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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

Re:
CSA Notice and Request for Comment
Proposed National Instrument 45-110 Start-up Crowdfunding Registration and Prospectus Exemptions
NCFA SUBMISSION TO CSA ON PROPOSED HARMONIZED RULES FOR START-UP SECURITIES CROWDFUNDING

The Canadian Securities Administrators (CSA) are seeking comments on proposed harmonized rules for start-up securities crowdfunding by 27 May 2020.

The National Crowdfunding and Fintech Association of Canada (NCFA) welcomes this initiative. The following addresses the specifics of the proposed rules, but please see our previous submissions on crowdfunding in Canada on our website in the advocacy section for more details – https://ncfacanada.org/advocacy/.

1. Harmonization
NCFA has argued for many years that CSA crowdfunding rules are unduly constraining, and this enhanced harmonization will enable a greater use of crowdfunding across Canada, help to fill a funding gap, and allow more retail investors to invest in businesses whose purpose they support.

2. Impact of the pandemic on fundraising
Today, early stage Ventures are the most likely not to get funded as they lack established relationships with banks (including BDC) and they have been amongst the hardest hit by the pandemic. Many VC funds are moving towards growth equity (later stage) investing and foreign investors mainly invest at later stages.

3. Funding cap
While the maximum total amount that could be raised by a business under the crowdfunding prospectus exemption per year would increase from $500,000 to $1 million, we continue to support a much higher amount of $5 million (and that a broader range of companies be able to participate). In the US, where Reg CF has shown reasonable success, proposed SEC changes to Reg CF include increasing the maximum raise from $1 million US to $5 million. In the result, “the industry is poised to take off”. See – https://crowdfundcapitaladvisors.com/downloads/regulation-crowdfunding-4-years-in-review/ and https://www.sec.gov/news/press-release/2020-55.

We note the 60% success rate in 2019 mentioned in the above US report, and the failure of the researchers to find any evidence of fraud. Unfortunately, so far as we are aware, similar data is not collected in Canada.

We also note that the US is joining other jurisdictions to enable a higher raise, for example:
- in Australia: companies can raise AUD 5M (https://ncfacanada.org/5-million-equity-crowdfunding-extended-to-private-companies/)

4. Investor cap
While we welcome the proposal to increase the maximum investment an investor can make in a distribution to $2,500 (from $1,500), with a higher limit of $5,000 if the purchaser obtains advice from a registered dealer, again we think the limit should be higher.
The investor cap should be raised to at least $5,000 per distribution, or $10,000 a positive suitability determination by a registered dealer. The commission may also consider implementing a maximum investment value per calendar year across all distributions such as $50,000 maximum per calendar year for an eligible investor.

What little data we have in Canada shows that the success rate of crowdfunded start-ups is relatively high (compared to all start-ups) and that investors, if educated about crowdfunding, welcome the opportunity to invest directly in ideas that they can connect with. In other jurisdictions, crowdfunding is an important source of start-up capital.

We need to make start-up capital easier to access in Canada and to make the system more competitive with other jurisdictions:

- UK does not have an investor cap
- In Australia, retail investors can invest up to 10,000 AUD per year
- In Germany, there is a limit of 10,000 EUR per investment for private individuals, but they cannot invest more than double their monthly net income
- 90% of the US States which have adopted or are considering adopting an intrastate crowdfunding exemption have chosen either $5,000 or $10,000 per single investment, unless the investor is accredited.

Eligible investors should be able to invest up to $100,000 with a positive suitability determination by a registered dealer.

Accredited investors should be able to invest without caps (as they may already invest an unlimited amount under the accredited investor exemption).

The commission should consider expanding the accredited investor exemption definition to allow a category of ‘qualified accredited investors’ that any individual can qualify if they pass a formal test, such as the Canadian Securities Course (CSC) or equivalently demonstrate the knowledge and ability to accept risks involved. This would encourage more qualified Canadians to participate in private capital markets and be inline with similar initiatives in the U.S.

