



Canadian Foundation *for*  
Advancement *of* Investor Rights

January 20, 2014

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**RE: Multilateral CSA Notice 45-312: Proposed Prospectus Exemption for Distributions to Existing Security Holders**

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FAIR Canada is pleased to offer comments to British Columbia, Alberta, Saskatchewan, Manitoba, Quebec, New Brunswick, Nova Scotia, Prince Edward Island, Yukon, Northwest Territories and Nunavut (the “Participating Jurisdictions”) regarding their proposed prospectus exemption that would allow issuers listed on the TSX Venture Exchange (“TSXV”) to raise money by distributing securities to their existing security holders.

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 Supports Refining Regulation to Improve Capital Formation by Venture Issuers**
  - 1.1 FAIR Canada supports regulatory efforts to improve the ability of issuers to raise capital in a cost efficient manner that, at the same time, provides adequate protection to investors. FAIR Canada supports allowing TSXV-listed issuers to raise money by distributing securities to their existing security holders provided shareholders are given adequate notice and

disclosure, time to consider the offering and ability to participate in the offering. Further the rules should include protections to avoid abuse including making offerings on a pro-rata basis consistent with investors' existing shareholdings.

- 1.2 **FAIR Canada recommends that securities regulators and other interested stakeholders examine why certain prospectus exemptions such as rights offerings are commonly used in other jurisdictions such as the United Kingdom, Hong Kong, and Australia whilst they are rarely used in the various jurisdictions in Canada.** We recommend that any such findings be made public. Such information may inform the modification of existing prospectus exemptions so that issuers will use them to raise capital, in a manner which will increase market efficiency and provide adequate investor protection.
- 1.3 FAIR Canada would have liked to have seen a more fulsome analysis of the issues in the Notice, including providing further details of the key features of this exemption currently in use in other jurisdictions (such as Australia) along with available information on the amount of capital raised in other jurisdictions through the exemption, and the percentage of total capital raised using the exemption as compared to other prospectus exemptions (if available).

## 2. Key Components Needed in the Proposed Exemption

- 2.1 Below we summarize the key components of the proposed exemption and highlight in italics the additional key components that FAIR Canada recommends the Participating Jurisdictions adopt, in order to prevent abuse by market players at the expense of investors and thus provide adequate investor protection:
- the issuer must have a class of equity securities listed on the TSXV;
  - the issuer must have filed all timely and periodic disclosure documents as required under applicable securities laws;
  - the offering can consist only of the class of equity securities listed on the TSXV or units consisting of the listed security and a warrant to acquire the listed security;
  - the issuer must issue a news release disclosing the proposed offering, including details of the use of proceeds;
  - each investor must confirm in writing to the issuer that as at the "record date" the investor held the type of listed security that the investor is acquiring under the proposed exemption;
  - *the investor can purchase additional shares consistent with their existing shareholdings. (For example, if an investor holds 10,000 shares, they can purchase up to an additional 10,000 shares (instead of an arbitrary \$15,000 limit absent advice regarding the suitability of the investment or no limit is advice as to suitability is provided). The limit should be based on shareholders holdings on the "record date";*
  - *the "record date" should be 30 days prior to the date of the announcement to prevent potential abuse by market participants;*

- *the private placement rules of the TSXV should be made an integral part of the proposed exemption so as to be enforceable by the regulators in the Participating Jurisdictions, including an aggregate limit on the amount raised to no more than 25% of the number of the existing outstanding securities of the class to be issued in any twelve month period;*
- *limits should be placed on the amount to which insiders can subscribe to their pro-rata amount where the offering is oversubscribed and public shareholders are subscribing for the balance of the offering. For example, if insiders own 10% of the outstanding shares, they should only be able to subscribe for up to 10% of the offering where the offering is oversubscribed, so as to allow all existing shareholders to have equal and fair access to the offering and to prevent abuses of the exemption;*
- *the announcement should disclose the holdings of insiders and whether the insiders intend to subscribe for the offering in full or in part. Insiders should not be permitted to subscribe for the offering unless they have disclosed an intention to subscribe in the announcement.*
- an investor should be provided with certain rights of action in the event of a misrepresentation in the issuer's continuous disclosure record and although an offering document is not required, if an issuer voluntarily provides one, an investor will have certain rights of action in the event of a misrepresentation in it;
- a standard four month hold period will be imposed on securities issued under the proposed exemption; and
- issuers must file a report of exemption distribution within 10 days after each distribution.

