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**RE: Multilateral CSA Notice 45-311 Exemptions from Certain Financial Statement-Related Requirements in the Offering Memorandum Exemption to Facilitate Access to Capital by Small Businesses**

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FAIR Canada is pleased to offer comments on Multilateral CSA Notice 45-311 (the “**Notice**”) issued by the securities regulatory authorities in Yukon, Alberta, Saskatchewan, Northwest Territories, Nunavut, Manitoba, Québec, Nova Scotia, New Brunswick, Prince Edward Island and Newfoundland and Labrador (the “**Participating Jurisdictions**”) regarding the publication of harmonized interim local orders that provide exemptions from certain requirements of Form 45-106F2 *Offering memorandum for non-qualifying issuers*.

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit [www.faircanada.ca](http://www.faircanada.ca) for more information.

**Executive Summary**

1. FAIR Canada is concerned that the offering memorandum- (“**OM**”) form exemption orders issued, and to be issued, in conjunction with the Notice further impair investor protection in the exempt market in the Participating Jurisdictions.

2. FAIR Canada does not believe that, absent the provision of audited financial statements, investors would have the requisite information to make an informed investment decision.
3. We recommend that the OM-form exemption orders be revoked and that a more critical review be undertaken by the Participating Jurisdictions (and British Columbia) regarding the level of investor protection afforded under the OM exemption, particularly in light of the serious compliance issues observed.
4. The Notice does not appear to contemplate any need to draw the absence of these protections to investors' attention where the OM-form exemption is relied upon. At an absolute minimum, the absence of audited financial statements and preparation without use of Canadian GAAP/IFRS should be drawn to the attention of potential investors.
5. FAIR Canada questions assertions by early stage businesses and SMEs that the cost of preparing audited financial statements is prohibitively expensive for capital-raising. The Notice does not provide any dollar figures with respect to the average or mean cost of obtaining an audit on financial statements or other financial information for early stage businesses and SMEs, nor does it compare this with the overall cost of raising capital through an otherwise-compliant OM exemption-reliant distribution.
6. Numerous CSA-member notices and reviews indicate a high level of non-compliance with the OM exemption. In light of the volume and seriousness of compliance issues related to the OM exemption, FAIR Canada questions why members of the CSA would prioritize an initiative to lessen disclosure to investors.
7. FAIR Canada recommends that the CSA prioritize the undertaking of empirical research to determine the incidence of fraud, misrepresentation and resulting losses suffered by investors as a result of investing in securities through purported reliance upon the OM exemption.

## **FAIR Canada Comments**

### OM-Form Exemption Orders

- 1.1. FAIR Canada is concerned that the offering memorandum- ("**OM**") form exemption orders issued, and to be issued, in conjunction with the Notice further impair investor protection in the exempt market in the Participating Jurisdictions.
- 1.2. The Participating Jurisdictions have issued, or intend to issue, OM-form exemption orders that will permit certain issuers relying on the OM exemption further exemption from:
  - (i) the requirement to obtain an audit on financial statements or other financial information, and
  - (ii) the requirement for financial statements to be prepared using Canadian GAAP applicable to publically accountable enterprises (IFRS).

- 1.3. In the Participating Jurisdictions, issuers can rely on the OM-form exemption orders subject to certain conditions, including the following:
- (i) the issuer is not a reporting issuer, investment fund, mortgage investment entity or an issuer engaged in the real estate business;
  - (ii) the issuer is not distributing complex securities;
  - (iii) the amount raised by an issuer group (the issuer and certain related issuers) under the OM-form exemption orders must never exceed \$500,000; and
  - (iv) the aggregate acquisition cost of all securities distributed under the OM-form exemption orders by an issuer group to a purchaser in a distribution and in the 12 months preceding the date of such a distribution, must not exceed \$2,000.

