OSC praised for crowdfunding policy

But investor rights group worries monetary limits are 'quite high'

BY MICHAEL McKIERNAN
For Law Times

Equity crowdfunding looks set to land in the province with the Ontario Securities Commission soliciting responses on a policy that would open up the online securities market to the general investing public.

The regulator's proposed policy, released March 20, would allow small- and medium-sized enterprises to raise up to $1.5 million per year from retail investors through accredited online portals without going through the expensive procedure of issuing a prospectus. Interested parties have until June 18 to comment on the proposal.

Brian Koscak, chairman of the Private Capital Markets Association of Canada and co-founder of the recently formed Equity Crowdfunding Alliance of Canada, says the prospectus exemption will help ease the "capital-raising crisis" facing Canadian companies, particularly smaller ones without the resources to meet the regulatory burdens associated with traditional means of fundraising.

"It's really exciting to see the OSC so engaged," says Koscak, who's also a partner in the Toronto office of Cassels Brock and Blackwell LLP.

"They have devoted significant resources to this, and it's wonderful to have a regulator that is really listening and trying to help. The more tools we can give companies to raise capital, the better, in my view. . . . If we don't get this right, our best and brightest are going to flock south to jurisdictions where they can raise capital."

Unlike donation crowdfunding platforms such as Kickstarter where users can receive products such as games, music or films in return for their financial contributions, their equity crowdfunding cousins allow individual investors to secure an ownership stake in a business in return for cash.

Online investing is currently available to a select few under the OSC's existing accredited-investor exemption for those who can meet a financial income or assets test. However, less than four per cent of Canadians can meet that test as it requires an annual income over $200,000 or financial assets worth more than $1 million. The OSC's policy would open the market up to anyone with an individual investment cap of $2,500 per campaign and $10,000 per year. Investors must also sign a risk acknowledgment confirming they understand they could lose their entire investment.

By combining securities law and social media, Koscak says equity crowdfunding could become a fun source of "infotainment" for retail investors.

But Marian Passmore, the director of policy at the Canadian Foundation for Advancement of Investor Rights, isn't so sure equity crowdfunding will prove a source of much amusement. The organization, a chief critic of equity crowdfunding, has shifted its focus in light of the OSC's approach.

"Overall, we're still opposed, but recognizing that it looks likely to go forward, we're making suggestions we think will help make it less harmful," she says. "We don't think there's enough in the policy to protect investors from harm and we don't think it's going to lead to the economic benefits or market efficiencies its proponents argue it will."

Passmore says the investor limits are "arbitrary and quite high" when viewed in the context of the median RRSP contribution by Canadians at about $3,000 per year.

"And that's for something that is a relatively safe investment and will likely earn a return, rather than equity crowdfunding, which can be much higher risk. It's unlikely to lead to any return, and in fact, you're quite likely to lose your entire investment even if there is no fraud," she says.

While Passmore concedes access to capital is a "real concern" in the economy, she says many retail investors lack the understanding required to make an informed choice about risky investments. People are likely to view signing an acknowledgment more as a formality than a serious caution, she says.

"They're likely to do more to protect sellers than warn investors. Through litigation in other cases, we see investors who don't remember signing this kind of acknowledgment. And if they did, they didn't pay much attention to it. We think that's highly problematic."

Ren Bucholz, a commercial litigator with Lenczner Slaght Royce Smith Griffin LLP, says the OSC's proposed policy is a "great place to start" but warns the regulator to move slowly with its implementation.

"It's important that there is a study period because there are still a number of unknowns in this system, including whether the portals are going to be able to effectively vet the companies that use its services," he says.

While the proposed policy is a 'great place to start,' the OSC should move slowly with its implementation, says Ren Bucholz.

Koscak has his own concerns about the OSC proposal as he feels it could have gone further while maintaining investor protection. He says the limits are actually too small for some people and may make it difficult for companies to hit the maximum fundraising target of $1.5 million. To raise that amount would require at least 600 investors making the maximum allowed individual pledge.

"That's a hard number to get to," says Koscak, who would rather have seen investment caps set on an individual basis according to a percentage of income. "I understand that a flat amount is more convenient for regulators, but it does not reflect what's necessarily best for investors."

He was also disappointed to see the OSC exclude real estate issuers from the crowdfunding exemption.

"To completely prohibit capital raising for this asset class, I would submit doesn't make sense because it treats real estate as a class that does not promote jobs or provide stimulus to the economy," says Koscak.

"One of the hottest areas of crowdfunding in the U.S. right now is real estate."

Overall, though, Koscak says the crowdfunding policy, in tandem with another proposed prospectus exemption unveiled the same day for offering memorandums, will help fill the "prospectus gap" that he says has held back fundraising in Ontario.

The offering memorandum exemption creates what Koscak calls a "baby" accredited investor as it allows individuals to put in up to $30,000 as long as they have a net income over $75,000 per year and $400,000 in assets. The policy would place no limit on the amount an issuer can raise.

"It's going to really move the meter because right now we have nothing between the private investor exemption and the accredited investor exemption," he says. "We're looking at a whole new ecosystem with a gentle, graduated upward slope of capital raising instead of the big jump we have now." LT

Descriptive names valuable

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According to Miller, highly descriptive domain names, such as the ones at issue in this case, can be even more valuable to a business than any trademarks it has registered.

"When people search a descriptive term online and it happens to be the same as a domain name, you're going to get a lot of hits," he says.

"It's difficult to get a trademark that is clearly descriptive because it's not allowed unless it has acquired a secondary meaning."

Miller says the decision could also help business owners conceal the true ownership of particular domain names by taking advantage of the property law concept of equitable interest.

"If you don't want people to know who owns the domain name, you can have someone on title as the registered owner but the equitable interest is unknown," he says. LT