

CSA Multilateral Notice and Request for Comment Proposed Order 45-539 *Small Business Financing*

March 25, 2021

Introduction

The Alberta Securities Commission (ASC) and the Financial and Consumer Affairs Authority of Saskatchewan (FCAA) (together, **staff** or **we**) are publishing for comment a proposed new prospectus exemption entitled *Small Business Financing* (the **Proposed Exemption**) which, if adopted, is intended to be available to streamline the financing process for small businesses in Alberta and Saskatchewan raising up to \$5,000,000 from investors in those provinces.

The comment period is open until **May 7, 2021** for comments to the Proposed Exemption. The Proposed Exemption is summarized below and is attached as Annex A to this Notice. The comment period relating to the proposed amendments to National Instrument 13-101 *System for Electronic Document Analysis and Retrieval (SEDAR)* is open until **May 24, 2021**.

Substance and Purpose

We understand that start-up and small businesses are an important part of our provincial economies, serving as key contributors to employment, quality of life and income within communities. The Proposed Exemption is designed to facilitate access to capital by these start-ups and other small businesses in Alberta and Saskatchewan, while still providing appropriate investor protection. It provides an exemption from the prospectus requirement, allowing a business in Alberta or Saskatchewan to raise up to \$5,000,000 from the general public in Alberta or Saskatchewan, using a simple, streamlined offering document with tiered offering and investment limits depending on whether specified financial statements are provided to investors.

The Proposed Exemption has been designed to respond to the challenges faced by start-ups and other small businesses encounter when trying to address modest financing needs. It is particularly intended to address the financing challenges of small local businesses that, while they may generate returns for investors and provide jobs, do not currently have the profile or growth prospects to attract the interest of venture capitalists or public capital markets. In Alberta, it is also intended to respond to and codify discretionary exemptive relief that has been sought by Alberta cooperatives and corporations in small towns and rural communities to help finance local projects.

Background

Absent an available prospectus exemption, securities law requires an issuer distributing securities to file and obtain a receipt for a prospectus. A prospectus provides comprehensive disclosure, allowing investors to make an informed investing decision. Securities law provides various exemptions from the prospectus requirement in circumstances where alternative conditions exist that suggest that investors do not require the protections of a prospectus.

We have previously explored ways to facilitate financing by small business. The offering memorandum exemption, now found in section 2.9 of National Instrument 45-106 *Prospectus Exemptions* (the **OM Exemption**) was intended to serve as a small business financing tool for smaller issuers moving beyond seed capital financing from family and close friends; however, it has been used for real estate development and mortgage investment entities and has had limited use by the type of early stage businesses for which it was intended.

We understand that for many small businesses that are raising only modest amounts of capital, the cost of preparing the financial statements required under the OM Exemption can be very significant, sometimes prohibitively expensive, relative to the amount of money being raised. We understand that this is because the annual financial statements required under the OM Exemption are required to be audited and prepared in accordance with Canadian generally accepted accounting principles (**GAAP**) applicable to publicly accountable enterprises, which are not typically the accounting principles used to prepare financial statements for small businesses that are not reporting issuers.

We have also endeavoured to address start-up and small business financing through the start-up crowdfunding regime but understand that not all issuers wish to conduct online financings and that, in some cases, the financing needs exceed the limits contemplated under the start-up crowdfunding regime.

The Proposed Exemption is intended to provide a prospectus exemption to better address the challenges faced by small businesses, while still addressing concerns relating to investor protection. It offers two tiers of offering and investment limits depending on the financial information provided to investors. Our goal is that this will provide a useful tool for small business that will allow them to graduate to higher financing amounts as they grow their business and have the means to provide additional financial information to investors.

Summary of the Proposed Exemption

The Proposed Exemption would provide Alberta or Saskatchewan-based start-ups and other small businesses with a coordinated and two-tiered prospectus exemption with differing offering and investment limits based on the amount of financial disclosure that is provided to investors. The Proposed Exemption would only be available to Alberta and Saskatchewan small businesses raising money from investors in those provinces. In order to provide investors with information on which to make an informed investment decision, issuers would be required to provide investors with a simple, streamlined offering document containing prescribed information as set out in Form 45-539F1 *Small Business Offering Document*. To assist issuers with preparing the offering document, we have provided an optional question and answer format.