### **3. FAIR Canada Responds to Certain Questions Posed in the Request for Comments**

#### ***(2) Should the proposed exemption be available to issuers listed on other Canadian markets?***

The proposed exemption should be limited at present to TSXV issuers as it is small and medium sized issuers that have been identified as having the greatest need to access capital and the greatest difficulty raising it. Larger issuers tend to have a much larger shareholder base and number of institutional shareholders who qualify as accredited investors, making it easier to access existing exemptions such as private placements to accredited investors. Another reason for the difficulty may be the small size of most TSXV issuers and the proportionately smaller size of potential offerings which make them less attractive to the larger investment dealers.

In addition, since the proposed exemption is new and experimental, it makes sense to monitor its usefulness to issuers, its take up by investors and whether it provides adequate investor protection and adequate controls to prevent abuses before broadening its scope further.

**(3) Investors will only be able to invest \$15,000 in a 12-month period unless they obtain advice from a registered investment dealer. Is \$15,000 the right investment limit?**

A \$15,000 limit is an arbitrary amount which will be too low for many retail investors and too high for others. As an alternative to an arbitrary amount, FAIR Canada recommends that the amount allowed to be invested through the proposed exemption should be based on current holdings and on a pro-rata basis which may help ensure that the investor has the wherewithal to make the investment but more importantly, will help protect investors from potential manipulation by less scrupulous actors who want to take advantage. For example, friends and associates of insiders of the issuer could purchase very small shareholdings in the issuer prior to the offering and then proceed to obtain large shareholdings as part of the offering (at a discount to the current market value) which would not be fair to the existing shareholders. Or, promoters of the issuer could convince unsophisticated investors to buy a small number of securities on or just before the record date, in order to sell to each of the retail investors an unsuitable number of securities in a speculative issuer. The opportunity for such manipulative schemes will be reduced through basing the maximum number of shares that may be subscribed for on the holdings of the shareholder on the record date and through requiring a pro-rata take up of the offering through the use of the exemption. This is also consistent with the approach in rights offerings which are generally considered the fairest way to make offerings to existing shareholders.

Given that investing in TSXV-listed issuers is high risk, FAIR Canada recommends that investors be warned that increasing their shareholdings results in increasing their exposure to high-risk investments and that they should consider whether, in light of their portfolio of holdings, it is appropriate to do so or not.

Should the investor wish to utilize the services of a registered investment dealer, the registrant in fulfilling their “know-your-product” and “know-your-client” obligations would determine whether the investment would be suitable given the individual’s personal financial circumstances, investment objectives, time horizon and risk tolerance level, and existing portfolio holdings. FAIR Canada has provided comments to the CSA as to why a statutory best interest standard would be both feasible and desirable to implement and stresses that having such a standard would help to ensure that the investment dealer’s recommendation as to whether to purchase the security is in the client’s best interest.

**(4) In what circumstances would it be suitable for an investor that is a retail security holder to invest more than \$15,000 in a TSXV issuer?**

See answer to question 3 above.

**(5) Do you agree that there should be no investment limit if an investor receives suitability advice from a registered investment dealer?**

See answer to question 3 above.

**(6) Do you agree that being a current security holder of an issuer enables an investor to make a more informed investment decision in that issuer?**

FAIR Canada's understanding is that most shareholders of TSXV issuers are at least aware that such investments are high risk, or they may be sophisticated investors. However, it may also be the case that some retail investors purchase the securities of TSXV-listed issuers anticipating large investment returns, without being fully aware of the risks of doing so. Therefore, being a current security holder of an issuer may mean that the investor will have made an informed decision by considering available information about the issuer or have engaged an investment adviser to do so but it certainly is no guarantee that this is the case. Thus, it is particularly important for venture issuers that their continuous disclosure obligations be met so that retail investors have as much information as possible in order to make more informed investment decision, for the announcement of the offering to include the most up to date information and for the notice to investors to clearly state that such investments are speculative and high risk and the investor should consider whether purchasing additional shareholdings in the TSXV-listed issuer would be suitable for them, given their portfolio of investments (as some investors will have purchased the securities through a discount brokerage rather than through an investment dealer with "know-your-product" and "know-your-client" obligations).

