represented the majority of issuers filing reports of exempt distribution with the OSC but this was more prominent among financial issuers (84%) than non-financial issuers (56%). Over half of the filings from non-financial reporting issuers involved issuers that were listed on the TSX Venture Exchange.

Figure 7

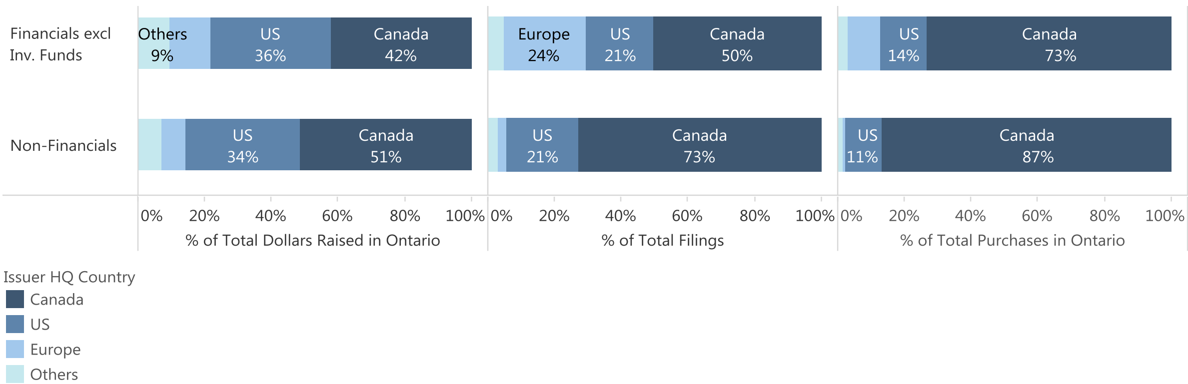


[7] For the purposes of this analysis, OSC staff made a best efforts attempt to assign appropriate industry groupings to issuers that selected "Other". It should be noted that the groupings were not confirmed by issuers.

Issuer Country

Issuers headquartered outside of Canada represented 50% of filings by financial issuers in 2014. The majority of these foreign issuers are US-based. In 2014, US-based issuers accounted for just over 20% of filings and more than one third of the capital raised in Ontario.

Figure 8



Amount Raised Per Filing

A large proportion of exempt market activity involved issuers that raised under $1.5 million. Distributions of under $1.5 million per filing represented over 60% of filings and close to 40% of purchases by Ontario investors in 2014. However, they only accounted for less than 2% of the total capital raised in 2014. Larger distributions (>$100 million per filing) represented over 50% of the total capital raised but included less than 3% of filings and involved under 10% of purchases in 2014.

Figure 9