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The following comments are personal opinions and do not reflect opinions of organizations that the author has consulting roles with. The expertise for these opinions is drawn from over 30 years of capital markets experience including a current role as Director Capital Markets & Chief Compliance Officer of Crowdmatrix. (Profile available on Linked In)

Crowdmatrix is a registered Exempt Market Dealer and has developed automated KYC and client onboarding systems for exempt investments.

Comments on Proposed NI 45-110 Startup Crowdfunding Registration and Prospectus Exemptions

"I skate to where the puck is going to be, not where it has been" Wayne Gretzky

Connecting Curated Issuers with Qualified Investors

Introduction:

As a long-standing capital markets participant, registrant and entrepreneur I have contributed input to areas of our economy and society that makes Canada a better place. When Canada prospers, we all prosper. As such, both directly and indirectly through associations, I have provided input and consulting on the evolution of capital markets, Canadian Crowdfunding regulations, and related digital infrastructure and businesses. Specifically, I was a member of the OSC SME Committee that examined ways to assist Canadian businesses to raise capital which included the introduction of the Ontario NI 45-108 Crowdfunding regulations.

It is important to look at the brief history of Crowdfunding and network theory in the context of newly created digital networks and software systems that have attempted to forge new pathways to connect curated Issuers with qualified Investors.

This CSA consultation paper highlights the lack of success in Canada building new digital business models based on the various provincial “Crowdfunding” regulations. Meanwhile in other parts of the internet economy Canadian network platforms are creating new business models and services with substantial utility and valuation. Harmonization of provincial regulations is a minimum goal particularly from a global competitiveness perspective, but this is a small part of the answer.

The new fuel of the 21st century is data and how it is harnessed. Canada must build next generation of national capital markets digital infrastructure to achieve policy goals ranging from economic growth to enforcing FINTRAC’s Anti Money Laundering (AML) mandate. Efficient data access and analysis of Issuers capital structures, financial reporting and business model assumptions allow vibrant capital markets. Efficient tools are necessary to allow Capital Market Registrants to efficiently fulfill Know Your Client (KYC) and Know Your Product (KYP) responsibilities within sustainable business models. All stakeholders including Registrants, professional advisors, and qualified Canadian and global investors must be able to easily access valid data on the next generation of emerging Canadian Issuers.

Canadian Investors are also a critical dataset for capital markets. Shareholder records systems are a dated with disparate systems utilizing the Canadian Depository System (CDS), transfer agents, independent legal shareholder registers and even spreadsheets. Strategic integration at the national level for the next generation of systems will create new business models and greater efficiency for all Canadian Issuers and Investors.

“Crowdfunding” through online discount brokerage platforms have successfully operated for over 20 years. Canadians can easily access and invest in SEDAR filing Canadian reporting Issuers. Secondary markets for public companies and ETFs have allowed discretionary access to all investors (Accredited and Non-Accredited) to the broadest range of Issuers. There needs to be the same simple investors access to primary funding rounds as there is with secondary trading markets.

The network of SEDAR Reporting Issuers of companies, funds and trusts (est. 10,000 Issuers x 10,000,000 Canadian Investors) are the most appropriate and profitable focus of CSA Registrants. This network can be significantly expanded with new digital infrastructures.

It is encouraging to see the SEDAR renewal project has been initiated, but there appears to a lack of ambition in the goals, technology, governance structure, branding and ownership participation of this important Canadian database. It was discouraging to see only nine NI 13-101 consultation responses where provided in July 2019 on the SEDAR renewal project. There has not been a public plan, pitch deck or disclosure document that outlines the detailed scope of SEDAR renewal project. As a minimum the CSA should disclose detailed plans that can be evaluated by all stakeholders. Crowd-sourced innovation may surprise on the upside. SEDAR collects data for the core part of the Canadian economy. If this meta-data within SEDAR was in a format for new user applications, the SEDAR governance entity would likely have a multi-billion dollar valuation.

