

**Multilateral CSA Notice of Publication and Request for Comment
Proposed Amendments to
National Instrument 45-106 *Prospectus and Registration Exemptions*
Relating to the Offering Memorandum Exemption
and in Alberta, New Brunswick and Saskatchewan,
Reports of Exempt Distribution**

March 20, 2014

Introduction

Each of the Alberta Securities Commission (**ASC**), Autorité des marchés financiers (**AMF**), Financial and Consumer Affairs Authority of Saskatchewan (**FCAA**) and Financial and Consumer Services Commission (New Brunswick) (**FCNB**) (collectively, the **Participating Jurisdictions** or **we**) are publishing for a 90-day comment period proposed amendments (the **Proposed Amendments**) to National Instrument 45-106 *Prospectus and Registration Exemptions* (**NI 45-106**) primarily relating to the current offering memorandum (**OM**) prospectus exemption (**OM Exemption**) in section 2.9 of NI 45-106.

In addition, the ASC, FCAA and FCNB are also publishing for a 90-day comment period, two new proposed forms of report of exempt distribution (**Exempt Distribution Reports**).

The Ontario Securities Commission (**OSC**) is concurrently publishing proposals relating to the OM Exemption and Exempt Distribution Reports.

Staff of the Participating Jurisdictions and the OSC have coordinated their efforts in developing proposals relating to the OM Exemption and, as applicable, the Exempt Distribution Reports.

Although there is a significant degree of alignment among the jurisdictions proposing changes to the OM Exemption, the FCNB and OSC are proposing a somewhat different version than that being proposed by the AMF, ASC and FCAA. Both versions are reflected in the Proposed Amendments published with this Notice.

The OM Exemption is an exemption designed to facilitate early stage and small business financing. Not surprisingly, this type of financing often tends to be quite local in nature. Consequently, differences in approach among jurisdictions can very appropriately reflect differences in local capital markets. However, harmonized securities regulation continues to be a goal of the members of the CSA and we are therefore interested in public comment on both the relative merits of the different approaches to the OM Exemption and the extent to which harmonization needs to be a priority in this area of securities regulation.

The content of the proposed new Exempt Distribution Reports are harmonized as among the ASC, FCAA, FCNB and OSC; however, in Ontario, the forms will be required to be submitted electronically.

In addition to proposing an OM Exemption and new Exempt Distribution Reports, the OSC's publication also proposes two prospectus exemptions that already exist, although in a somewhat different form, in each of the other CSA jurisdictions, i.e., the family, friends and business associates exemption and the existing security holder exemption.

Although the text of the Proposed Amendments includes the OSC's proposed changes to the family, friends and business associates (**FFBA**) exemption in section 2.5 of NI 45-106, it reflects that the Participating Jurisdictions are not proposing to adopt the OSC's proposed variations to the exemption at this time and are maintaining the current form of FFBA exemption.

Effective March 13, 2014, a harmonized existing security holder exemption, published under Multilateral CSA Notice 45-313 *Prospectus Exemption for Distributions to Existing Security Holders* was adopted in all jurisdictions of the CSA other than the Newfoundland and Labrador and Ontario through local blanket orders or rules. The OSC's proposed existing security holder exemption is very similar to the version existing in the other CSA jurisdictions but does propose some modifications.

We are interested in public comment in respect of the OSC's proposed variations on the FFBA exemption and the existing security holder exemption.

Concurrently with publication of this notice, various members of the CSA, including the Participating Jurisdictions other than the ASC, have published for comment one or more proposed prospectus exemptions and associated dealer registration or dealer registration exemption proposals with respect to securities-based crowdfunding. Although the ASC has not published those proposals, the ASC will be considering the public comment in respect of them.

The text of the Proposed Amendments is in Annex A of this notice and will be available on websites of the Participating Jurisdictions at:

www.albertasecurities.com
www.fcaa.gov.sk.ca
www.fcnb.ca/securities_1.html
www.lautorite.qc.ca

In Alberta, New Brunswick and Saskatchewan, the proposed Reports of Exempt Distribution are also included in Annex A.

Substance and Purpose

Proposed amendments

In Alberta, Québec and Saskatchewan, the Proposed Amendments contemplate the following:

- to limit the risks associated with an investment by a retail investor in illiquid securities, new caps on the aggregate amount that can be sold to any one investor under the OM Exemption in a 12 month period have been proposed:
 - \$10,000 in respect of all investors who are not eligible investors; and

- \$30,000 in respect of investors who are individuals that are not accredited investors and who do not qualify as specified family members, close personal friends or close business associates under the FFBA exemption;
- to provide investors with the same rights of action in respect of all disclosure made in relation to a distribution under the OM Exemption, a requirement that all marketing materials relating to a distribution under an offering memorandum be deemed to form part of an offering memorandum and be required to be incorporated by reference; and
- to provide investors with an opportunity to monitor the use by an issuer of the funds it raises, a requirement that an issuer provide ongoing annual audited financial statements and specified disclosure of its use of proceeds derived from distributions under the OM Exemption.