5. Working capital certification
A funding portal relying on the start-up crowdfunding registration exemption must deliver to the regulator in each jurisdiction a completed Form 45 110F5 Annual Working Capital Certification within 10 days of each calendar year-end. The 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 portal will use to return the assets to these purchasers.

While a portal must be and remain solvent to operate, we believe that maintaining a 12 month capital requirement for crowdfunding dealers and funding portal registrants would be challenging especially given the pressure of small margins and the impact of COVID-19 now and for the foreseeable future.

6. Statutory liability
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.

Due to the more limited resources of smaller issuers, this provision should only apply where the aggregate proceeds exceed $1.5 Million.

7. Eligible securities
These are: a common share; a non-convertible preference share; a security convertible into a common or a preference share; a non-convertible debt security linked to a fixed or floating interest rate; and a unit of a limited partnership.

- We would like to suggest that convertible preference shares be considered eligible securities within this instrument.
- Units of a trust should also be included as eligible securities.

8. Sunset clause
The absence of an expiry date in the instrument will enhance certainty for market participants.

9. Repeal of MI 45-108
MI 45-108 should be repealed.

10. Reports of Exempt Distribution
The regulator should consider fee reduction for filing reports of exempt distributions - these can add up to around $1,500 per raise which is a significant fee particularly for a smaller issuer. One potential way to manage this would be to allow registered dealers and funding portals to file reports of exempt distributions in batches (ie. once a quarter) and only pay a single fee per batch of transactions.

11. Peer-to-Peer Lending
The securities regime should contemplate a separate set of requirements for non-convertible loans made between a borrower and lenders. In other jurisdictions, such a transaction comes with a much lighter regulatory burden which is important for it to be feasible for a peer-to-peer lending market to exist.

Specifically, no offering document should be required to be prepared by a borrower where the transaction taking place is a simple loan made between lenders and a borrower - rather the loans should be made under a standard form loan agreement facilitated by a platform. In order to minimize burden on the borrower, the platform should be required to undertake certain due diligence on the borrower and determine an interest rate, loan amount and repayment structure - the borrower would thereby only be required to execute a loan agreement in order to transact in this capacity.

The current proposed regime would result in adverse selection bias as only borrowers that are less creditworthy would be likely to go to the lengths required under the crowdfunding regime as there are currently other options in the market to raise capital that are less burdensome for the borrower such as private lenders.
12. General comments
NCFA continues to ask for government support to ensure the Canadian fintech sector is not being held back and remains competitive with international comparators such as in the UK and US including:

- Improved data collection-analysis and reporting transparency. The lack of basic data (mirroring what is happening with respect to Coronavirus) is a recurring theme that requires a solution. NCFA is willing to collaborate with any government to help develop and provide a solution;
- Allow advertising and general solicitation;
- Consider bad actor check on management and beneficial shareholders (shared database);
- Provide (funding for) ongoing education;
- Take advantage of proven tax and other incentives;
- Be proactive and champion innovation;
- And maintain a public list of only active operating funding portals and registrants with a regular check of their operating status combined with a definition of ‘active’ portals (ie., >1 capital raise in the proceeding 12 months).

See select NCFA submissions:
NCFA meeting with OSC - briefing notes on Aug 24, 2017
NCFA submission to Ontario Minister of Finance: Urgent Need for Regulatory Change (report | summary) on Oct 18 2017
NCFA meeting with BCSC - briefing notes on Aug 15, 2017
NCFA Response to ASC Request for comments 45-108 on Sep 9, 2018

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About NCFA
The National Crowdfunding & Fintech Association(NCFA Canada) is a financial innovation ecosystem that provides education, market intelligence, industry stewardship, networking and funding opportunities and services to thousands of community members and works closely with industry, government, partners, and affiliates to create a vibrant and innovative fintech and funding industry in Canada. For more information, please visit: ncfacanada.org