



February 27, 2012

**BY E-MAIL**

Gordon Smith  
British Columbia Securities Commission  
PO Box 10142, Pacific Centre  
701 West Georgia Street  
Vancouver, British Columbia V7Y 1L2  
gsmith@bcsc.bc.ca

and to all of the securities regulators listed in Schedule "A" to this letter

Dear Sirs/Mesdames:

**Re: Consultation Note 45-401 Review of Minimum Amount and Accredited Investor Exemptions  
(the "Consultation Note")**

We write in response to the Consultation Note and the discussion concerning possible changes to the accredited investor exemption (the "**AI Exemption**") and the \$150,000 MA Exemption (the "**MA Exemption**") found in National Instrument 45-106 Prospectus and Registration Exemptions ("**NI 45-106**").

**General Discussion**

In the context of this discussion Reed Pope LLP works with many issuer clients at different stages in their life cycle – from enterprise formation through to investor exit. We also assist in financial and strategic disposition transactions, as well as family, seed, angel and venture round investments – sometimes for the issuer and sometimes for the investors.

Every year Victoria and Vancouver Island spawn many new businesses – as well as traditional financial service, real estate based, aquaculture, marine, forestry and customary business sectors, the IT, knowledge based and high-tech sectors are very active. In these latter sectors there is a tension between retaining the enterprise, economic benefits, employment and spin-off opportunities within Canada and the pull of out-of-country migration most usually to the USA – primarily the Pacific coastal states. We are also seeing migration to other parts of the USA. It is not unusual for us to address with our clients at the enterprise formation stage whether their capital raising should take place in Canada or in the USA. For those with scalable expectations it is almost certain that there will be later rounds of investment – super angels or venture capital – which will bring almost irresistible pressure to relocate to the United States.

In addition, our clients must consider the limited size of the pool of potential MA Exemption and AI Exemption investors who are readily accessible from the West Coast. Our lines of communication and access to capital are probably more north-south than east-west.

This means that our issuer clients and their investors must consider the impact of the rules for capital formation not only in Canada but also in the USA. We are concerned that the recent US decisions not to increase the threshold for net worth for American accredited investors and to exclude only the principal residence from an investor's qualifying asset base, as well as experiments in internet-based crowd funding and reselling of securities of non-reporting issuers, will increase pressure to migrate even earlier in an issuer's life cycle. When we combine these new developments with the recent Canadian legislative changes to restrict investment of funds in registered retirement savings plans our concerns about new enterprise formation in Canada become even greater.<sup>1</sup>

As we act for investors who qualify under the MA and AI Exemptions we are also aware of their issues, which include:

- (a) that the compliance costs imposed on issuers regulated under securities laws compared to those on unregulated investments (primarily investment real estate) represents erosion in the effective use of invested capital;
- (b) that the public market place has not provided their return on investment expectations;
- (c) the wish for portfolio diversification into the same alternative investments as are available to institutional investors; and
- (d) the opportunity to make greater returns by investing outside of Canada – including into vehicles that migrate for access to larger capital pools.

It is in this context that we join in the discussion – well aware that in addition to the consumer protection aspects of Canadian securities laws there is also the need to ensure a dynamic, expanding economy with appropriately structured and regulated capital markets. Based on our experiences since the introduction of NI 45-106 we have not seen examples of mischief that warrant the proposed changes. Rather, and as discussed below, we suggest that the \$1,000,000 AI threshold be adjusted to match the real estate test of the competing US threshold.

The majority of our issuer clients are not reporting issuers and they rely on prospectus and registration exemptions to raise capital for essentially their entire life cycle. Given our geographic region and the small size of our clients, many of our clients simply do not have access to the type of institutional

---

<sup>1</sup> The Canadian Advanced Technology Alliance (CATA) expressed similar concerns at [http://www.cata.ca/Media\\_and\\_Events/Press\\_Releases/cata\\_pr02021201.html](http://www.cata.ca/Media_and_Events/Press_Releases/cata_pr02021201.html)

funding that is available in central Canada. This is exacerbated by the fact that in recent years, venture capital funds have largely moved away from providing seed and even follow-on rounds of capital.