#### Reduced Investor Protection

- 1.4. Investors use audited financial statement disclosure to decide whether or not to invest in particular securities. Financial statement disclosure is intended to encourage more efficient management and to discourage fraud. Financial statement disclosure theoretically works by creating a “level playing field”, where all investors have access to the same information. Auditors serve a fundamental purpose and fill an important role in promoting confidence and trust in certain financial information in financial statements. Auditors are intended to ensure independence, impartiality and expertise; audits enable shareholders to oversee management.
- 1.5. As noted in Canadian Securities Administrators- (“CSA”) issued guidance for preparing and filing an OM, “[w]hile an OM is generally not required to contain the level of detail and extent of disclosure required by a prospectus, it must provide a prospective purchaser with sufficient information to make an informed investment decision”<sup>1</sup>.
- 1.6. FAIR Canada does not believe that, absent the provision of audited financial statements, investors would have the requisite information to make an informed investment decision, regardless of the additional conditions imposed under the OM-form exemption orders (as outlined in section 1.3).
- 1.7. We recommend that the OM-form exemption orders be revoked and that a more critical review be undertaken by the Participating Jurisdictions (and British Columbia) regarding the level of investor protection afforded under the OM exemption, particularly in light of the serious compliance issues observed.
- 1.8. Furthermore, we question the implications of permitting certification of the entire OM without the completion of an audit of financial statements and where financial statements are not prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises

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<sup>1</sup> Multilateral CSA Staff Notice 45-309 *Guidance for Preparing and Filing an Offering Memorandum* under National Instrument 45-106 *Prospectus and Registration Exemptions* (April 26, 2012), available online: <[http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/4/45-309/4178361-v1-Multilateral\\_CSA\\_Staff\\_Notice\\_45-309.pdf](http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/4/45-309/4178361-v1-Multilateral_CSA_Staff_Notice_45-309.pdf)>, at page 4.

(IFRS). Issuance of the OM-form exemption orders that allow issuers to be exempt from such requirements removes the accepted standards for preparing financial statements. What will signatories be certifying with respect to the financial statements absent these requirements?

- 1.9. Additionally, the Notice does not appear to contemplate any need to draw the absence of these protections to investors' attention where the OM-form exemption is relied upon. While we are sceptical of the efficacy of standard form disclosure, at an absolute minimum the absence of audited financial statements completed in accordance with GAAP/IFRS, which are otherwise required to be provided but have been exempted in the circumstances, should be stressed to potential investors to make them aware of the implications of unaudited, non-GAAP/IFRS conformant financial statements.

#### No Evidence of Costliness Provided

- 1.10. FAIR Canada questions assertions by early stage businesses and SMEs that the cost of preparing audited financial statements is prohibitively expensive for capital-raising. The implication in the Notice is that this is what makes the OM exemption too costly for early stage businesses and SMEs to use. The Notice does not provide any dollar figures with respect to the average or mean cost of obtaining an audit on financial statements or other financial information for early stage businesses and SMEs, nor does it compare this with the overall cost of raising capital through an otherwise-compliant OM exemption-reliant distribution.
- 1.11. We question whether the preparation of audited financial statements makes up a significant portion of the costs of raising capital through fully compliant reliance upon the OM exemption in the absence of any evidence provided.
- 1.12. Furthermore, requirements under provincial and federal business corporations acts and provincial securities acts require corporations to appoint an auditor to hold office, impose duties upon such auditors, and require the preparation of annual financial statements. FAIR Canada is concerned that the exemptions provided under the OM-form exemption orders may run contrary to these statutory requirements. Further, there is the potential for the OM-form exemption orders to cause confusion about the requirements for early stage businesses and SMEs to prepare the requisite financial statements.

