

CSA Notice and Request for Comment

Proposed National Instrument 45-110 *Start-up Crowdfunding Registration and Prospectus Exemptions*

February 27, 2020

Introduction

We, the Canadian Securities Administrators (the **CSA** or **we**), are publishing the following for a 90-day comment period expiring on May 27, 2020:

- Proposed National Instrument 45-110 *Start-up Crowdfunding Registration and Prospectus Exemptions* (the **Instrument**);
- Proposed *Start-up Crowdfunding Guide for Businesses* (the **Guide for Businesses**);
- Proposed *Start-up Crowdfunding Guide for Funding Portals* (the **Guide for Funding Portals**).

Collectively, the Guide for Businesses and the Guide for Funding Portals are referred to as the **Guides** in this Notice.

We are also proposing consequential amendments to National Instrument 45-102 *Resale of Securities* and National Instrument 13-101 *System for Electronic Document Analysis and Retrieval (SEDAR)* (the **consequential amendments**).

We are issuing this Notice to solicit comments on the Instrument, the consequential amendments and the Guides. We welcome all comments on this publication and have also included specific questions in the Comments section.

This Notice is also available on the following websites of CSA jurisdictions:

www.lautorite.qc.ca

www.bcsc.bc.ca

www.albertasecurities.com

www.osc.gov.on.ca

nssc.novascotia.ca

www.fcaa.gov.sk.ca

www.fcnb.ca

www.mbsecurities.ca

Background

Securities crowdfunding is an emerging way for businesses, particularly start-ups and early stage issuers, to raise capital. With securities crowdfunding, a business raises funds through the Internet by issuing securities (such as shares or debt instruments) to many

people. This form of financing is intended to provide an alternative source of capital to non-reporting issuers at an earlier stage of development.

On May 14, 2015, the securities regulatory authorities of British Columbia, Saskatchewan, Manitoba, Québec, New Brunswick and Nova Scotia adopted substantially harmonized registration and prospectus exemptions that allow start-ups and early stage issuers to raise capital in these jurisdictions under a tailored framework for securities crowdfunding. On October 2, 2019, the securities regulatory authority of Alberta adopted a substantially harmonized registration and prospectus exemption (the securities regulatory authorities in British Columbia, Alberta, Saskatchewan, Manitoba, Québec, New Brunswick and Nova Scotia collectively being the **blanket order jurisdictions**). The blanket order jurisdictions implemented the registration and prospectus exemptions by way of local blanket orders, as amended from time to time¹ (the **start-up crowdfunding blanket orders**).

Since the adoption of the start-up crowdfunding blanket orders and as of December 31, 2019:

- 11 funding portals have relied on the registration exemption under the start-up crowdfunding blanket orders in order to establish platforms;
- 1 registered dealer has facilitated start-up crowdfunding distributions;
- A total of 70 distributions have been completed in reliance on the prospectus exemption under the start-up crowdfunding blanket orders by 62 different issuers;
- The aggregate proceeds of all distributions made under the start-up crowdfunding blanket orders is \$3,470,754 (\$4,709,919 including the amounts raised with other prospectus exemptions as part of the same crowdfunding offering);
- The average investment amount per investor for distributions made in reliance of the start-up crowdfunding blanket orders is \$734.

In addition to the start-up crowdfunding blanket orders, two other securities crowdfunding regimes were adopted by CSA jurisdictions:

- Multilateral Instrument 45-108 *Crowdfunding (MI 45-108)* came into force on January 25, 2016 in Saskatchewan, Manitoba, Ontario, Québec, New Brunswick and Nova Scotia. Alberta adopted MI 45-108 on February 22, 2017. To date, no funding portal has registered as a restricted dealer under MI 45-108 and there has been no use of the regime.
- Alberta Securities Commission Rule 45-517 *Prospectus Exemption for Start-up Businesses* (ASC Rule 45-517) came into force on July 19, 2016. ASC Rule 45-517 is similar to the start-up crowdfunding blanket orders but does not provide an exemption from the registration requirement and does not require the use of a

¹ For example, please refer to Multilateral CSA Notice 45-317 *Amendments to Start-up Crowdfunding Registration and Prospectus Exemptions* and Multilateral CSA Notice 45-319 *Amendments to Start-up Crowdfunding Registration and Prospectus Exemptions*.

funding portal. As of December 31, 2019, there has been limited use of ASC Rule 45-517, with 6 distributions raising in aggregate \$130,650.