Our clients generally use the private issuer exemption found in NI 45-106 until they no longer qualify for that exemption, after which they use the family, friends and business associates exemption, the AI Exemption, the MA Exemption and, in some cases, the offering memorandum exemption. The AI Exemption and the MA Exemption are both integral to our clients' capital raising efforts and are heavily relied upon. Consequently, in considering any changes to the AI Exemption and the MA Exemption, we are mindful that any changes should make it easier for our clients to access capital, and not further restrict their access to such capital. We are of the view that if our issuer clients cannot locate sufficient funding in Canada using available prospectus exemptions, they will be forced to move directly to the US capital market.

The majority of investors whom we see in our practice, and who invest in reliance on the AI Exemption or the MA Exemption (or as an accredited investor under the private issuer exemption) are individuals rather than corporate or institutional investors. To the extent that they are corporate entities, they are often family holding companies or family investment companies. Many investments in which our clients are involved (either as investor or issuer) also occur in reliance upon the Northwest Exemption.

The AI Exemption is particularly important to our clients since the definition of "accredited investor" is also used in the private issuer exemption that most of our clients use for an extended period of time.

In our experience an investor relying on the MA Exemption is usually knowledgeable and experienced, easily and willingly makes and risks a \$150,000 investment, but does not qualify under the AI Exemption net income or financial asset tests. This is often the investor cohort where (in our particular market) we find angel investors.

The issue of adjusting thresholds based on inflation is raised with respect to both exemptions. It is not clear how inflation, which is primarily a consumption related measurement (it erodes purchasing power and asset values), should have any application to the threshold amount. The impact of adjusting thresholds by inflation (no matter which inflation measurement is used) would be to impose a double reduction in the number of qualifying investors: inflation would erode the capital they have available to invest and the increase in thresholds would further remove them from the marketplace. In our market, salaries have not increased significantly in the last few years, and wealth creation opportunities have been limited. In British Columbia the \$150,000 threshold only came into effect with NI 45-106 in the latter part of 2005. We see nothing that has happened since that time that warrants changing the threshold amount. Since salaries have not increased significantly in recent years, and wealth creation opportunities have been limited, it would be artificial and detrimental to raise the threshold by this metric. We very much doubt that the threshold would be decreased by a deflationary trend.

Rather than looking at inflation as a metric for reviewing the MA Exemption and AI Exemption thresholds, we suggest that a more meaningful analysis would include a census review to determine the size of the pool of potential investors who could use these exemptions. With the changes to RRSP qualifying investment rules this is an even smaller pool than existed before December 2011.

Although we practice law solely in the province of British Columbia, our clients regularly seek investors in Alberta and Ontario, and to a lesser extent in other provinces and territories of Canada.

### **Principles underlying the MA Exemption and the AI Exemption**

1. *What is the appropriate basis for the MA Exemption and the AI Exemption? For example, should these exemptions be premised on an investor's:*

- *Financial resources (ability to withstand financial loss or obtain expert advice);*
- *Access to financial and other key information about the issuer;*
- *Educational background;*
- *Work experience;*
- *Investment experience; or*
- *Other criteria?*

*Please explain.*

In our view any constraint on the freedom of an investor to contract should not be greater than that needed to remedy real and specific concerns with the operation of the marketplace. Access to the necessary information to make an appropriate investment decision should underpin securities regulation. Generally, the role of the regulatory authorities should not extend to making decisions on the suitability of a particular investment opportunity.

The MA Exemption and the AI Exemption should both be premised on the capacity of an investor to acquire sufficient information to make an informed investment decision. Since the financial melt-down we have become aware that the concept of the "sophisticated investor" is open to question. Certainly, for some products it is clear that neither the issuers nor the investors really understood the investment opportunity. In the same way that British Columbia responded to the specific mischief of syndicated mortgages – not by destroying the industry but by requiring specific disclosure - it seems appropriate that the chosen remedy for any deficiency in information to make a knowledgeable investment decision should be specific disclosure such as that being introduced for securitized products.