Provided that the "issuer group"¹ raises no more than \$1,500,000 under the Proposed Exemption in a 12 month period (not including investments by investors who are qualified to invest under one of the other prospectus exemptions contemplated in the Proposed Exemption)² no financial statements are required to be provided with the offering document.

If the issuer group were to raise in excess of \$1,500,000 under the Proposed Exemption in a 12 month period from investors who would not qualify to invest under another specified exemption, including under an ongoing offering, the issuer would be required to provide investors with an offering document that contains the specified financial statements, before accepting the subscription. The specified financial statements are permitted to be prepared in accordance with a modified regulatory standard that is based on Canadian GAAP applicable to private enterprises (but with subsidiaries being consolidated and any significantly influenced investees and joint ventures being accounted for using the equity method). Annual financial statements would be required to be included but would not be required to be audited if they have been subject to a review engagement by a certified public accountant. If investors are provided with the specified financial statements, both higher offering limits and higher investment limits are permitted.

The Proposed Exemption provides tiered offering and investment limits as follows:

- 1) If the specified financial statements are **not** provided,
 - a) the maximum that an issuer group could raise from investors who would not qualify to invest under another specified exemption in a 12 month period under the Proposed Exemption is \$1,500,000, subject to a lifetime limit of \$5,000,000;
 - b) the maximum that an investor (who would not qualify to invest under another specified exemption) could invest in the issuer group in a 12 month period is
 - o \$2,500, or
 - o if the investor is a minimum income investor or "MII,"³ \$10,000;
- 2) If the specified financial statements are provided,
 - a) the issuer group could raise up to the aggregate lifetime maximum of \$5,000,000 under the Proposed Exemption from investors who would not qualify to invest under another specified exemption;
 - b) the maximum that an investor (who would not qualify to invest under another specified exemption) could invest in the issuer group in a 12 month period is

¹ The issuer group means, in respect of an issuer, any of the issuer, an affiliate of the issuer, an issuer that is engaged in a common enterprise with the issuer or with an affiliate of the issuer, and an issuer whose business is founded or organized by a person or company who founded or organized the issuer.

² Investments by persons or companies who qualify to invest under the accredited investor exemption, the close family, friend and business associate exemption, the foreign investor exemption, [and the self-certified investor exemption] are not included in calculating the \$1,500,000 or \$5,000,000 offering limits.

³ A minimum income investor or MII is defined in the Proposed Exemption and refers, generally, to those having had for the last two years annual net income in excess of \$75,000 or \$125,000 with their spouse and, in the case of non-individuals, generally to persons or companies that are controlled by a MII.

- \$5,000, or
- if the investor is a "MII," \$20,000.

The Proposed Exemption would not create any ongoing financial statement requirements for issuers that raise no more than \$1,500,000 from investors who would not qualify to invest under another specified exemption under the Proposed Exemption in a 12 month period. However, in the absence of a voting trust or other agreement, issuers that rely on the Proposed Exemption may be subject to corporate law or other requirements to prepare and send audited annual financial statements to their shareholders on an annual basis.

If the issuer group were to raise more than \$1,500,000 from investors who would not qualify to invest under another specified exemption under the Proposed Exemption in a 12 month period, the issuer would be required to file an undertaking as specified by Form 45-539F3 *Small Business Undertaking* to deliver annually their annual financial statements and a Form 45-106F16 *Notice of Use of Proceeds* and make them reasonably available to each holder of a security distributed under the Proposed Exemption. The Proposed Exemption contemplates that those annual financial statements need not be audited if subject to a review engagement and could be prepared using the modified regulatory accounting principles. However, as noted above, in the absence of a voting trust or other agreement, issuers that rely on the Proposed Exemption may be subject to corporate law or other requirements to prepare and send audited annual financial statements to their shareholders on an annual basis.

For issuers that are required to undertake to deliver financial statements on an annual recurring basis, we propose that those ongoing financial statements would be submitted electronically through SEDAR and made reasonably available to current security holders but would not be made publicly available on SEDAR. We would consider financial statements to be reasonably available to security holders if delivered in paper or electronic format or if purchasers are notified when they posted on the issuer's website.