The SEDAR renewal project does provide an aspirational template to create a new alternative Canadian **Qualified Issuer Database (QID)**. QID would serve a verified data source for the next level of 100,000 Canadian Issuers (below the 10,000 SEDAR Reporting Issuers) that seek to access capital and strategic

investors. The QID companies would then have a pathway to potentially graduate to SEDAR Reporting Issuer status. The QID proposal is included with this consultation because this new reporting database may be an important efficiency catalyst to allow Canadian Crowdfunding to achieve widespread success.

The annual budgets of capital markets securities regulators, related associations and related federal regulators are an estimated \$1 Billion per year. The value of the public regulatory stack, systems and databases are very significant. The connected networks of all the stakeholders are critical to the functioning of the Canadian capital markets. It is important that these combined Canadian regulatory public assets and budgets are optimized to reflect the Canadian economy of 2030 and beyond. The resources are available to develop a visionary plan.

This response expands on the specific questions in this NI 45-110 Consultation. The current NI 45-110 proposal, even if harmonized, does not seem ambitious enough to achieve intended results. NI 45-110 may even be a regulatory failure like the MI 45-108 regulations. The initial part of this response discusses more ambitious policy goals with some rationale. The final Annex A answers question 1 -5 of the Consultation paper.

Summary Recommendations:

1. Level 1 - Startup Issuers (Increase Private Exemption from 50 to 100 Investors)

Startup Issuers that cannot provide financial statements are not likely to be appropriate Issuer clients (for Capital Market Registrants under CSA jurisdiction) to provide curation, due diligence and Know Your Product (KYP) services. Startup Issuers are an important group of entrepreneurial Issuers that needs to be allowed to develop but not necessarily under rule-based CSA oversight.

The term **Startup Crowdfunding Registration and Prospectus Exemptions (NI 45-110)**, with emphasis on **Startup**, may be a misleading term to include in any type of CSA order or exemption as it may imply that Registrant organizations (EMD, Investment Dealer or Regulators) have completed an appropriate due diligence, capitalization structure and valuation review.

The proposed NI 45-110 is a reasonable attempt to harmonize existing provincial crowdfunding regulations, but it still has many of the same regulatory rules as the existing Crowdfunding exemptions that have not produced any significant interest as a business model or evidence that any significant funds will be raised for Canadian companies. It would be useful if the noted 11 funding portals that have relied on the start-up exemption provided insights on experience to date and potential for the future.

Rather than restricting Startup Issuer funding innovation we should encourage new approaches that are not governed by CSA oversight. We should allow funding networks more flexibility while meeting Know Your Client (KYC) and AML goals. This will allow a broader range of Canadian investors and stakeholders to participate in the earliest stage ecosystem if they wish to assume the properly disclosed risk.

As an alternative to CSA oversight, the earliest stage Startup Issuers should be allowed to seek up to 100 investors (currently 50 limit) using the private issuer exemption. More analysis is required but the 100 investor limit would be across all security tranches for each Issuer's capitalization structure.

These Startup Issuers should be able to use different strategies to obtain a maximum of 100 investors. This includes direct online investor processing systems and virtual and live investor events that are profiled and linked directly to Issuer's websites, email and text communications. Private access automated KYC and subscription form digital signature systems must be linked directly to the Issuer's communications. These automated investor processing systems will form a key part of the Issuer's start-up strategy to collect and verify the initial 100 investors. Third party KYC review of these initial investors can be completed by compliance specialists.

The Issuer's executive management and directors will explain the investment merits of the offering and assume all disclosure liabilities. The Issuer must obtain appropriate legal and compliance services to certify that any final securities title is valid, and that all Investors (Individual and Corporate) meet FINTRAC AML KYC regulations and fit into an appropriate Accredited Investor exemption.

FINTRAC would have the federal mandate to investigate any Canadian Issuer to ensure that AML KYC and appropriate disclosures are achieved. A recent emphasis by FINTRAC on possible AML non-compliance for real estate companies suggests that it is companies with less than 100 shareholders that need this type of oversight. Federal oversight mandates already exist through business registration numbers and HST registration that are necessary to establish legitimate Canadian companies.

CSA Registrants may choose to provide advisory consulting services to these earliest stage Startup Issuers but not under the full mandate or responsibility of a CSA Registrant.

