



BC Notice 2014/03

Notice and Request for Comment on Start-Up Crowdfunding

Introduction and Background

“Crowdfunding” is a term that describes raising small amounts of money from many people, usually over the internet. Charities and some businesses who offer pre-sales already use the concept.

In April 2012, the US adopted a new crowdfunding exemption that would allow companies to sell securities to anyone over the internet through either a registered broker-dealer or a registered portal. The US exemption will not be available until the SEC adopts certain rules to support it. In Canada, Saskatchewan adopted a crowdfunding exemption allowing the sale of securities late last year.

Today some members of the Canadian Securities Administrators published a proposed crowdfunding exemption, modelled on the Saskatchewan exemption (the start-up crowdfunding exemption). We request comment on whether BCSC should consider adopting a similar exemption in British Columbia.

The exemption

The start-up crowdfunding exemption would allow an issuer to distribute securities without a prospectus provided the issuer complies with certain conditions, including the following:

- the issuer raises no more than \$150,000 per offering and offers no more than twice per year
- no investor invests more than \$1,500 per offering
- the issuer is not a reporting issuer or an investment fund
- the offering must go through an on-line funding portal
- the issuer provides a streamlined offering document to investors through the portal

The start-up crowdfunding exemption would allow a portal to operate without being registered under securities legislation provided the portal complies with certain conditions, including the following:

- the portal is prohibited from providing investment advice
- the portal must ensure investors confirm online that they have read and understood the issuer’s offering document and the risk warnings required under the exemption
- the portal must ensure that all funds are held in trust for investors until the issuer raises the minimum amount required to close the offering
- the portal must provide advance notice of its intention to use the exemption

We provide further information on the start-up crowdfunding exemption in Appendix A.

British Columbia's existing regulatory regime

Securities legislation requires an issuer distributing securities to file and obtain a receipt for a prospectus.

The BCSC already has a number of exemptions that allow businesses to raise capital without filing a prospectus, including:

- private issuer exemption
- family, friends and business associates exemption
- accredited investor exemption
- offering memorandum exemption

Securities legislation also requires anyone in the business of trading securities to be registered as a dealer. If a business is not in the business of trading, they are not required to register, regardless of the method used to sell securities.

Today, a form of crowdfunding would already be permitted in BC with the use of an offering memorandum. Under the existing regulatory regime, a BC business could distribute securities through a website operated by a registered dealer. If the business relied on the offering memorandum prospectus exemption, it could raise any amount from any investor in BC.

Crowdfunding for small and early-stage businesses in British Columbia

We understand that many small and early-stage businesses believe the current regime is too expensive, relative to the amount of capital they need. We would like to know whether a start-up crowdfunding exemption would fill a funding gap in the current regime.

The start-up crowdfunding exemption would be directed at small and early-stage businesses, designed to allow them to raise a defined amount of money in a more cost effective way. Investors in these start-ups would accept the risks of investing in early-stage businesses with some protection through limits on their investments.

As the business grows and requires more capital, it could look to other sources of funds, through the accredited investor exemption or the offering memorandum exemption.

Request for comments

We welcome all comments on the start-up crowdfunding exemption. We have the following specific questions on the proposal:

General

1. Is there a funding gap that prevents small and early-stage businesses from raising sufficient capital under our existing prospectus exemptions? If so, please describe where you think the gap exists and what causes it.

2. Will the start-up crowdfunding exemption address this funding gap? Why or why not?
3. Although the start-up crowdfunding exemption is intended to assist start-up and early stage businesses, it is not restricted to those issuers. Should we restrict the exemption to issuers that have raised less than a certain amount since their formation? Should we limit the total amount an issuer can raise under this exemption?

Portal obligations

Under the start-up crowdfunding exemption, portals will not be registered. This will mean they will not be subject to the same regulatory oversight as registrants. The start-up crowdfunding exemption includes elements designed to protect investors.

4. Do the requirements of the start-up crowdfunding exemption adequately protect investors?
5. Should we require the portal to do due diligence on issuers and their principals? If so, what level of due diligence should we require?
6. Should we impose any additional conditions on portals that rely on this exemption?

Limits on investing

Under the start-up crowdfunding exemption, investors are limited to investing no more than \$1,500 per offering. Because of this limit, issuers may end up having many security holders holding small numbers of securities of the issuer.

7. Should we impose an investment limit based on a percentage of the investor's net assets or net income, instead of a fixed dollar amount? Would having this type of investment limit add complexity to the start-up crowdfunding exemption?
8. Should we add a requirement that issuers give investors a "cooling-off" period similar to the two-day right of rescission under the offering memorandum exemption?

Improvements on offering memorandum exemption

9. The offering memorandum exemption is not widely used by small and early-stage businesses. We have heard that the costs of complying with the financial statement requirements in the offering memorandum form may be prohibitive and we welcome suggestions on ways to adjust those requirements. Are there other issues with the offering memorandum exemption that we should reconsider in order to make it a more useful exemption for small businesses?