The following conditions in the Proposed Exemption are designed to off-set risks to investors:

- requiring each investor to complete an enhanced risk acknowledgement form;
- imposing an aggregate lifetime limit of \$5,000,000 on the amount that an issuer group can raise under the Proposed Exemption; and
- capping the amount that can be invested and potentially lost with differing limits depending on an investor's income level and whether or not specified financial statements are provided.

Other key elements of the Proposed Exemption include the following:

- the issuer's head office must be in Alberta or Saskatchewan;
- the issuer must not be a reporting issuer or an investment fund;⁴

⁴ An investment fund is defined in securities legislation as a mutual fund or a non-redeemable investment fund, which terms are also defined in the *Act*. Generally, an investment fund is an issuer whose primary purpose is to invest money provided by its security holders in one or more other persons or companies. Refer to Part 1 in the Companion Policies to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant*

- it does not permit continuous distributions, i.e., offerings must be completed within 120 days and if the minimum offering is not raised, funds must be returned to investors;
- securities distributed are restricted to one or more of the following securities of the issuer:
 - common shares;
 - preference shares;
 - debt securities, other than securitized products or structured finance products;
 - units of a limited partnership;
 - membership shares or investment shares issued by a cooperative organized under the *Cooperatives Act* (Alberta); or
 - securities convertible or exchangeable into any of the above, such as warrants or convertible debentures.

Although the exemption is not available to investment funds, we anticipate that it may be used by some businesses that act as a vehicle for collective investment, such as

- those operating similar to venture capital funds,⁵ actively engaging in the management of the businesses in which they invest or,
- those that, similar to some opportunity development cooperatives in Alberta, issue a separate class or series of shares in respect of each underlying investment, and do not commingle the funds in respect of the various underlying investments.

The offering document would not be required to be provided in advance to the ASC or the FCAA but would be required to be submitted electronically through SEDAR within 10 days following the distribution, e.g., following the closing, together with a Form 45-106F1 *Report of Exempt Distribution* reporting on the distribution. Although not required to be provided to the ASC or FCAA, the issuer would also be required to obtain from each investor a completed risk acknowledgement in Form 45-539F2 *Small Business Risk Acknowledgement* and to retain that document. To ensure that each investor reads the risk acknowledgement form and it is not completed in advance by the issuer or salesperson, the risk acknowledgement must be fully completed by the investor and the issuer must not have reason to believe it is untrue.

The offering document would constitute an offering memorandum under securities legislation, providing investors with additional rights of action in the event of a misrepresentation in the offering document.

Securities issued under the Proposed Exemption would also be subject to the standard resale restrictions, which would continue indefinitely until the issuer becomes a reporting issuer. Accordingly, until that time, the securities could only be resold under another prospectus exemption or under a prospectus.

The Proposed Exemption would provide only a prospectus exemption. It would not provide an exemption from the dealer registration requirement or any other provision of securities

Obligations and National Instrument 81-106 *Investment Fund Continuous Disclosure*, which provide useful guidance on the characteristics of an investment fund.

⁵ See the discussion of venture capital and private equity in Companion Policy 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

legislation. Issuers that are not “in the business” of trading in respect of securities are not required to be registered as dealers. The companion policy to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* provides guidance on what it means to be “in the business” of trading securities.⁶

Concurrently with the publication of this Notice, the ASC has published for comment Blanket Order 31-536 *Alberta Small Business Finder’s Exemption*, updating and replacing ASC Blanket Order 31-505 *Registration Exemption for Trades in Connection Certain Prospectus-Exempt Distributions*. We encourage market participants in Alberta to review that proposal as well. That exemption is not being proposed in Saskatchewan.

The Proposed Exemption would only provide a proposed prospectus exemption from Alberta and Saskatchewan securities law and not the laws of other jurisdictions. It could not be relied on for the distribution of securities into other jurisdictions.

Consequential Amendments

If the Proposed Exemption is adopted, we propose to amend National Instrument 13-101 *System for Electronic Document Analysis and Retrieval (SEDAR)* to reflect the filing requirements under the Proposed Exemption. Annex B to this notice contain the proposed consequential amendments to that instrument.

In addition, if the Proposed Exemption is adopted, the ASC proposes to repeal ASC Rule 45-517 *Prospectus Exemption for Start-Up Businesses*. Annex C to this notice contains the proposed repeal of that instrument.