In our experience, both exemptions are appropriate for investors who have sufficient resources to conduct due diligence when making their investment decisions and who do not need the protection of detailed disclosure such as that found in a prospectus or offering memorandum. Certainly, the negotiation of term sheets, share rights, subscription agreements, investor rights agreements and

Reed Pope LLP

shareholders' agreements that often accompany these exemptions indicates a level of investor knowledge that goes beyond the information disclosed in prospectus or offering memoranda or through the efforts of registrants. These investors also have the financial resources to determine whether or not they can withstand the possible financial loss.

Educational background and work experience may assist in providing an investor with the knowledge necessary to evaluate the investment opportunity, but should not be the principal criteria for use of the AI Exemption or the MA Exemption. As well, even if educational background or work experience were added to the qualification criteria, it would be difficult to determine the type and amount of experience that would be required to ensure that each investor has adequate knowledge. In our practice, we do not generally experience any issues related to investor qualification under these two exemptions, as the current qualification requirements are straightforward and easy to apply. We are of the view that introducing additional requirements would unnecessarily complicate qualification and change the nature of these exemptions, which work well in their current form.

2. *Does the involvement in the distribution of a registrant who has an obligation to recommend only suitable investments to the purchaser address any concerns?*

Based on our experience the involvement of a registrant would not assist the purchaser. In our experience, the requirement to involve a registrant would be regarded as counter-productive. If an investor considers the skills and experience of a registrant to be helpful they will engage such a person, in the same way they use their lawyers, accountants, tax advisors etc. We do not believe that the requirement to introduce a stranger as advisor would add any benefit for these kinds of investors – the process of “knowing your client” and the level of “know your product” knowledge is unlikely to be regarded as assisting the investor in making his investment decision.

We have observed that in our particular market, registrants are not generally perceived as adding a great deal of value to an investment transaction.

#### **MA Exemption**

3. *Do you have any comments on the issues described in the Consultation Note?*

In our view, the MA Exemption is premised on the capacity of the investor to analyze the investment decision using their resources and to make the risk analysis about the ability to withstand financial loss. Most investors relying on this exemption will do their own due diligence and obtain information about the investment and the issuer prior to completing an investment of this amount. We suggest that sophistication is more an investment analysis process that can occur either as a result of the investor's past experience or the use of personal and trusted advisors. In itself “sophistication” should not be a

prerequisite for use of this exemption. It would be very restrictive to define "sophistication" in some manner, or require a certain type of education. Indeed, education does not guarantee sophistication.

In our experience, the intent behind and requirements of the MA Exemption are not problematic. We do, however, occasionally come across the investors who sell liquid assets so as to obtain cash in order to use this exemption, which should not be happening. In some circumstances, it may be beneficial to the investor to be able to invest the minimum amount in smaller increments rather than in one lump sum. For this reason, we would suggest giving investors the option of investing the Minimum Amount in one or more tranches over an aggregate period of not more than 180 days, with each tranche being on the same terms and with respect to the same securities. We would further suggest that the subscription agreement in respect of the aggregate investment require that if the investor does not invest the full amount required to qualify for this exemption, the issuer will promptly return the full amount of the investment to the investor, without interest or penalty. Our principal concern with investment over several tranches is that the issuer would be unable to access the funds until after the last tranche has completed, which would create access to capital concerns for the small issuers that we commonly deal with.

4. *Are there other issues you may have with the MA Exemption?*

We have no other issues with the MA Exemption. We find this to be a popular exemption and very useful for investors (particularly small corporate investors such as family holding companies) who might otherwise be unable to qualify as an accredited investor.

5. *Do you agree with maintaining the MA Exemption in its current form?*

Yes. The investor has the protection of its remedy for misrepresentation under common law. We would suggest considering statutory civil remedies for the investor, similar to those provided in Ontario for a misrepresentation in an offering memorandum. In this case the remedy would apply to any disclosure document (in whatever form) provided by an issuer. This would provide the rescission remedy that would not be otherwise available. However, given the negotiating imbalance in favour of the investor that we see in most transactions we are concerned that this would support advice to issuers to migrate to a more favourable jurisdiction.