Please send us your comments about this proposal in writing on or before June 18, 2014. Deliver your comments and refer your questions to:

British Columbia Securities Commission
P.O. Box 10142, Pacific Centre
701 West Georgia Street

Vancouver, British Columbia V7Y 1L2

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Under the *Freedom of Information and Protection of Privacy Act*, we cannot keep your submissions confidential.

March 20, 2014

Brenda M. Leong

Chair

Appendix A

Further details on the start-up crowdfunding exemption

The following is a high-level summary of the start-up crowdfunding exemption proposed by the Autorité des marchés financiers, the Financial and Consumer Affairs Authority of Saskatchewan, Financial and Consumer Service Commission of New Brunswick, the Manitoba Securities Commission and the Nova Scotia Securities Commission. You may find further details about the proposed exemption, including the required forms described below, at:

www.lautorite.qc.ca
www.fcaa.gov.sk.ca/SKEC
www.fcnb.ca/securities_1.html
www.msc.gov.mb.ca
<http://nssc.gov.ns.ca/>

Element of exemption	Details
Issuer restrictions	
Qualification criteria	<ul style="list-style-type: none"> • Head office must be located in a participating jurisdiction • Available to non-reporting issuers only • Not available to investment funds
Distribution details	
Types of securities	<ul style="list-style-type: none"> • Limited to distributions by an issuer of securities of its own issue • Limited types of securities can be offered: <ul style="list-style-type: none"> ○ common shares ○ non-convertible preference shares ○ securities convertible into common shares or non-convertible preference shares ○ non-convertible debt securities linked to a fixed or floating interest rate ○ units of a limited partnership
Offering parameters	<ul style="list-style-type: none"> • Cannot raise more than \$150,000 under each offering • Distribution cannot remain open for more than 90 days • The exemption cannot be used more than twice in a calendar year • Offering document must disclose minimum offering size and whether there is a maximum offering size • The minimum amount must be equal to the amount needed to carry out the purpose for which the funds are sought • No concurrent offering using the start-up crowdfunding exemption for the same project
Restrictions on solicitation and advertising	<ul style="list-style-type: none"> • Offering materials can be made available to potential investors only on portal's website • Offering materials must be delivered to regulator 10 days before the distribution

Element of exemption	Details
Investor protection measures	
Investment limits	<ul style="list-style-type: none"> • An investor cannot invest more than \$1,500 in a single investment under the exemption
Risk acknowledgement	<ul style="list-style-type: none"> • Investors must read and understand the important risk warning that includes that: <ul style="list-style-type: none"> ○ they understand they may lose their entire investment ○ they understand the illiquid nature of the investment ○ they have read and understood the offering document ○ the investment opportunity has not been approved by a securities regulatory authority ○ they have not received advice from the portal or a securities regulatory authority ○ they don't have as many legal rights when purchasing this investment as they would through a prospectus offering ○ they reside in a participating jurisdiction
Disclosure at point of sale	<ul style="list-style-type: none"> • Standardized disclosure document must be provided that includes basic information about the offering, the issuer and the portal • No financial statements are required
Statutory rights	<ul style="list-style-type: none"> • There may be limited or no right of action for rescission or damages in the event of a misrepresentation in any materials made available to investors
Resale restrictions	<ul style="list-style-type: none"> • Securities are subject to an indefinite hold period and can only be resold under a prospectus, another prospectus exemption or after the issuer becomes a reporting issuer
Provision of ongoing disclosure	<ul style="list-style-type: none"> • No requirement for ongoing disclosure above any requirements in the issuer's corporate governance statute. • Issuers may decide to provide ongoing disclosure to their shareholders
Other	<ul style="list-style-type: none"> • Each promoter, officer, director and control person of the issuer must deliver a completed <i>Individual Information Form</i> 10 business days prior to beginning to trade
Reporting	
Reporting of distribution	<ul style="list-style-type: none"> • Report of exempt distribution must be filed by issuers within 30 days of the distribution

Element of exemption	Details
Portal requirements	
Registration	<ul style="list-style-type: none"> • No registration requirement for the portal
Portal obligations	
Portal obligations	<ul style="list-style-type: none"> • The head office of the portal must be located in any of the participating jurisdictions and its promoters, directors, officers and control person must be Canadian residents • The portal delivers a complete <i>Portal Information Form</i> 30 days prior to beginning to facilitate distributions • Each promoter, director, officer and control person of the owner of the portal delivers a complete <i>Portal Individual Information Form</i> 30 days prior to the portal beginning to facilitate distributions • Portals will be required to: <ul style="list-style-type: none"> ○ Make the offering document of the issuer and the important risk warnings separately available to investors electronically online ○ Allow an investment only once the investor confirms online they have read and understood the offering document and important risk warnings ○ Release funds to the issuer only when the minimum offering amount to close the offering has been reached ○ Ensure that all funds received for an offering are held in trust for the investors ○ Provide the issuer with the details on the investors (name, address, telephone number, email address, detail of purchase) within 15 days of closing of the offering
Prohibited activities	
Prohibited activities	<ul style="list-style-type: none"> • A portal cannot: <ul style="list-style-type: none"> ○ provide advice ○ be related to the issuer of the securities