Request for Comments

We welcome your comments on all aspects of the Proposed Exemption. In particular, we seek feedback on the following questions:

1. To what extent do you anticipate that this prospectus exemption would be relied on by Alberta and Saskatchewan businesses? Do you think that the exemption will be relied on more for financings
 - a. above the proposed threshold of \$1,500,000 per 12 months at which financial statements are triggered?
 - b. or below the proposed threshold?
2. In setting the investment limits, we considered both the level of disclosure being provided to investors and the investor’s ability to withstand loss. Investors investing as minimum income investors or “MIIs” would not be accredited investors and can be assumed to have annual income of less than \$200,000. In particular, we have proposed that an MII has had annual net income in excess of \$75,000 or \$125,000 with their spouse for the last two years and, in the case of non-individuals, generally to persons or companies that are controlled by a MII. We have not proposed an asset test by which a person or company could qualify to invest.

⁶ See s. 1.1 under the heading “Business trigger examples (a) – Securities issuers”.

We were concerned that an investor e.g., a retired investor, might meet an asset test based on the value of their home but have very little income and not be able to withstand the loss of their investment. Should we consider adding a liquid asset test? If so, would \$500,000 in net realizable financial assets (i.e., cash and securities) be an appropriate limit?

3. Are the limits on investment for MIIs under the Proposed Exemption in any 12 month period appropriate i.e.,
 - a. \$10,000 when the specified financial statements are not provided, and
 - b. \$20,000 when the specified financial statements are provided?
4. Investors who do not qualify as "MIIs" can be assumed to have annual income of less than \$75,000 and/or a combined income with their spouse of less than \$125,000. Are the limits on investment under the Proposed Exemption in any 12 month period appropriate i.e.,
 - a. \$2,500 when the specified financial statements are not provided, and
 - b. \$5,000 when the specified financial statements are provided?
5. Purchasers would have a two day cancellation right or cooling off period and would also have a statutory right of action to sue for damages or rescission in the event of a misrepresentation, without needing to prove that they relied on that misrepresentation. Are other conditions beyond the offering document, risk acknowledgement and investment limits necessary to address investor protection concerns?
6. We have proposed that an issuer group that raises more than \$1,500,000 from investors who do not qualify to invest under other specified exemptions in any 12 month period under the Proposed Exemption would need to undertake to make available a notice of use of proceeds to each holder of a security distributed under the Proposed Exemption (and any transferee of such security). Do you think that this requirement should apply to all raises under the Proposed Exemption (i.e., including raises of less than \$1,500,000 in any 12 month period)?
7. We have proposed that the issuer be required to deliver the offering document together with a Form 45-106F1 *Report of Exempt Distribution* and the undertaking, if required, within 10 days following the distribution. Under the start-up crowdfunding regime, issuers have 30 days. Is 10 days a reasonable timeline to complete this filing, which must be done electronically through SEDAR?
8. We have proposed that the issuer group could raise up to the aggregate lifetime maximum of \$5,000,000 under the Proposed Exemption. The intention of imposing a lifetime limit is to encourage issuers to graduate to the disclosure required either by the OM Exemption or that of a reporting issuer once they have raised more than the specified amount from investors. The \$5,000,000 limit does not apply to investments made by investors under other exemptions e.g., accredited investor, family, close personal friends and business associates, foreign investors, or, if adopted, self-certified investors. Is \$5,000,000 the appropriate limit for requiring an issuer to graduate to the disclosure requirements under the OM Exemption?