6. *How much should the minimum investment threshold be increased? Would your answer to this question change depending on whether:*

- *Any disclosure is provided to investors, including risk factor disclosure?*
- *The purchaser is an individual, instead of an institutional investor?*
- *The security is novel or complex?*
- *The issuer of the security is a reporting issuer?*

Reed Pope LLP

- *A registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?*

We do not recommend changing the threshold.

As stated above, we are of the view that in general, an investor investing this amount will conduct due diligence of their own accord. That being the case, this exemption should not be tied to issuer disclosure requirements.

Our answer to this question would not change in any of the above-listed circumstances.

7. *Should the \$150,000 threshold be periodically indexed to inflation?*

No. See above.

8. *If we changed the \$150,000 threshold what would the impact be on capital raising?*

If the experience of British Columbia in moving from \$97,000 to \$150,000 is taken into account, any increase in the threshold would reduce the use of the exemption and issuers would lose access to that capital that would previously have been qualified. In addition, investors who have the capacity to make appropriate investment decisions absent a prospectus or offering memorandum type of disclosure would lose the opportunity to make investment decisions except at a significantly greater cost of capital to the issuer, thereby reducing the value of the investment to the investor.

9. *Should individuals be able to acquire securities under the MA Exemption? Would your answer to this question change depending on whether:*

- *any disclosure is provided to investors, including risk factor disclosure?*
- *the security is novel or complex?*
- *the issuer of the security is a reporting issuer?*
- *a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?*

The MA Exemption should not be closed to individuals. In our practice, we find that this exemption is used equally by individuals and small corporate investors, and it would therefore be counterproductive to restrict individuals from using it and close off an important source of capital to small issuers.

Our answer to this question would not change in any of the above-listed circumstances.

10. *If individuals are able to acquire securities under the MA Exemption, should there be any limitations?*

Reed Pope LLP

No, there should not be any limitations. We are concerned that an increase would likely result in the MA Exemption simply not being used, with investors choosing other opportunities to invest and issuers losing access to that capital.

11. *If we limited the use of the exemption to persons who are not individuals, what would the impact be on capital raising?*

Given that in our experience, many investors who rely on this exemption are individuals, limiting the use of this exemption to persons who are not individuals would severely restrict the ability of issuers in our market to raise capital through this exemption.

12. *Are there alternative qualification criteria for the MA Exemption?*

Given that the MA Exemption is based upon the ability to withstand financial loss, in our view there are no appropriate alternative qualification criteria for this exemption.

13. *Are there other limitations that should be imposed on the use of the MA Exemption?*

It may be appropriate to limit the number of times that this exemption may be used by a single investor, especially as this exemption is intended to be used in a situation where the investor does not qualify as an accredited investor.

14. *Should the MA Exemption be repealed? Would your answer to this question change depending on whether:*

- *any disclosure is provided to investors, including risk factor disclosure?*
- *the purchaser is an individual, instead of an institutional investor?*
- *the security is novel or complex?*
- *the issuer of the security is a reporting issuer?*
- *a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?*

The MA Exemption should not be repealed. We see it being used on a regular basis and it is considered by our issuer and investor clients to be a useful prospectus exemption. Our answer would not change in any of the circumstances set out above.

15. *If the MA Exemption was repealed:*

- *would that materially affect issuers' ability to raise capital?*

Reed Pope LLP



- *is the AI exemption (in its current or modified form) an adequate alternative to the MA Exemption?*

A repeal of the MA Exemption would materially affect issuers' ability to raise capital in the market in which we operate, and would not be adequately replaced by the AI Exemption because the MA Exemption is used, in our experience, by investors who have significant cash resources but who may not otherwise meet the requirements of the AI Exemption.

16 *Are there other options for modifying the MA Exemption that we should consider?*

We have not identified any other options for modifying the MA Exemption that would be appropriate. The continued use of this exemption represents a market differentiator with the US exempt marketplace. As there is nothing in the Consultation Note that sets out specific concerns with the threshold we have not observe any mischief that would warrant the proposed change.

**AI Exemption**

17. *Do you have comments on the issues described above?*

The AI Exemption is widely used by our clients, not only in itself but also by accredited investors under the private issuer exemption. Other than the private issuer exemption, the AI Exemption is probably the single most important prospectus exemption available to our clients.