In addition, a number of firms registered as exempt market dealers and restricted dealers have launched online funding portals that facilitate crowdfunding through existing prospectus exemptions such as the offering memorandum and accredited investor exemptions under National Instrument 45-106 *Prospectus Exemptions* (NI 45-106).

We have heard from market participants that a harmonized regulatory framework tailored for securities crowdfunding available across Canada would foster the use of securities crowdfunding as an alternative for start-ups and early stage issuers to raise capital.

Substance and Purpose of the Instrument

The CSA have proposed the Instrument to improve the harmonization of the regulatory framework for securities crowdfunding by start-ups and early stage issuers.

Although the Instrument shares key features with the start-up crowdfunding blanket orders, we have made targeted amendments to improve the effectiveness of crowdfunding as a capital raising tool for start-ups and early stage issuers, while maintaining adequate investor protection. In the blanket order jurisdictions, the Instrument will replace the start-up crowdfunding blanket orders.

A comparative chart of the key differences between the Instrument and the start-up crowdfunding blanket orders is provided in Annex A.

Summary of the Instrument

The Instrument provides:

- an exemption from the prospectus requirement (the **start-up crowdfunding prospectus exemption**) that allows a non-reporting issuer to distribute eligible securities through an online funding portal; and
- an exemption from the dealer registration requirement (the **start-up crowdfunding registration exemption**) for funding portals that facilitate online distributions by issuers relying on the start-up crowdfunding prospectus exemption.

Start-up crowdfunding prospectus exemption

The start-up crowdfunding prospectus exemption is available to issuers that meet a number of conditions, including:

- the distribution of, and payment for, the security is facilitated through a funding portal that is relying on the start-up crowdfunding registration exemption or operated by an exempt market dealer or investment dealer;

- the aggregate gross proceeds raised by the issuer group² during the 12-months before the closing of the start-up crowdfunding distribution does not exceed \$1,000,000;
- each purchaser invests no more than \$2,500 or, if the purchaser has obtained advice from a registered dealer that such investment is suitable for the purchaser, \$5,000;
- the issuer prepares an offering document disclosing information about the business and the start-up crowdfunding distribution and makes it available to each purchaser through the funding portal's platform;
- the closing of the start-up crowdfunding distribution does not occur unless the issuer raises the minimum offering amount stated in the offering document within the 90-day period after the date the offering document is made available on the funding portal's platform; and
- the issuer provides the purchaser with a two-day contractual right to withdraw from an agreement to purchase the security by delivering a notice to the funding portal.

The issuer is not required to provide financial statements to investors in connection with a start-up crowdfunding distribution. No continuous disclosure requirements are tied to the start-up crowdfunding prospectus exemption.

The prospectus exemption is not available if the issuer intends to use the proceeds of the distribution to invest in, merge with, amalgamate with, or acquire an unspecified business. Investors in issuers that propose raising capital for these purposes are better protected in regimes other than start-up crowdfunding, such as the TSX Venture Exchange capital pool company program.

Start-up crowdfunding registration exemption

The start-up crowdfunding registration exemption is available to funding portals that meet a number of conditions, including:

- at least 30 days prior to the first date the funding portal facilitates a start-up crowdfunding distribution in a jurisdiction, the funding portal delivers to the securities regulatory authority or regulator in each jurisdiction a completed Form 45-110F3 *Funding Portal Information* and, for each principal of the funding portal, a completed Form 45-110F4 *Portal Individual Information*;
- the funding portal or any of its principals must not be, or have been, the subject of certain proceedings in the last 10 years as specified in the Instrument, including

² 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.