2. **Level 2 – Qualified Issuers (Create a new Issuer reporting category)**

Qualified Issuers (QI) will be a new voluntary regulated category and reporting system like SEDAR Reporting Issuers. Qualified Issuers will have established all the necessary Startup Issuer foundational steps including valid incorporation and federal registrations, have multiple arms-length investors, established financial and CRA tax reporting systems, pass FINTRAC Anti Money Laundering (AML) standards through Canadian bank account certification and have a curated business plan.

These Qualified Issuer curation steps will allow CSA Registrants to efficiently apply all the latest digital platform crowdfunding and network strategies (both current and envisioned). These new CSA Registrant systems can then provide capital and strategic investors with Registrant compensation in the form of cash, stock, warrants, carry or any other structure.

The SEDAR model with an estimated 10,000 Reporting Issuers provides a template for Qualified Issuers. New processes, databases and network models must be created to efficiently manage the next level of an estimated 100,000 Canadian Qualified Issuers.

3. **Create a Canadian Qualified Issuer Database (QID).**

The QID will draw on the experiences of the SEDAR model but be more comprehensive and under federal jurisdiction with input / oversight of FINTRAC for AML, Canada Revenue Agency (CRA) for

taxation and Canadian banks. The structure of ownership and fees for QID will be innovative to ensure there are incentives for these Qualified Issuers to participate in this new reporting system. Registration with QID will be part of the growth path for emerging Issuers. These Canadian Qualified Issuers may have necessary certifications to be allowed as TSFA and RRSP investments. QID would be a foundational reporting structure for possible blockchain (or future equivalent) based Issuers. QID will be an appropriate curated Issuer database for CSA Registrants to target as clients.

The QID may provide a pathway for smaller real estate development companies that do not seek SEDAR Reporting Issuer status but may need a broader range of investors to provide capital for local projects. Other examples of QID companies are likely in all parts of the private sector economy.

QID would be designed to utilize the latest search, analysis and possible Artificial Intelligence systems. QID companies will be able to enable optional privacy switches to restrict access to certain filings. Other innovative QID features will be developed based on user requirements and state of art technology.

4. **Level 3 – Reporting Issuers (SEDAR)**

Reporting Issuers on SEDAR are typically the primary focus of Capital Market Registrants. Audited financials and continuous disclosure are a higher burden but are appropriate as these Issuers can utilize the full array of Capital Market services and strategies. The SEDAR renewal project should ensure that this database is designed for capital market services of 2030 and beyond with greater integration with FINTRAC, CRA, Canadian Banks and global online reporting systems. There may also be greater use of blockchain (or future equivalent) securitization systems that attract global investors.

Details on the proposed SEDAR renewal project should be the subject of widespread public consultation and be open to the widest range of innovation on fees structures and ownership incentives.

5. **Create a new Individual Investor (II) Prospectus Exemption (Maximum investment of \$5000)**

All Canadians regardless of net worth, income or qualifications should have the right to participate in the widest range of investments with simple \$5000 limit. This will allow more strategic Non-Accredited Investors to participate in Startup Issuers and any other type of financing. The **Individual Investor** prospectus exemption category is simple and can then be added to any offering documents for any Issuer that seek to raise funds with or without the assistance of a Registrant. It would be at the discretion of Issuers if they wish to include the Individual Investor prospectus exemption on subscription forms.

6. **Create a new Qualified Accredited Investor (QAI) Prospectus Exemption**

Accredited investor exemptions have been created as a policy for individual investor protection. There are many sophisticated non-accredited investors that should be allowed to qualify as an

Accredited Investor by demonstrating expertise through personal education, testing and certification. This new Qualified Accredited Investor prospectus exemption will be attainable by a larger number of Canadians. The rules on beneficial ownership of corporations and trusts will also allow for Qualified Accredited Investors in the shareholding structure.

Canadian investors have a wide range of individual circumstances to assess the merits of investments. There are not any individual barriers to open an online discount brokerage account which can access a wide range of investments.

Any Canadian should be allowed to qualify and maintain a Qualified Accredited Investor exemption if they complete designated online education tests and complete standard KYC / AML authentication steps.

Completing the Canadian Securities Course (or equivalent) with annual updates would demonstrate knowledge and an interest in participating in a wider range of alternative exempt investments. This would allow any Canadian to achieve unrestricted Accredited Investor status. A greater number of active participants will improve the quality and liquidity of Canadian exempt capital markets.