Given that changes in personal incomes have not changed significantly over the past decade and that there has been an increase in unemployment, we see no reason to raise the income qualification thresholds. The impact of inflation is to reduce the capacity of income earners to invest – static salaries and increased costs should result in a reduction of the income based pool of accredited investors. In our experience the income test is infrequently used to qualify as an accredited investor.

We recommend that the definition of "financial assets" under section 1.1 of NI 45-106 be amended (and perhaps redefined as "investment assets") to include real estate assets other than an individual's principal residence. It is quite common for individuals to hold their investment assets in the form of real estate, the value of which should be able to be included in any calculation of an individual's assets, but which, under the current definition, cannot be included for the purpose of qualifying as an accredited investor under section 1.1(j) of NI 45-106. If an investor has real estate assets with net value in excess of \$1,000,000, but less than \$5,000,000 (which would qualify the individual under section 1.1(l)), such an individual would not be able to qualify as an accredited investor – a distinction that seems arbitrary and artificial. By not allowing individuals to include their real estate investment properties for purposes of qualification as an accredited investor, it is much more difficult for individuals to qualify and restricts

issuer access to capital that would be available if these individuals held their investments in any other form.

Other than as set out above, we believe the AI Exemption is easy to use and appropriately applied.

18. *Are there any other issues you may have with the AI exemption?*

No, we have not experienced any other issues with the AI Exemption.

19. *Do you agree with retaining the AI exemption and the definition of "accredited investor" in their current form?*

Other than raising the qualification threshold, we agree with retaining the AI Exemption and the definition of "accredited investor" in their current form.

20. *What should the income and asset thresholds be? Would your answer to this question change depending on whether:*

- *any disclosure is provided to investors, including risk factor disclosure?*
- *the security is novel or complex?*
- *the issuer of the security is a reporting issuer?*
- *a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?*

We are of the view that the income and asset thresholds are generally appropriate, save as follows:

- Given that salaries in our region have not increased significantly in the last few years, and there have been limited wealth creation opportunities, we are of the view that any increase in the thresholds would be artificial and inappropriate.
- We believe that the definition of "financial assets" under section 1.1 of NI 45-106 should be amended (and perhaps redefined as "investment assets") to include real estate assets other than an individual's principal residence. This would allow individuals to qualify as accredited investors under section 1.1(j) even if their investments are held in the form of real estate. Including real estate investments in the value of the assets held by an investor simply reflects the modern reality that many individuals hold their investments in the form of real estate rather than cash.

21. *Should the income and asset thresholds be periodically indexed to inflation?*

No.

Reed Pope LLP

22. *If we changed the income and asset thresholds, what would the impact be on capital raising?*

If the thresholds were increased (whether to reflect the rate of inflation or otherwise), it would likely result in a decrease in the use of the AI Exemption as fewer investors would qualify and, since this exemption is frequently used by investors in our market, issuers would lose access to a significant source of domestic capital and would be more likely to simply migrate out of the country in order to access capital in other markets.

23. *What qualification criteria should be used in the AI exemption for individual investors? Would your answer to this question change depending on whether:*

- *any disclosure is provided to investors, including risk factor disclosure?*
- *the security is novel or complex?*
- *the issuer of the security is a reporting issuer?*
- *a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?*

In our view and as for the MA Exemption, the AI Exemption is premised on the capacity of the investor to analyze the investment decision using its resources, and to make a risk analysis about its ability to withstand financial loss. Most investors relying on this exemption will do their own due diligence and obtain information about the investment and the issuer prior to completing an investment. We suggest that sophistication is an investment analysis process that can come about either through the investor's past experience or the use of personal and trusted advisors. In itself "sophistication" should not be a prerequisite for use of this exemption. It would be very restrictive to define "sophistication" in some manner, or require a certain type of education. Indeed, education does not guarantee sophistication.

We believe that the current income and asset qualification thresholds in the AI Exemption are appropriate qualification criteria for individual investors. We believe that complicating the qualification criteria by introducing alternative qualification criteria would unnecessarily complicate the exemption and result in reduced use. In our practice, we do not experience any issues related to an investor's suitability under the AI Exemption so see no need to change the current qualification basis.