- claims related to fraud, theft, breach of trust, illegal distributions, or allegations of similar conduct;
- the funding portal holds each purchaser's assets separate and apart from the funding portal's own property, in trust for the purchaser, and in the case of cash, in a designated trust account at a Canadian financial institution;
 - the funding portal provides the necessary disclosures (such as the issuer's offering document and any amendments) and obtains the necessary risk acknowledgement from purchasers under the Instrument in connection with a distribution of eligible securities;
 - the funding portal is not registered under securities legislation; and
 - the funding portal does not:
 - provide advice to a purchaser about the merits of the investment or otherwise recommend or represent that an eligible security is suitable, or
 - receive a commission, fee or other similar payment from a purchaser under a start-up crowdfunding distribution.

A funding portal cannot rely on the start-up crowdfunding registration exemption if it is insolvent. A funding portal relying on the start-up crowdfunding registration exemption must deliver to the securities regulatory authority or regulator in each jurisdiction a completed Form 45 110F5 *Annual Working Capital Certification* within 10 days of each calendar year-end. As part of its obligation to deliver a completed Form 45 110F5 *Annual Working Capital Certification*, the funding portal must certify that it has sufficient working capital to continue its operations for at least the next 12 months. If the funding portal becomes insolvent or discontinues operations, it must promptly notify the securities regulatory authority or the regulator, and any purchasers for which it holds assets, of the process the funding portal will use to return the assets to these purchasers.

Under the Instrument, a firm registered in the category of exempt market dealer or investment dealer may operate a funding portal that facilitates the distribution of securities under the start-up crowdfunding prospectus exemption provided that it meets the requirements set out in the Instrument.

Guide for Businesses and Guide for Funding Portals

The purpose of the Guides is to assist funding portals and issuers in understanding the requirements under the Instrument.

The Guide for Businesses provides information in a plain-language, Q&A format that issuers should consider when conducting a start-up crowdfunding distribution.

The Guide for Funding Portals provides information that businesses that intend to conduct funding portal activities should consider, including considerations applicable to funding portals relying on the start-up crowdfunding registration exemption and those operated by registered dealers.

We expect the Guides to be published as a CSA staff notice with the final Instrument.

Extension of the Start-up Crowdfunding Blanket Orders

The start-up crowdfunding blanket orders are scheduled to expire on May 13, 2020. The blanket order jurisdictions are publishing an amendment to their local blanket order concurrently with this Notice so that the blanket orders will remain available until the Instrument is available, if adopted.

Local Matters

An annex is being published in each local jurisdiction that is making related changes to local securities laws, including local notices or other policy instruments in that jurisdiction. It also includes any additional information that is relevant to that jurisdiction only.

Publication

The Instrument, the consequential amendments and the Guides are published together with this Notice.

Comments

In addition to your comments on all aspects of the Instrument, the Guides and the consequential amendments, the CSA also seek specific feedback on the following questions:

1. We are considering repealing MI 45-108 because there has been no use of this regime. We also note that the adoption of the Instrument may reduce the need for market participants to rely on MI 45-108. Do you think MI 45-108 should be maintained? If so, please explain why.
2. We recognize the need to provide a balance in the Instrument between investor protection and streamlined, light-touch requirements for capital raising in the spirit of crowdfunding.

The Instrument contemplates individual investment limits of \$2,500 for each purchaser and \$5,000 for each purchaser, if the purchaser has obtained advice from a registered dealer that such investment is suitable for the purchaser. We recognize there may be need for greater flexibility in capital raising and continue to consider whether to increase the individual investment limit to one or more of the following:

- a. \$5,000 for each purchaser;
- b. \$10,000 for each purchaser, if the purchaser has obtained advice from a registered dealer that such investment is suitable for the purchaser; and

- c. a number in between those currently in the Instrument, and those mentioned above.