Reports of exempt distribution

In order to enhance the ability to monitor use of capital-raising prospectus exemptions and the parties involved in them and to better inform their policy-making, the ASC, FCAA and FCNB are proposing two new Exempt Distribution Reports, one in respect of investment funds and one in respect of other issuers. These Exempt Distribution Reports would replace the current Form 45-106F1 *Report of Exempt Distribution (Form 45-106F1)*. The proposed Exempt Distribution Reports are harmonized with the electronic forms being proposed by the OSC.

For distributions under certain exemptions (including the accredited investor and minimum amount exemptions), investment funds currently have the option to report annually within 30 days after their financial year-end instead of within 10 days after a distribution. The ASC, FCAA and FCNB are proposing to increase the alternative frequency of the filing requirement for investment funds from annually to quarterly within 30 days after each calendar quarter. This corresponds with the proposal of the OSC.

Although the ASC and FCAA are proposing to adopt these two new forms of Exempt Distribution Report, to alleviate the potential regulatory burden to an issuer when having to file multiple types of forms in multiple jurisdictions, the ASC and FCAA are proposing to permit, in certain circumstances, for a transitional period, the current Form 45-106F1 to be filed.

Differences from FCNB and OSC proposals

The proposals of the FCNB and OSC in respect of the OM Exemption are very similar to the proposals of the AMF, ASC and FCAA; however, the FCNB and OSC proposals contain certain variations, including:

- that an issuer using the OM Exemption cannot be an investment fund or related to a registrant involved in the offering;
- a different definition of “eligible investor” which contemplates,
 - a change in the net asset test in respect of an individual, and
 - removal of the net income test for non-individuals;

- that an issuer that uses the OM Exemption must provide notice of certain significant events to its security holders, within 10 days of occurrence; and
- a different form of risk acknowledgement which will only be required to be obtained from individuals who are not permitted clients.

The AMF, ASC and FCAA are not proposing to adopt this new form of risk acknowledgement proposed by the FCNB and OSC; however, to avoid requiring issuers to use different forms in different circumstances, the ASC proposes to allow that form to be used in certain circumstances.

Although the AMF, ASC and FCAA are not proposing to adopt the variations to the OM Exemption proposed by the FCNB and OSC, we are interested in feedback in respect of them and will consider the comments in exploring further areas of harmonization.

The OSC is also publishing proposed changes to Companion Policy 45-106CP. The Participating Jurisdictions are not publishing the proposed changes to the companion policy at this time; however, during the comment period we will be considering the OSC's proposed changes with the goal of ultimately publishing a harmonized Companion Policy 45-106CP.

Next steps

We contemplate a two-phased approach to amending the OM Exemption. In this first phase, we propose to change the terms of the prospectus exemption. In the second phase, our goal is that members of the CSA engage in revisiting both the offering memorandum form disclosure requirements and work towards a harmonized risk acknowledgement form.

Background

The Participating Jurisdictions have been reviewing use of the OM Exemption in their respective jurisdictions and have worked with staff of the OSC in developing the Proposed Amendments and, in Alberta, New Brunswick and Saskatchewan, the Exempt Distribution Reports.

Further information regarding the local experience with the OM Exemption in each of Alberta, Québec and Saskatchewan is set out in Annex B to this Notice.

Summary of the Proposed Amendments

In New Brunswick, a summary of the Proposed Amendments of the FCNB will be published with this Notice. Unless otherwise stated, the following is only a summary of the Proposed Amendments in Alberta, Québec and Saskatchewan.

Eligible investor test

The AMF, ASC and FCAA are not currently proposing a change to the “eligible investor” definition.

Currently, one of the ways an investor can qualify as “eligible investor” is if his or her net assets are at least \$400,000. Based on Statistics Canada data it would appear that if investors are qualifying as “eligible investors” based on a net asset test, there are very few who could do so without including their principal residence. To reduce the risk to individuals with incomes below

\$75,000 mortgaging their homes to invest in exempt market securities, we considered excluding an investor's principal residence from the net asset test and have considered whether, in that case, the net asset threshold should be adjusted.