Our answer to this question would not change in any of the circumstances set out above.

If the CSA has concerns about the level of sophistication of the investors using the AI Exemption generally, and their ability to properly evaluate an investment opportunity, we would suggest placing more responsibility on issuers to ensure the accuracy of any materials they provide to investors that may not qualify as offering memoranda or other prospectus-level documents, without regulating the type or content of materials provided to investors under the AI Exemption (for instance, requiring investors to certify in writing that any materials they have provided to the investor are accurate).

Reed Pope LLP

24. *If we changed the qualification criteria, what would the impact be on capital raising?*

Any multi-layer qualification criteria or alternative qualification criteria for individuals would likely result in a decrease in the use of the AI Exemption, since either (a) fewer investors would qualify, or (b) investors would view the exemption requirement as overly complicated and would elect to invest in other markets instead. Since this exemption is frequently used by investors in our market, issuers would therefore lose access to a significant source of capital and investors would lose access to investment opportunities that should be theirs to consider.

25. *Should individuals be able to acquire securities under the AI exemption? Would your answer to this question change depending on whether:*

- *any disclosure is provided to investors, including risk factor disclosure?*
- *the security is novel or complex?*
- *the issuer of the security is a reporting issuer?*
- *a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?*

The AI Exemption should not be closed to individuals. In our practice, we find that this exemption is frequently used by individuals and is a very important source of funding for issuers in our market. It would therefore be counterproductive to restrict individuals from using it and thereby close off an important source of capital to small issuers.

Our answer to this question would not change in any of the above-listed circumstances.

26. *Should an investment limit be imposed on accredited investors who are individuals? If a limit is appropriate, what should the limit be? Would your answer to these questions change depending on whether:*

- *any disclosure is provided to investors, including risk factor disclosure?*
- *the security is novel or complex?*
- *the issuer of the security is a reporting issuer?*
- *a registrant is involved in the distribution who has an obligation to recommend only suitable investments to the purchaser?*

We believe that an investment limit is not appropriate, since the AI Exemption is frequently used by angel investors who invest repeatedly. Limiting the number of times the AI Exemption can be used, or the amount of an individual's overall investment in reliance on the AI Exemption, would be counterproductive in our market as issuers would lose access to significant capital.

Reed Pope LLP

27. *If investment limitations for individuals were imposed, what would the impact be on capital raising?*

The AI Exemption is very commonly used in our region, and is often used by investors who are individuals. Limiting the number of times the AI Exemption can be used, or the amount of the overall investment under this exemption, would be counterproductive in our market as issuers would lose access to significant capital and investors would direct their funds into other markets such as the USA.

28. *Should this be considered in a review of the AI exemption?*

We have not experienced any issues concerning investor compliance with qualification criteria, and do not believe that it is necessary to introduce third-party certification of accredited investor status.

29. *Do you agree with imposing such a requirement?*

We do not believe it is necessary to impose such a requirement.

30. *Are there alternatives that we should consider?*

There are no alternatives that come to mind.

31. *Are there other options we should consider for revising the AI exemption or for substituting an alternative exemption?*

Our clients use the AI Exemption frequently and with success. We believe that the AI Exemption in general works well in its current form and is well understood and implemented by both investors and issuers. We do not recommend any significant changes or substitutions to it at this time.

Please contact us if you have any questions about our comments or wish to discuss any of the above points with us. Thank you for your consideration.

Yours truly,

REED POPE LLP



R. KEITH REED



JENNIFER MACGREGOR-GREER

Reed Pope LLP

**SCHEDULE "A"**

**SECURITIES REGULATORS**

Alberta Securities Commission  
Saskatchewan Financial Services Commission  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
New Brunswick Securities Commission  
Superintendent of Securities, Prince Edward Island  
Nova Scotia Securities Commission  
Securities Commission of Newfoundland and Labrador  
Superintendent of Securities, Northwest Territories  
Superintendent of Securities, Yukon Territory  
Superintendent of Securities, Nunavut