9. We have proposed that an issuer group that raises more than \$1,500,000 from investors who do not qualify to invest under other specified exemptions under the Proposed Exemption in any 12 month period would need to undertake to deliver annual financial statements. However, we have proposed that these need not be audited, if subject to a review engagement report, and need not be prepared in accordance with Canadian GAAP for publicly accountable enterprises if they comply with the modified regulatory accounting principles set out in the Proposed Exemption.
- a. Given the requirements of applicable corporate law, to what extent is there benefit in permitting the annual financial statements to be subject only to a review engagement report?
 - b. To what extent does the relief from having to deliver annual financial statements prepared in accordance with Canadian GAAP for publicly accountable enterprises reduce the regulatory burden for small businesses?
 - c. Do you anticipate that issuers will have difficulty engaging accountants to review and provide review engagement reports if financial statements are prepared in accordance with the modified regulatory accounting principles set out in the Proposed Exemption?
 - d. The reason for requiring ongoing financial statements is to allow investors to see whether the offering proceeds were used as described in the offering document. We have contemplated that the requirement to provide ongoing financial statements continue until the proceeds raised by the issuer under the Proposed Exemption have been completely expended. Is this appropriate or should this obligation continue until the earlier of (i) the date the issuer becomes a reporting issuer in any jurisdiction of Canada, and (ii) the date the issuer ceases to carry on business?
10. Registered dealers may be unwilling to participate in financings under the Proposed Exemption given the small amount of capital being raised. Is this a reasonable assumption? Would registered dealers be likely to participate in such financings?
11. We have indicated that although the Proposed Exemption would not be available to investment funds, we anticipate that it may be used by businesses that act as vehicles for collective investment, including opportunity development cooperatives (**ODCs**). Do you anticipate that ODCs or other businesses that act as vehicles for collective investment would rely on this exemption? If so, should we require additional disclosure from such issuers in line with what is being contemplated for "collective investment vehicles" as defined in the Proposed Amendments to National Instrument 45-106 *Prospectus Exemptions* and Proposed Changes to Companion Policy 45-106CP *Prospectus Exemptions* Relating to the Offering Memorandum Prospectus Exemption.⁷

⁷ See: <https://www.albertasecurities.com/securities-law-and-policy/regulatory-instruments/45-106>. If adopted, issuers that are collective investment vehicles would be required to complete new Schedule 2 *Additional Disclosure Requirements for an Issuer That is a Collective Investment Vehicle* to Form 45-106F2, which includes: (i) a description of the issuer's investment objectives; (ii) disclosure of penalties, sanctions, bankruptcy, insolvency and

12. Do you anticipate that this exemption would be of interest to issuers that are raising money without a specific business objective, commonly known as "blind pools" or "blank checks?" If so, would it be appropriate to bar these issuers from using this exemption by prohibiting the proceeds of the distribution from being used by the issuer to invest in, merge or amalgamate with or acquire a business that has not been described in the issuer's offering document? Alternatively, rather than bar these issuers from using the exemption, are there conditions to its use that would be appropriate to impose on such issuers (e.g., funds raised must be held in trust until a business is invested in, merged with, amalgamated with, or acquired, a shareholders meeting is required to approve the business that will be invested in, merged with, amalgamated with, or acquired etc.).

Alberta-only

13. With respect to multi-jurisdictional crowdfunding offerings, ASC Rule 45-517 *Prospectus Exemption for Start-Up Businesses* (45-517) has been superseded by ASC Blanket Order 45-521 *Start-up Crowdfunding Registration and Prospectus Exemptions* (which is anticipated to in turn be superseded by National Instrument 45-110 *Start-up Crowdfunding Registration and Prospectus Exemptions*). 45-517 has only been used for local non-crowdfunding offerings. The Proposed Exemption would increase the investment and offering limits as compared to 45-517 and consequently there does not appear to be a reason to maintain 45-517. Do you agree or disagree? Please explain.

Submitting Comments

Please submit your comments to the Proposed Exemption in writing on or before **May 7, 2021** and/or to the consequential amendments to National Instrument 13-101 *System for Electronic Document Analysis and Retrieval (SEDAR)* in writing on or before **May 24, 2021**.

Comments may be submitted by either of the following:

- 1) **By sending an email** to New.Economy@asc.ca or
- 2) **By hard copy** to the attention of:

Cathy Tearoe
Senior Legal & Policy Counsel, New Economy
Alberta Securities Commission
Suite 600, 250 – 5th Street SW
Calgary, AB T2P 0R4

Please note that comments received will be made publicly available and will be posted on the ASC's website at www.albertasecurities.com. Accordingly, you should not include personal information directly in comments. It is important that you state on whose behalf you are making the submission.

criminal or quasi- criminal convictions for persons involved in the selection and management of the investments;
(iii) disclosure of information regarding the portfolio; and (iv) disclosure regarding the performance of the portfolio.

Questions

If you have any questions in respect of the Proposed Exemption, please contact any of the following:

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