After further consideration, the AMF, ASC and FCAA determined not to propose excluding principal residence at this time but instead are seeking public feedback on this matter. Factors that influenced that decision include the following:

- the \$30,000 investment cap, discussed below, limits the potential exposure of an investor to a risky investment;
- excluding principal residence may treat investors with similar net worth differently depending upon the types of assets they choose to hold; and
- implications to capital raising.

We anticipate conducting further research and analysis in respect of the implications of excluding principal residence.

Annual limits on distributions to investors

Non-eligible investors

Currently, distributions to investors who do not qualify as "eligible investors" are subject to a \$10,000 limit per distribution¹. The AMF, ASC and FCAA are proposing to revise this requirement so that the limit is not per distribution but rather an aggregate limit that would apply to investments in any issuer by an investor under the OM Exemption in the preceding 12 month period.

Investors will continue to be able to qualify as "eligible investors" on the basis of investment advice from an investment dealer.

The introduction of a 12 month limit as opposed to a per distribution limit is intended to address concerns that the purpose of the \$10,000 cap may, in some cases, be circumvented by non-eligible investors investing in excess of \$10,000 through successive investments in the same or related issuers.

Eligible investors

Currently, there is no limit on the amount that an eligible investor can invest. Based on a review of investments under the OM Exemption in Alberta over a two year period, the median total annual investment by eligible investors under the OM Exemption is less than \$30,000. However, in some cases, investors made very significant investments in a year.

The AMF, ASC and FCAA propose to impose a \$30,000 limit on the amount that can be raised by an issuer from an eligible investor who is *an individual*. The calculation of the \$30,000 would

¹ The FCNB and OSC proposals contemplate that this limit would only apply to individuals.

include investments in any issuer by an individual investor under the OM Exemption in the preceding 12 months. A \$30,000 annual investment represents a significant portion of the net income or net assets of an individual that is not an accredited investor.

In calculating this limit, investments made under other prospectus exemptions would not be counted and this limit will not apply to individuals investing under the OM Exemption who would qualify to invest under the accredited investor or FFBA exemption². The limit will also not apply to non-individual eligible investors, such as companies. They will continue to be able to invest an unlimited amount under the OM Exemption.

Marketing materials

The Participating Jurisdictions have proposed that any marketing materials used in connection with a distribution under the OM Exemption be incorporated by reference into the OM so that there is statutory liability for a misrepresentation. We have included a definition of marketing materials in the Proposed Amendments. The AMF, ASC and FCAA have proposed that the marketing materials be filed with securities regulators³.

Ongoing annual disclosure

When the OM Exemption was first being considered for adoption, some form of ongoing financial disclosure requirement was considered. However, we concluded that it was not necessary as we thought most small issuers would be subject to annual financial statement requirements under applicable corporate law. This assumption has proven inaccurate. Many issuers using the OM Exemption are not organized under business corporation's statutes and are not subject to an annual financial statement requirement.

In the absence of financial statements, security holders are unable to assess how the financing proceeds have been used. Accordingly, the Participating Jurisdictions have proposed a requirement that an issuer relying on the OM Exemption prepare annual financial statements within 120 days of its financial year end. We also propose that a discussion of the use of proceeds accompany the financial statements.

This ongoing disclosure would be required to be filed with securities regulators in Alberta, Québec and Saskatchewan and either provided to or made available to security holders, e.g., through a website. Although we are contemplating a filing requirement, because these issuers would not be reporting issuers we will consider keeping them private and are reviewing alternatives in that regard⁴. With respect to making the disclosure available to security holders, we contemplate that an issuer could use a password protected website to give security holders access to the disclosure without making the disclosure generally publicly available. We have proposed that this ongoing disclosure requirement continue until the earlier of the issuer (1) becoming a reporting issuer and (2) ceasing to carry on business.

² The FCNB and OSC proposals do not contemplate that an individual who qualifies under the FFBA exemption could exceed the cap under the OM Exemption. However, those individuals could continue to invest under the applicable FFBA exemption.

³ The FCNB and OSC proposals contemplate that these documents be delivered to securities regulatory authorities.

⁴ The FCNB and OSC proposals contemplate that these documents be delivered to securities regulatory authorities.

The goal of the AMF, ASC and FCAA in requiring this ongoing disclosure is not to create a quasi-reporting issuer regime. We recognize most users of the OM Exemption are non-reporting issuers and that therefore securities acquired by investors are subject to indefinite resale restrictions and there is very limited ability for a security holder to resell securities in these circumstances. Consequently the rationale for requiring this ongoing disclosure is not to provide security holders with the information on which to make an informed investment decision. We contemplate the ongoing disclosure as a means of introducing accountability to issuers that rely on the OM Exemption with respect to the use of proceeds. It also creates a level playing field so that there is not an incentive to use a non-corporate structure to avoid reporting obligations.