The existing Accredited Investor categories based on wealth and income would remain.

7. Create a new Verified Accredited Investor Database (VAID)

A national voluntary **Verified Accredited Investor Database (VAID)** would verify all existing Accredited Investors in Canada. This would include existing Accredited Investor categories and the proposed new Qualified Accredited Investor.

The VAID would allow efficient communication with privacy consent of investment offerings on digital Crowdfunding platforms. Accredited Investors (Individual and Corporate) by categories of net worth and income will also be encouraged with direct incentives to join and maintain the VAID status to allow efficient access to the broadest range of investments. VAID status will be universal, private and can be efficiently used by many types of financial services companies with greater reliability.

It is estimated if the VAID was created, the active existing Qualified Accredited Investor population in Canada might expand from 400,000 to 4,000,000 by 2030. Canadians born in the 2000 or later will be very proficient at online education and may well be one of the most proficient, informed and active Canadian investor groups in history. Low interest rates will require a much greater need to understand alternative investments when traditional bank accounts likely provide zero interest savings.

The network effect of the VAID with consent access to the investment offerings should not be underestimated. There are many ways that private sector capital market participants and other related service providers can leverage the common benefits of the VAID and QID. VAID and QID could potentially be a Canadian network effect of (4,000,000 x 100,000).

The VAID database can only be effective if it is created under a federal regulated mandate. It will belong to all Canadians. This type of Accredited Investor verification will also be useful with the future growth of regulated blockchain (or a future equivalent) based global markets.

The proposed Qualified Accredited Investor prospectus exemption also provides aspirational merit-based access to every Canadian compared to the existing Accredited Investor categories that discriminates based on wealth and income.

History of Investment Crowdfunding

Crowdfunding 2010

The term crowdfunding (for investments) came into popular use around 2010 when Angelist was formed. It was in response to the 2008/9 financial crisis and recession that caused politicians and advocates to find more efficient ways to support and finance smaller companies

The concept of network platform business model expanded into many sectors of the economy. Angelist, in the heart of Silicon Valley wealth, stood out as syndicated technology investment platform that captured interest of venture capitalists, and traditional capital market participants. In response politicians and government responded with studies and consultations that were initiated by the SEC and the OSC around 2012 and resulted in existing Crowdfunding regulations introduced in the US and Canada in 2016.

It is important to realize that in the past decade the actual digital infrastructure has become significantly easier and less expensive to build with each passing year. This technology innovation continued to accelerate with the mobile app boom that started around 2010 and the subsequent wave of blockchain based and other fintech models that continue to evolve. The resulting global network effects are growing at an exponential rate.

However, the ability to build inexpensive digital infrastructure does not necessarily translate into successful business models. Indeed, the incumbent regulated capital market systems are still very resilient, competitive and successful.

The Cannabis industry used traditional capital market methods and regulations to create a new business sector, successfully raised an estimated \$20 billion and created 100s of new companies without any new fintech systems including crowdfunding. The Cannabis sector did not use larger institutional capital pools for funding and in the early stages was funded primarily by retail investors. The Cannabis boom did utilize advances in investor relations communications technologies and early adoption and market liquidity leverage through ETFs that indirectly assisted many large financings.

Crowdfunding 2020

The results of the past 10 years of securities Crowdfunding consultation and regulatory development in Canada has been disappointing. The amount of funds and companies assisted by these new regulations has been insignificant.

The lack of federal harmonization for Crowdfunding regulations is a unique Canadian problem (vs global competitors) that must be resolved if Canadian regulators are going to keep up with the pace of digital capital markets change. Harmonization is only one issue, what is really needed is to look to where the

Canadian capital markets will be in 2030 and design the national digital infrastructure and regulatory framework that serves and benefits all Canadians.

The CSA and participant members are mandated by government goals. It is encouraging to see that the OSC has been given the responsibility to ensure economic growth is now part of its regulatory mandate.

Like the 2008/9 crisis, 2020 has started with the unexpected Covid black swan event that is creating tremendous strain on the Canadian economy and capital markets. It will disrupt and bankrupt many existing business models, but hopefully starting in 2021 we will be creating many new business models that will create new Canadian opportunities in the next decade. The recent success of Canadian based Shopify is a model for every aspiring Canadian entrepreneur.