What would be an appropriate individual investment limit? Please explain and identify the investor protections you think support that amount.

3. Additionally, the Instrument contemplates a limit on aggregate proceeds raised by the issuer group during the 12-month period of \$1,000,000. We recognize there may be need for greater flexibility in capital raising and continue to consider whether to increase the offering limit to one of the following:
 - a. \$1,500,000; or
 - b. a number in between \$1,000,000 and \$1,500,000.

What would be an appropriate offering limit? Please explain and identify the investor protections you think support that amount.

4. Under the Instrument, issuers, and in some jurisdictions, the directors and executives signing the offering document will be subject to statutory liability if the offering document provided to the investor contains a misrepresentation. The purpose of statutory liability is to make recovery of damages easier for investors in the event of a misrepresentation in the offering document. We have heard that some issuers view statutory liability as potentially increasing the regulatory burden of using the start-up crowdfunding prospectus exemption. We also recognize that claims of misrepresentation by a purchaser may be unlikely given the low investment limits under the Instrument. Overall, we think that any added regulatory burden is balanced against the additional capital raising opportunities provided by the Instrument.

Do you think that statutory liability for misrepresentation in the offering document will deter start-ups and early stage issuers from raising capital using the Instrument? Is any deterrent justified when it appears unlikely that claims for misrepresentations will be made?

5. The definition of “eligible securities” is limited to:
 - common shares,
 - non-convertible preference shares,
 - securities, such as warrants, subscription receipts and simple agreements for future equity (or SAFEs), convertible into common shares or non-convertible preference shares,
 - non-convertible debt securities linked to a fixed or floating interest rate, and
 - units of a limited partnership.

The definition of “eligible security” was intended to reflect the type of securities a start-up or early stage issuers would likely be selling and to ensure that the exemption was not used to sell more complex securities, such as asset-backed securities and structured products. Are there other types of securities that it would be appropriate to include in the definition of “eligible security” (e.g. trust units, co-operatives member shares or other)? If so, what other type of securities and why?

Please provide your comments in writing by **May 27, 2020**.

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. In addition, all comments received will be posted on the websites of each of the Alberta Securities Commission at www.albertasecurities.com, the Autorité des marchés financiers at www.lautorite.qc.ca and the Ontario Securities Commission at www.osc.gov.on.ca. Therefore, 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.

Thank you in advance for your comments.

Please address your comments to each of the following:

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Please send your comments **only** to the following addresses. Your comments will be forwarded to the remaining jurisdictions:

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Contents of Annexes

This notice contains the following annexes:

- Annex A - Key differences between the registration and prospectus exemptions under Proposed National Instrument 45-110 *Start-up Crowdfunding Registration and Prospectus Exemptions* and the Start-up Crowdfunding Registration and Prospectus Blanket Orders
- Annex B – Local Matters (Ontario only)
- Annex C – Proposed National Instrument 45-110 *Start-up Crowdfunding Registration and Prospectus Exemptions*
- Annex D – Proposed Form 45-110F1 *Offering Document*
- Annex E – Proposed Form 45-110F2 *Risk Acknowledgement*
- Annex F – Proposed Form 45-110F3 *Funding Portal Information*
- Annex G – Proposed Form 45-110F4 *Portal Individual Information*
- Annex H – Proposed Form 45-110F5 *Annual Working Capital Certification*
- Annex I – CSA Staff Notice 45-XXX *Guidance for using the start-up crowdfunding registration and prospectus exemptions*
- Annex J – Proposed Amendments to National Instrument 13-101 *System for Electronic Document Analysis and Retrieval (SEDAR)*
- Annex K – Proposed Amendments to National Instrument 45-102 *Resale of Securities*

Questions

Please refer your questions to any of:

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Annex A

Key differences between the registration and prospectus exemptions under Proposed National Instrument 45-110 *Start-up Crowdfunding Registration and Prospectus Exemptions* and the Start-up Crowdfunding Blanket Orders

Key theme	Start-up crowdfunding blanket orders	Instrument
Maximum aggregate proceeds that can be raised by the issuer group under the prospectus exemption	\$250,000 per distribution, up to two times in a calendar year.	\$1,000,000 during the 12 months before the closing of the offering.
Maximum investment amount per person per distribution under the prospectus exemption	<ul style="list-style-type: none"> • \$1,500; or • in British Columbia, Alberta and Saskatchewan, \$5,000, provided that the purchaser has obtained advice from a registered dealer that such investment is suitable for the purchaser 	<ul style="list-style-type: none"> • \$2,500; or • \$5,000, provided that the purchaser has obtained advice from a registered dealer that such investment is suitable for the purchaser
Confirmation by the regulator before a funding portal starts to facilitate distributions	<p>The funding portal cannot facilitate distributions until the regulator confirms in writing receipt of:</p> <ul style="list-style-type: none"> • a duly completed funding portal information form; • a duly completed individual information form for each principal of the funding portal; and • such other documents and information as may be requested by the regulator. 	<p>The funding portal must deliver the required forms at least 30 days before facilitating distributions. There is no requirement for the regulator’s written confirmation. However, a funding portal may not rely on the start-up crowdfunding registration exemption if, within 30 days of receiving the funding portal information form, the regulator has notified the funding portal, it or any of its principals has been notified by the regulator that its process and procedure for handling of purchasers’ funds does not satisfy the conditions of the Instrument.</p>

Key theme	Start-up crowdfunding blanket orders	Instrument
Bad actor disqualification	Not applicable.	A funding portal cannot rely on the start-up crowdfunding registration exemption if it or any of its principals is or has been the subject of certain proceedings in the last 10 years related to a claim based in whole or in part on various conduct such fraud, theft, breach of trust, or allegations of similar conduct.
Funding portals financial resources certification	Not applicable.	On an annual basis, the funding portal must certify that it has sufficient working capital to continue its operations for at least the next 12 months by delivering a completed funding portal information form or Form 45-110F5 <i>Annual Working Capital Certification</i> .
Liability in the event the offering document contains misrepresentations	There is no statutory liability under securities law. The blanket orders do not require the issuer to provide contractual rights to purchasers. Purchasers may have rights under common law or civil law.	The issuer is subject to statutory liability similar to the offering memorandum exemption under section 2.9 of NI 45-106.
Investment in an unspecified business	No restrictions.	The start-up crowdfunding prospectus exemption is not available to issuers who intend to use the proceeds of the distribution to invest in, merge with or acquire an unspecified business.
Report of exempt distribution form	Except in British Columbia, issuers must use Form 5 – <i>Start-up Crowdfunding – Report of distribution</i> . In British Columbia, issuers must use Form 45-106F1 <i>Report of Exempt Distribution</i> .	Issuers must use Form 45-106F1 <i>Report of Exempt Distribution</i> .
Expiry date	The orders were initially set to expire on May 13, 2020. The start-up crowdfunding blanket orders will be extended to remain available until the Instrument is available, if adopted.	The Instrument has no expiry date.

Annex B

Local Matters

British Columbia Securities Commission

BC Instrument 45-535

Effective February 27, 2020, the BCSC has varied BCI 45-535 *Start-up Crowdfunding Registration and Prospectus Exemptions* (BCI 45-535) to extend the expiry date of BCI 45-535 from May 13, 2020 to the date that is 90-days after the effective date of a rule that provides for

- (a) a prospectus exemption for a distribution through a funding portal of an eligible security; and
- (b) a registration exemption exempting certain funding portals for such distributions under the prospectus exemption referred to in paragraph (a), above.

This variation of BCI 45-535 will permit market participants to have continued access to start-up crowdfunding until a harmonized rule is available, if adopted.