***(7) What is the appropriate record date for the exemption?***

FAIR Canada recommends that the record date be thirty days prior to the announcement of the offering so as to prevent any gaming of the system, in particular by persons close to the issuer who may have access to information about the proposed offering. This, when coupled with distribution on a pro-rata basis, should reduce the potential for abuse and would be more effective at providing investor protection.

***(8) We are currently proposing that the exemption be subject to the same resale restrictions as most other capital raising exemptions (i.e., a four month restricted period). However, there are some similarities between the proposed exemption and the rights offering exemption, which is only subject to a seasoning period.***

***a) Do you agree that a four month hold period is appropriate for this exemption.***

Yes, as a four month hold period will be helpful to ensure that investors are purchasing as principal. In any event, investors who are existing shareholders would be free to trade their securities of the issuer held on the record date during the four month hold period for the newly issued securities.

***b) Should we require issuers to provide additional continuous disclosure, such as an annual information form?***

FAIR Canada supports the proposed requirement for an issuer to certify to investors in the subscription agreement that there are no material facts or material changes relating to the issuer that have not been generally disclosed and the statutory or contractual right of action in the event of a misrepresentation in an issuer's continuous disclosure documents. The announcement should disclose the holdings of insiders and whether insiders intend to subscribe for the offering in whole or in part. Insiders

should only be permitted to subscribe where they have disclosed an intention to do so in the announcement. Provided our proposed enhanced requirements are adopted, we do not think that an annual information form is necessarily required in addition to these requirements.

- c) *If we were to consider a seasoning period for this exemption, should we consider some of the restrictions that apply under a prospectus-exempt rights offering, such as “claw-backs” limiting insider participation.*

Yes, as noted in section 2 above, FAIR Canada believes that a limit should be set, similar to the rights offering exemption, so that no more than 25% in the amount of outstanding securities of the class to be issued can be offered in any 12 month period. Furthermore, insiders should only be allowed to participate based upon their pro-rata existing shareholdings where public shareholders are willing to subscribe for the securities being offered.

- d) *If securities offered under the exemption were only subject to a seasoning period, would there be a greater need to ensure investors are made aware of and have an opportunity to participate in the offering?*

Existing shareholders should be provided with notice of the offering and given a reasonable opportunity (e.g. five business days) to consider whether to subscribe.

- (9) We have not proposed any conditions regarding the structure of the financing, i.e., minimum or maximum price, maximum dilution, or period in which an offering must be completed. We contemplate that the proposed financing would be conducted under the standard private placement rules of the TSXV which, among other things, allow pricing at a discount to market price. Is this appropriate or are there structural requirements that we should make a condition of the exemption?**

The private placement rules of the TSXV should be made an integral part of the proposed exemption so as to be enforceable by the securities regulators in the Participating Jurisdictions, including: (1) an aggregate limit on the amount raised to no more than 25% of the principal amount of the outstanding securities of the class to be issued in any twelve month period and (2) a limit on price discounts based on the TSXV rules for private placements. The equivalent of the private placement rules of the TSXV should be included in the rule or exemption order and compliance should be a condition of the exemption.

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 Ermanno Pascutto at 416-214-3443 ([ermanno.pascutto@faircanada.ca](mailto:ermanno.pascutto@faircanada.ca)) or Marian Passmore at 416-214-3441 ([marian.passmore@faircanada.ca](mailto:marian.passmore@faircanada.ca)).

Sincerely,

A handwritten signature in blue ink, appearing to read "E. Fortin".

Canadian Foundation for Advancement of Investor Rights