PUBLICATION

Start-Ups, Smaller Businesses in Ontario, other Provinces to Benefit from New Crowdfunding Rules for Raising Capital

Date: December 01, 2015
Lawyers You Should Know: Patrick Cummins

Original Newsletter(s) this article was published in: Blaneys on Business: December 2015

New securities rules to make it simpler and cheaper for start-ups and smaller businesses to obtain financing by selling equity on internet-based funding portals take effect in Ontario, Quebec, Manitoba, New Brunswick and Nova Scotia on January 25, 2016.

The new rules allow firms to engage in crowdfunding (soliciting capital from large numbers of investors on-line) through portals operated by registered securities dealers and exempt those firms from accompanying the solicitation with an expensive business-describing prospectus.

This new equity crowdfunding regime will have significant implications for Canadian start-ups and small and medium-sized enterprises carrying on business in the five participating provinces. It is established by Multilateral Instrument 45-108, *Crowdfunding,* as ratified and published by those jurisdictions.

Here is a summary of the significant funding opportunities and investor protections in the new regime:

General Overview

- "Crowdfunding" is a term used to describe raising small amounts of money from many people over the internet. The concept is used often by charities, athletes, sports teams, artists and politicians to procure the loyalty of a crowd and rally them financially around a shared cause, product or project. This type of crowdfunding is known as donation-based crowdfunding and has been permitted in Canada, as contributors or donors are not allowed to become

shareholders or equity holders. The new equity crowdfunding regime being introduced in January does not apply to donation-based crowdfunding;
- Until the introduction of the new crowdfunding regime, crowdfunding did not involve the issuance of securities. Crowdfunding is now being permitted as a way for businesses, particularly start-ups and small to medium-sized enterprises, to raise capital (up to $1.5 million during a 12-month period) on-line in exchange for equity shares;
- The new regime streamlines the selling of equity shares over the internet;
- Investment limits based on the investor's income and financial resources have been introduced to reduce his or her exposure to a risky investment. When using the crowdfunding prospectus exemption, issuers will only be able to offer non-complex securities. They will also be prohibited from advertising and will be liable for the information they present to investors, and
- The requirement that issuers must distribute their securities through a registered funding portal will fulfill certain gatekeeper functions designed to protect investors. These include reviewing the issuer's disclosure and obtaining background checks on the issuer and its directors, executive officers and promoters.

Crowdfunding Models

The following is a comparison of common crowdfunding models:

	Equity	Donation-Based
How does it work?	Investors purchase equity securities such as common shares. Individuals are able to invest in entrepreneurial start-ups through an intermediary, known as a "funding portal."	Backers donate varying sums of money to support a specific cause or project without expecting a financial return.
What do you get?	Investors receive equity securities from the business. This means they become part owners or shareholders of the company, as they would if they had purchased a share or stock on an established stock market. Investment returns from early-stage and start-up companies are extremely uncertain and the investments are therefore high-risk. For this reason, securities regulators have introduced registered funding portals to fulfill certain gatekeeper	Backers who use this model may receive special mention or thanks. However, the pledge is essentially a donation.

	functions.	

Safeguards

The new equity crowdfunding regime requires that registered funding portals have sufficient proficiency, integrity and solvency (including prescribed capital) to carry out their functions adequately. Competency or proficiency requirements are aimed at ensuring that only qualified persons deal in securities. Integrity requirements refer to the business conduct requirements and are meant to ensure registered people are held accountable to client investors and regulators for securities-related activities. Financial solvency requirements are intended to ensure registered people are financially viable.

The new regime incorporates important investor protection measures, including:

- investors are subject to the following limits:
    1. in the case of an investor that does not qualify as an accredited investor, $2,500 per investment and, in Ontario only, an annual limit of $10,000;
    2. in the case of an accredited investor, $25,000 per investment and, in Ontario only, an annual limit of $50,000, with no investment limits for a permitted client (e.g., an individual with net financial assets exceeding $5 million);
- requirements to provide investors with annual financial statements, annual notice regarding the use of the proceeds raised under the exemption and notice in the event of a discontinuation of the issuer's industry or a change of control of the issuer;
- the requirement for investors to sign a risk acknowledgement form highlighting the key risks associated with the investment and which requires investors to confirm that they have understood the risk warnings and the information in the crowdfunding offering document;
- the requirement that all investments be made through a single registered crowdfunding portal that is unrelated to the issuer;
- the requirement that funding portals fulfill certain gatekeeper responsibilities prior to giving an issuer access to its on-line platform, including reviewing for completeness, accuracy and any misleading statements, the issuer's disclosure in the crowdfunding-offering document and other permitted materials, and
- funding portals must review information and obtain background checks on the issuer and its principals, and deny an issuer access to the funding portal in certain circumstances.

Compliance and Oversight Program

As a broader group of retail investors will be able to access the exempt market through the equity crowdfunding regime, the Ontario Securities Commission is developing a compliance and oversight program to monitor distributions under this new capital-raising tool. This program will have three main elements -- assessing compliance, enhancing awareness and gathering data to support the first two activities.

Conclusion

This article highlights some of the main features of the new equity crowdfunding regime. It is in no way a complete overview or summary. There are a number of specific features of the equity crowdfunding regime that will apply to various market participants. Blaney McMurtry LLP has experience assisting firms and individuals in complying with their obligations under the new equity crowdfunding regime. If you have any questions, please contact Patrick J. Cummins.

Patrick J. Cummins focuses on securities law and acts for clients in connection with public and private offerings. He provides ongoing advice to public and private companies and mutual fund companies and also services public issuers with respect to regulatory compliance, financing issues, shareholder communications and other regulated matters.

Patrick can be reached directly at (416) 593-3928 and pcummins@blaney.com.