The Participating Jurisdictions have proposed that the annual financial statements be audited and that the issuer be required to comply, as if it were a reporting issuer, with either:

- Part 4.1 of National Instrument 51-102 *Continuous Disclosure Obligations* and National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards* for an issuer that is not an investment fund; or
- in Alberta, Québec or Saskatchewan, National Instrument 81-106 *Investment Fund Continuous Disclosure* for an issuer that is an investment fund⁵.

This means that the annual financial statements will generally be required to be prepared in accordance with International Financial Reporting Standards (**IFRS**). This approach to ongoing financial statement disclosure is consistent with what is required of an issuer when preparing financial statements for inclusion in an OM. Similarly, the requirement to have the ongoing financial statements audited is also consistent with the annual financial statement requirements in the OM form and the requirements under corporate law in some jurisdictions.

We are mindful of the fact that additional continuous disclosure obligations increase the cost of using the OM Exemption, reducing the cost benefit intended to be associated with it. We are interested in public comment on the cost implications of such requirements.

Limits on types of securities

The Participating Jurisdictions propose to restrict the OM Exemption so that it is not available for the distribution of complex securities, i.e., specified derivatives and structured finance products⁶. This reflects the policy objectives of the exemption, i.e., focusing on financing efforts of small businesses and providing retail investors with a simplified plain language disclosure document describing the business and associated risks.

Reports of exempt distribution

The ASC, FCAA and FCNB are proposing to adopt two new forms of Exempt Distribution Report, Form 45-106F10 for investment funds and Form 45-106F11 for other issuers. These proposed Exempt Distribution Reports have been harmonized with the disclosure requirements proposed by the OSC. The mechanism for submitting the information will differ from the OSC

⁵ The FCNB and OSC propose to make the exemption unavailable to investment funds.

⁶ The FCNB and OSC contemplate additional restrictions e.g., excluding investment funds.

as the OSC will require the forms to be filed electronically through the OSC's electronic filing system.

For distributions under certain exemptions (including the accredited investor and minimum amount exemptions), investment funds currently have the option to report annually within 30 days after their financial year-end instead of within 10 days after a distribution. The ASC, FCAA and FCNB are proposing to increase the alternative frequency of the filing requirement for investment funds from annually to quarterly within 30 days after each calendar quarter. This corresponds with the proposal of the OSC.

The ASC and FCAA recognize that the addition of new forms of Exempt Distribution Reports could increase the regulatory burden for issuers conducting distributions in multiple jurisdictions. In order to alleviate this additional burden the ASC and FCAA are proposing for an interim period to accept an Exempt Distribution Report in the current Form 45-106F1 if the distribution is also in a jurisdiction that continues to require Form 45-106F1. We are reviewing whether we can also accept the Form 45-106F6 required to be filed in British Columbia.

The AMF is not proposing at this time to adopt the new forms of Exempt Distribution Reports or to make any changes to the filing deadline for the filing of Exempt Distribution Reports by investment funds. However, the AMF is interested in feedback in respect of these proposals.

In phase 2, we hope to seek further harmonization within the CSA in respect of Exempt Distribution Reports.

Questions on Proposed Amendments

We would appreciate feedback on the Proposed Amendments generally, as well as on the following questions:

1. Under the current framework in Alberta, Québec and Saskatchewan, both individual and non-individual investors are subject to the \$10,000 annual investment limit if they do not meet the definition of an eligible investor. Should non-individual investors, such as companies, be subject to the \$10,000 limit if they do not qualify as an eligible investor? Please explain.
2. Are there circumstances where it would be suitable for an individual eligible investor who is not an accredited investor and not eligible to invest under the FFBA exemption to invest more than \$30,000 per year under the OM Exemption? If so, please describe them.
3. Given the costs associated with doing so, how likely is it that an individual would create a corporation or other entity to circumvent the \$30,000 cap?
4. Investors who do not qualify as eligible investors based on net income or net assets can qualify as eligible investors on the basis of advice from a registered investment dealer. In what circumstances do investors actually seek and receive advice from a registered investment dealer? Does this introduce any complications or difficulties?