One the initial goals of Crowdfunding was to make it easier for entrepreneurial companies to connect with qualified investors. By 2021 to encourage economic recovery, this goal will be a priority of all governments. The CSA should not underestimate its power and responsibility to develop innovative regulations and common digital infrastructure (SEDAR) to advance Canadian capital markets. We need to pick up the pace of regulatory change to keep up with the pace of digital change that is advancing at an accelerating rate.

Important responsibilities for capital market registrants are to curate investment opportunities to screen for fraud, overvaluation and illegal activities such as money laundering. CSA Registrants cannot predict the future but can provide guidance on forecasts and valuation based on the best available information. Understanding these responsibilities also coincides with successful investment dealer and wealth management business models that guide investors into opportunities with a higher probability of success. Risk is a necessary component to participate in early stage companies where the future is uncertain, but the upside can be significant. CSA Registrants can play an important oversight role in helping investors understand these risk/reward models.

Startup Companies are an important economic activity. Startup incubators and pitch deck development are now standard curriculum at universities and colleges. Anyone born 2000 and later has both the digital training and role models to aspire to be a successful Canadian entrepreneur in many existing and new sectors of the economy. Indeed it is very reasonable for the next generation of entrepreneurs will be able to build a website, register a company, trademark a brand, and establish a bank account that is digitally linked to online accounting software and government of Canada CRA account for a little as \$10,000. It will almost be an entrance requirement that must be met if there is any chance of future success. By 2030 it is likely that bright Canadian high school students will have the ability to create a Shopify digital ecommerce company that completes all the above steps including a blockchain listed token. These types of innovative tasks should not be inhibited by unnecessary CSA oversight.

For this group of the earliest stage Startup Companies, the Private Issuers exemption should be expanded to allow up to 100 investors (vs 50). The founding entrepreneurs can use any strategy that is relevant to source these investors including private digital platforms. The only requirement is that any offering ensures that a registered law firm (or alternative) certifies that investors have valid title to the securities offered. The Issuers must also certify that the Investors (Individual and Beneficial Corporate) meet standard KYC requirements as defined by FINTRAC AML regulations and expanded Accredited Investor definitions. Disclosure and acknowledgement that this is a high-risk Startup Venture will be required in subscription documents. FINTRAC would have the right and mandate to audit any Canadian Issuer to ensure it meets these regulatory requirements. CSA Registrants, at their discretion, may decide to provide

consulting services to these Startup Companies but not under the responsibilities and liabilities of a CSA Registrant in any category.

It is after the above noted Startup Company curation stage, or the new Qualified Issuer stage, that CSA Registrants can apply the next generation of digital Crowdfunding platforms, global KYC systems and investor databases to raise larger fund tranches and expand the number of Investors.

Crowdfunding 2030

It is likely by 2030 there will be global capital markets that provide immediate settlement of many types of securities with sovereign backed digital currencies. The competitive advantage for Canada will be to have the databases and metadata of qualified Issuers and Investors that meet common global regulatory standards. Disclosure will be discretionary for Issuers but if they choose to participate in these global capital markets the network leverage will be very significant.

Artificial Intelligence (AI) may be assisting Registrants in finding, analyzing and curating Issuers. Investors may have their own personal AI assistants to build investment portfolios. There will likely be a new generation of Canadian entrepreneurs that have become very wealthy following models like the recent success of Shopify and others.

By 2030 Canadians will expect governments and associated regulators to build the common digital infrastructure and associated regulations to share future economic success and wealth with all Canadians.

Response to Questions:

1. The OSC initiated almost three years of regulatory research, comments, committee, and community townhalls at significant cost to develop MI 45-108. The final user results for MI 45-108 are disappointing. This is a case study on how securities regulatory initiatives need to find new ways to create successful innovative regulations that keep pace with the pace of digital capital markets innovation. MI 45-108 was too restrictive and presented a business model of stand-alone funding portals that were required to meet 90% of regulatory steps of a typical Registrant sponsored funding transactions. The limitations on funding amounts and investor participation were arbitrary. As part of the regulatory initiative, there should have been an economic assessment on whether MI 45-108 was a viable business model.