#### More General Concerns about the OM Exemption

- 1.13. Numerous CSA-member notices and reviews indicate a high level of non-compliance with the OM exemption. For example, Saskatchewan's Financial Services Commission Securities Division's (now the Financial and Consumer Affairs Authority, the "**Saskatchewan Authority**") Staff Notice 45-704 noted that during its detailed review of non-qualifying issuers' OMs, "[s]taff identified **material disclosure deficiencies in all of the OMs reviewed**. In general, **the OMs were poorly prepared and did not provide the disclosure required.**"<sup>2</sup> [emphasis added]

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<sup>2</sup> Saskatchewan Financial Services Commission Securities Division Staff Notice 45-704 Review of Offering Memorandums under NI 45-106 *Prospectus and Registration Exemptions* (last amended March 7, 2011) at page 2.

- 1.14. The Saskatchewan Authority also found considerable non-compliance with financial statement requirements, including non-provision of financial statements in the OM.<sup>3</sup> Further, the Saskatchewan Authority identified significant investors rights issues in its notice.
- 1.15. The CSA has also issued a staff notice outlining common deficiencies, including: failing to file a copy of the OM with the relevant securities regulator or filing late; making distributions using a stale-dated OM; using an incorrect form of update; failing to include sufficient information to enable investors to make an informed investment decision; inadequate disclosure about the issuer's business (particularly new entities); failing to provide balanced disclosure; inadequate disclosure of available funds and use of available funds; inappropriate reallocation of available funds; omission of key terms of material agreements; omission of compensation disclosure; inadequate disclosure of management experience; dissemination of material forward-looking information not included in the OM; omission of required interim financial reports; omission of key elements of financial statements; failure to obtain required audits; omission of required audit reports or including non-compliant audit reports; inappropriate use of a Notice to Reader cautioning that financial statements may not be appropriate for their purposes; failure to prepare financial statements in accordance with appropriate accounting principles; and improper certification of the OM.<sup>4</sup>
- 1.16. In light of the volume and seriousness of compliance issues related to the OM exemption, FAIR Canada questions why members of the CSA would prioritize an initiative to lessen disclosure to investors. In our view, it would be more appropriate to examine whether the current requirements and compliance therewith ensure an acceptable level of protection to investors.
- 1.17. In particular, FAIR Canada recommends that the CSA prioritize the undertaking of empirical research to determine the incidence of fraud, misrepresentation and resulting losses suffered by investors as a result of investing in securities through purported reliance upon the OM exemption. FAIR Canada notes that no such empirical data is currently available despite the serious compliance deficiencies noted above.
- 1.18. In light of the serious deficiencies highlighted with respect to the provision of financial reports, omission of key elements of financial statements, and failure to obtain audits as required, we do not believe that the exemptions proposed in the Notice are an appropriate regulatory response. Such a response could suggest that acts of refusal or ignorance of the current requirements could be persuasive in making a case for regulatory change (in lowering the bar even further). It could be viewed as a reward for non-compliance.
- 1.19. FAIR Canada has concerns regarding the OM exemption more broadly. We intend to outline these concerns in our comments in response to the OSC's Staff Consultation Paper 45-710 *Considerations for New Capital Raising Prospectus Exemptions*.

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<sup>3</sup> Staff Notice 45-704 at page 5.

<sup>4</sup> Multilateral CSA Staff Notice 45-309 *Guidance for Preparing and Filing an Offering Memorandum* under National Instrument 45-106 *Prospectus and Registration Exemptions* at pages 2 – 11.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Lindsay Speed at 416-214-3442 (lindsay.speed@faircanada.ca).

Sincerely,



Canadian Foundation for Advancement of Investor Rights

To be forwarded to:

Alberta Securities Commission  
Financial and Consumer Affairs Authority of Saskatchewan  
Manitoba Securities Commission  
Autorité des marchés financiers  
Nova Scotia Securities Commission  
New Brunswick Securities Commission  
Newfoundland Securities Commission  
Prince Edward Island Securities Office  
Department of Community Services, Government of Yukon  
Office of the Superintendent of Securities, Government of the Northwest Territories  
Legal Registries Division, Department of Justice, Government of Nunavut

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