5. The eligible investor definition includes persons that have a net income of \$75,000 and persons that have net assets of \$400,000. These income and asset thresholds currently apply equally to individual and non-individual investors, such as companies.
 - a. Should the \$75,000 income threshold only apply to individuals? If so, please explain.
 - b. Should the net asset amount exclude the value of the principal residence for individual investors? If so, should the \$400,000 net asset threshold be lowered as a result?
 - c. Should pensions be included in the net asset test under the OM Exemption? Please provide the basis for your answer.
6. The FCAA would appreciate feedback on whether lawyers and public accountants should continue to be considered “eligibility advisers” in Saskatchewan for purposes of the OM Exemption? Please provide the basis for your opinion.
7. How common is it for an issuer that relies on the OM Exemption to make annual financial statements available to security holders?
 - a. How is this done? Are they delivered?
 - b. Are those financial statements typically audited?
 - c. If the financial statements are not typically audited, is there an auditor involved and, if so, what standard of engagement is typically applied?
 - d. Do issuers that prepared financial statements in accordance with IFRS for inclusion in their OMs typically continue to prepare financial statements in accordance with IFRS or do they transition to generally accepted accounting principles for private enterprises (ASPE)?
 - e. Is it common for security holders to request annual financial statements? Do they request audited financial statements?
 - f. What do you estimate as the annual cost of preparing the proposed audited annual financial statements?
 - g. Do you anticipate that issuers will mail annual financial statements to security holders or place them on a website?
 - h. What do you estimate as the cost of making annual financial statements available to security holders?

8. Under the Proposed Amendments, issuers relying on the OM Exemption would be required to deliver annual financial statements until the issuer either becomes a reporting issuer or ceases to carry on business. Are there other situations when it would be appropriate to no longer require ongoing annual financial statements for such issuers? If so, please describe them.
9. How do issuers relying on the OM Exemption typically communicate with their security holders? Do they maintain websites?
10. Should issuers be permitted to cease providing annual financial statements to their security holders after proceeds of a distribution are fully spent? If so, is there a period of time after which it is reasonable to assume that the proceeds of a distribution under the OM Exemption will have been fully spent?
11. Should non-individual investors (e.g., companies or trusts) be required to sign a risk acknowledgment form? Please explain.
12. Should “permitted clients⁷”, as defined in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Obligations* be required to sign a risk acknowledgement form? Please explain.
13. Should non-redeemable investment funds continue to be permitted to use the OM Exemption?
14. Are there certain types of issuers that should be excluded from using the OM Exemption?
15. Should issuers that are related to registrants that are involved in the sale of the issuer’s securities under the OM Exemption be permitted to continue using the OM Exemption?
16. Currently, most CSA jurisdictions that have an OM Exemption have adopted local blanket orders that permit an issuer to raise up to \$500,000 under the OM Exemption without having to include audited financial statements in the OM. Further, the blanket orders permit the financial statements to be prepared in accordance with ASPE rather than IFRS.
 - (a) Should these blanket orders be continued or revoked? Please provide the basis for your answer.
 - (b) If you believe the blanket orders should be continued, should the same threshold amount be used in determining which issuers are subject to an ongoing annual

⁷ The term permitted client is defined similarly to the term “accredited investor” but imposes higher financial thresholds, for example, in order to qualify as an accredited investor based on assets an individual would require \$1 million in net realizable financial assets. To qualify as a permitted client the individual would require \$5 million in net realizable financial assets.

financial statement requirement or an audit requirement? Please provide the basis for your answer.

Request for comments

We welcome all comments on the Proposed Amendments and the proposed Exempt Distribution Reports.

Please submit your comments in writing on or before **June 18, 2014**. If you are not sending your comments by email, please send a CD containing the submissions (in Microsoft Word format).

Please note that comments received will be made publicly available and posted on the websites of the AMF at www.lautorite.qc.ca and the ASC at www.albertasecurities.com and may be posted on the websites of certain other securities regulatory authorities. You should not include personal information directly in comments to be published. It is important that you state on whose behalf you are making the submission.

Please **address** your submission as follows:

Alberta Securities Commission
Autorité des marchés financiers
Financial and Consumer Affairs Authority of Saskatchewan

Please **deliver** your comments **only** to the two addresses below. Your comments will be distributed to the other participating jurisdictions.

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Contents of Annexes

The following annexes form part of this Notice:

Annex A – Proposed Amendments to National Instrument 45-106 *Prospectus and Registration Exemptions*,

including, in Alberta, New Brunswick and Saskatchewan

- Form 45-106F10 *Report of Exempt Distribution for Investment Fund Issuers (Alberta, New Brunswick, Ontario and Saskatchewan)*;
- Form 45-106F11 *Report of Exempt Distribution for Issuers Other than Investment Funds (Alberta, New Brunswick, Ontario and Saskatchewan)*; and

Annex B – Background – Local experience with OM Exemption.

4. Questions

Please refer your questions to any of the following:

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