MI 45-108 should be repealed but not without creating an alternative framework that meet the initial “Crowdfunding” goals of responsibly funding early stage Canadian Issuers with the assistance of CSA registrants. This important Canadian policy goal still exists. The proposed NI 45-110 Startup Crowdfunding Registration and Prospectus Exemption does not appear to be a viable alternative to either MI 45-108 or the original crowdfunding policy intentions.

As discussed in prior recommendations, the Private Issuer Exemption should be increased to 100 investors and early stage Startup Issuers should be allowed to utilize any digital tools and strategies that are available to acquire those investors. The Issuers must find Investors that meet existing and proposed Accredited Investors exemptions. Executive and Directors of the Issuers should be held liable for any misrepresentations, fraud, KYC or AML violations.

The MI 45-108 attempt to provide guidelines for the Startup Issuers and portals was useful. CSA registrants should be wary of Private Issuers that have not completed minimum start-up steps including providing reasonable unaudited financial statements, disclosure documents, management and directors background checks and verified existing shareholder records.

The expansion of general Accredited Investor exemptions and databases of verified qualified Canadian Issuers as discussed in the prior recommendations is the start of a more complete analysis of regulatory requirements for the next generation of digital crowdfunding systems.

2. The proposed investment limits for the NI 45-110 are too restrictive and are likely to have a limited material impact for funding the capital structure of Startup Issuers.

A simpler approach would be to reduce the barriers to non-accredited investors participation with a wider range of prospectus exemptions. The prior recommendations propose creating:

- i) Individual Investor Exemption (\$5000)
- ii) Qualified Accredited Investor Exemption (No Investment Limit)

It is difficult to envision it would be worthwhile task for a Registrant to assume responsibility for recommending any increase in any prescribed investment limit. (ie from \$5000 to \$10000) for a risky investment. Any strategic non-Accredited investor would likely be able to qualify for a Friends, Family and Associates exemption if there was a need to increase an individual's investment participation amount in a specific Private Issuer.

3. Subject to the proposed 100 Investor limit, there does not seem to be any rationale for capping the amount of funds that can be raised by any Issuer if Issuer meets legal requirements and there is Investor demand.
4. Issuer's executive and directors should be held liable for any misrepresentation, fraud or non-compliance with Canadian laws and regulations such as FINTRAC KYC and AML guidelines.
5. There does not seem to be any rationale for limiting security types and structures if there is complete disclosure, the Issuer meets legal requirements and there is Investor demand.

If the capital structure is too complicated the Issuer may find the Investor participation is limited. Complicated capital structures may also increase accounting and title verification costs.

6. As outlined previously, either a financing is under the formal assistance of a CSA Registrant or it is not. For Startup Issuers the private issuer exemption is available (with the recommendation to expand allowable activities and number of investors be increased from 50 to 100.) The rationale for charging CSA Registrant fees to unregistered entities does not appear to have merit. If the CSA charges a fee there may be a perceived due diligence review. CSA Registrants that wish to build the next generation of onboarding and crowdfunding systems that are directly linked to dealer registration should not require any additional CSA review. The potential new efficiencies of these next generation onboarding and investor qualification strategies and systems are still evolving and may be significant as business practices develop.

7. If the noted amendments make it easier for all Registrants to improve efficiency and facilitate innovation than they are endorsed. If the amendments have the purpose of further expanding OSC rulemaking authority into areas that it does not currently have jurisdiction than they are not endorsed. The rationale for these amendments is not fully explained in Question 7.
8. The status quo is not having any impact on raising capital for Startup Issuers. Different provincial regulations do not have merit. The proposed solution does not provide any rationale as to why it will work any better than the status quo. National harmonization of all securities regulations is the repeated recommendation of most private sectors CSA registrants and related stakeholders. A more complete review of Alternatives to assist with the financing of Startup and emerging stage Qualified Issuers is still required.
9. A reasonable question for the CSA is why there is not a more fulsome analysis of how regulators can assist with multi-investor arms-length financing strategies for early stage Startup Issuers and emerging Qualified Issuers?