

Canadian Securities Regulators Propose Crowdfunding Exemption

On March 20, 2014, securities regulators in Quebec, Saskatchewan, New Brunswick, Manitoba and Nova Scotia published for comment proposed crowdfunding prospectus exemptions, which consist of (a) an integrated crowdfunding prospectus exemption (the "**Crowdfunding Exemption**"), which would be available to reporting issuers and non-reporting issuers, and (b) a start-up crowdfunding prospectus and registration exemption (the "**Start-Up Exemption**"), which would be available only to non-reporting issuers and is designed to provide an alternative source of capital to early stage companies. The Ontario Securities Commission (the "**OSC**") has concurrently published draft materials containing a proposed exemption similar in substance to the Crowdfunding Exemption (for additional information on the OSC's proposed crowdfunding exemption and other recent proposed prospectus exemptions, please refer to our bulletin [here](#)).

Crowdfunding generally refers to raising small amounts of funds from a potentially large number of people through an internet portal acting as intermediary. While crowdfunding has become an important method for raising project financing, to date it has largely only been used to raise money for specific ventures and has not generally involved the issuance of securities. However, in certain jurisdictions, such as Australia, crowdfunding has emerged as a viable way for companies to raise capital through the issuance of securities.

The proposed exemptions will be welcomed by start-ups and early-stage businesses that have increasingly been pushing to make a crowdfunding prospectus exemption available in Canada, in particular since it was introduced in the United States under the JOBS Act in 2012 (although the Securities and Exchange Commission has not yet adopted rules to implement the crowdfunding exemption in the United States).

Crowdfunding Exemption

The Crowdfunding Exemption is intended to permit issuers to raise funds from investors through an online portal registered with securities regulators and would be available to reporting issuers and non-reporting issuers that are organized, have its head office and have a majority of its directors resident in Canada.

The following is a summary of the key requirements, limits and conditions which issuers would be required to meet under the current proposal:

- *Maximum Amount.* Issuers would not be permitted to raise more than \$1.5 million under the exemption during any 12 month period.
- *Individual Limits.* Individual investors would not be permitted to invest more than \$2,500 in a single offering or more than an aggregate \$10,000 in a calendar year.
- *Offering Materials and Advertisement.* A streamlined disclosure document would be provided to investors with basic information on the offering, the issuer and the portal, including prescribed financial information and where certain financial thresholds are met, audited financial statements. Offering materials would be required to be made available to potential investors on the portal's website, and issuers and others involved in the offering would be limited in the manner in which they can advertise and solicit potential investors.

- *Types of Securities.* Offerings under the exemption would be limited to common shares, non-convertible preference shares, securities convertible into common shares or non-convertible preference shares, non-convertible debt securities, units of a limited partnership and flow-through shares under the *Income Tax Act*.
- *Investor Protections.* Investors would be required to sign a risk acknowledgement form confirming that they understand the risks of the investment. In addition, they would be provided with a two day period in which they may withdraw their subscription and would have a statutory right of action for rescission or damages in the event of a misrepresentation in the offering materials.
- *Ongoing Disclosure Requirements.* Reporting issuers would be required to comply with their existing continuous disclosure obligations and non-reporting issuers would be required to provide disclosure of specified events, a notice of how the proceeds from the offering are expended and where certain financial thresholds are met, audited financial statements.
- *Resale Restrictions.* For reporting issuers, securities issued in reliance on the exemption would be subject to a four month hold period, and for non-reporting issuers, an indefinite hold period.

The proposed framework for the Crowdfunding Exemption also includes a set of funding portal registration requirements. Registered portals would be required to comply with the general registrant requirements applicable to exempt market dealers, and in addition would be required to conduct background checks on issuers, directors, officers, promoters and control persons and review the information presented by the issuer on the portal's website. Portals would also be subject to a number of restrictions, including prohibitions on providing specific recommendations or advice to investors on the securities being offered, holding or handling investor funds or securities, investing or underwriting any issuer and facilitating secondary trading.

Start-Up Exemption

Saskatchewan became the first province in Canada to adopt a crowdfunding exemption for the sale of securities late last year, which is similar in substance to the currently proposed Start-Up Exemption. Like the Crowdfunding Exemption, the Start-Up Exemption would provide issuers with an exemption from the prospectus requirement where securities are issued through an online funding portal through which they provide a streamlined offering document to investors.

The Start-Up Exemption would be available only to non-reporting issuers and would be subject to less onerous requirements than the Crowdfunding Exemption, which may make it suitable to smaller issuers. Issuers relying on the Start-Up Exemption would not be subject to ongoing disclosure requirements, including the requirement to file audited annual financial statements. In addition, portals would have an exemption from the registration requirement under applicable securities laws, but would still be required to comply with certain restrictions.

While the Start-Up Exemption could potentially prove useful to issuers as a cost-efficient and effective way to raise seed capital, the low thresholds permitted under the exemption would make it only useful to very small and early-stage businesses, as issuers would be limited to raising no more than \$150,000 per offering and would be limited to no more than two offerings per year under the exemption. In addition, investors would be limited to investing no more than \$1,500 per offering.

It is proposed that the Start-Up Exemption would be contained in blanket orders which would contain substantially harmonized terms and conditions across the applicable provinces. Concurrent with the publication of the proposed Start-Up Exemption, the British Columbia Securities Commission has issued a notice and request for comment on whether it should adopt an exemption similar to the proposed Start-Up Exemption.

The comment period for the Crowdfunding Exemption and Start-Up Exemption is open until June 18, 2014.

by [Michael Yang](#) and [Mark Neighbor](#)

For more information on this topic please contact:

Hong Kong	Michael Yang	852.3101.0293	michael.yang@mcmillan.ca
Vancouver	Mark Neighbor	604.691.7439	mark.neighbor@mcmillan.ca

[a cautionary note](#)

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

© McMillan LLP 2014