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Fondation canadienne *pour* l'avancement *des* droits *des* investisseurs

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British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Service NL
Northwest Territories Office of the Superintendent of Securities
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Nunavut

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CSA Notice and Request for Comment Proposed Amendments to National Instrument 45-106 Prospectus Exemptions to introduce the Listed Issuer Financing Exemption

FAIR Canada is pleased to provide our comments and recommendations on the proposal to introduce a Listed Issuer Financing Exemption (the Proposal or Proposed Exemption).

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FAIR Canada is a national, independent charitable organization dedicated to being a catalyst for advancing investor' rights in Canada. As a voice of the Canadian investor and financial consumer, FAIR Canada promotes its mission through outreach and education on public policy issues, policy submissions to governments and regulators, and proactive identification of emerging issues.[1]

FAIR Canada supports efforts to promote vibrant capital markets as a general principle, including facilitating capital raising for reporting issuers. In our view, a system that provides for the efficient allocation of capital towards productive enterprises is an objective all market participants share.

The challenge, as always, is to ensure that efforts to streamline capital raising processes for issuers also appropriately balances the needs of investors, including providing proportionate and reasonable investor protections. As drafted, the Proposed Exemption does not strike the appropriate balance. Moreover, we believe it exposes investors, particularly retail investors, to significant and unacceptable risks.

Is Reliance on Continuous Disclosure Justified?

Like most other prospectus exemptions, the Proposal is designed to relieve issuers, particularly smaller and less resourced issuers in this case, from the burden of complying with needed and well accepted investor protection safeguards when securities are distributed to the public.

However, unlike most other prospectus exemptions, the Proposal does not include the typical conditions that act as guardrails to protect investors in the absence of a prospectus. For example, there is no limit on who can purchase under the Proposed Exemption; no limit on how much they can purchase; there is no requirement that additional information be delivered to the investor; that the investor sign a risk acknowledgment declaration; or any other measure designed to act as a proxy for gauging suitability (or at least the ability to withstand the loss of the entire investment).

Rather, the Proposed Exemption relies chiefly on one, and only one, guardrail – that is the issuer has an up-to-date continuous disclosure (CD) record.

This one guardrail is buttressed by requiring the issuer to certify that its CD record contains all material facts about the issuer and the securities being distributed, and that the record does not contain a misrepresentation. To further buttress this requirement, the Proposed

[1] Visit www.-faircanada.ca for more information.

Exemption adds a watered-down measure of potential accountability by defining the offering document[2] as a "core document" for purposes of secondary market liability.

In our view, the fundamental problem with the Proposed Exemption is it assumes the CD record is indeed comprehensive and robust. But who is reviewing the CD record to ensure this is indeed the case? Are regulators currently reviewing all CD filings, particularly of smaller issuers, to warrant this degree of reliance? Alternatively, is every CSA member undertaking the same level of review to instill confidence that investors in one jurisdiction can rely on the CD record of an issuer reporting in another CSA jurisdiction?

We suspect that very few issuers ever get a full review of their CD record or even a partial review. So how is this degree of reliance justified?

It appears to be justified on the basis that investors could always sue the issuer for a misrepresentation.[3] The threat of a lawsuit then, serves as the ultimate check to protect investors. But even here, the Proposal falls short and exposes investors to significant risks.

As proposed, investors could only sue under the civil liability regime for a misrepresentation in secondary market disclosure. While the regime removes the need to prove reliance, it places significant caps on the amounts that the investors can be awarded in damages. This is because it was designed for a different purpose and with significantly different considerations in mind than the liability standard for prospectuses. In short, unlike other situations where the investor could sue the issuer to have their entire investment returned, the Proposed Exemption provides a significantly reduced opportunity for compensation.

We fail to understand why the CSA believe it is appropriate to limit the exposure of an issuer for a misrepresentation under the Proposed Exemption. By limiting the amount that investors can recover in such situations, the CSA in essence, is transferring part of the risk for a misrepresentation to investors. In other words, the issuer gets the benefit of every dollar received under the exempt distribution, but the investor is limited in the amount they can get back from the issuer.

This strikes us as patently unfair and unreasonable. Given the significant information asymmetry between the issuer and investors, investors already take on significantly more risks when buying securities directly from the issuer. They should not then have to also, in effect, subsidize the issuer for the risk there is a misrepresentation in that issuer's disclosure.

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[2] Proposed Form 45-106F* Listed Issuer Financing Exemption Offering Document.

[3] There is also the risk that the regulator will take enforcement action against the issuer. However, this avenue is initiated at the discretion of the regulator, not the investor. In addition, very few regulators currently have the power to order compensation to harmed investors, let alone restitution. So, while the threat of enforcement action exists, it does little to compensate the investor that has already been harmed.

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In this respect, we note that the Modernization Task Force (Ontario) appreciated the need to attach prospectus level liability to address this concern. We believe the Task Force got it right when it comes to the liability standard.

Other concerns with the Proposal

In addition to what we consider to be undue reliance on an issuer's CD record as the main guardrail, the Proposed Exemption relies on several other rebuttable assumptions. These include, for example:

- A reporting issuer's CD, updated as it may be, addresses all concerns regarding the information asymmetry between what the issuer knows about its business and what the investor can glean from the CD record.
- Subjecting the issuer to less liability exposure still provides sufficient market discipline to ensure comprehensive disclosure (and, parenthetically, less boilerplate disclosure than what is commonly found in CD filings today).
- All investors, including retail investors, will understand the nature of the risk when purchasing under the Proposed Exemption, as well as any constraints put on their ability to pursue compensation when harmed.

The Proposal also assumes that retail investors will review the CD record and become familiar with the issuer's business and operations. We suspect that most will not. This is not just speculation on our part. According to a research report[4] commissioned by Broadridge Investor Communications Corporation on Canadian retail investors, it found that:

- Few investors are aware of SEDAR (32%) or use it (4% use it once a year and 6% use it more than once a year).

The research also found that:

- Lack of awareness is greater among segments of investors with *lower income, lower wealth, less education, or among older investors*.[5]

In addition, as noted by the OSC in Annex E of the Proposal, there are potentially other very significant risks, including:

[4] The report, entitled "Canada Investor Quantitative Report – Research Findings" (July 2021), was shared with the CSA on September 13, 2021.
[5] Ibid, page 5.

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> … if prospectus distributions are replaced by distributions under the [Proposed] Exemption, there may be a reduction in the quality of the disclosure and there may be a higher likelihood of a misrepresentation. The potential reduction in the quality of disclosure may also affect the investors purchasing in the secondary market, since the disclosure will be filed publicly.

In our view, the departure from the prevailing approach for crafting prospectus exemptions is significant, and it introduces substantial new risks to market integrity, as well as to investor protection. Unfortunately, we believe these risks may undermine confidence in the integrity of our capital markets and, ultimately, could raise the cost of capital for all issuers.

Conclusion

While we applaud the CSA for considering novel ways to ease the burden on smaller issuers and facilitate their ability to raise capital from investors, the Proposed Exemption introduces significant and unacceptable risks to investors that need to be addressed.

We thank the CSA for the opportunity to provide our comments in this submission. We would be pleased to discuss our submission with the CSA should you have questions or require further explanation of our views on these matters. Please contact me at jp.bureaud@faircanada.ca.

Sincerely,

Jean-Paul Bureaud,
Executive Director

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