

February 29, 2012

BY E-MAIL

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Office of the Attorney General, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

British Columbia Securities Commission PO Box 10142, Pacific Centre 701 West Georgia Street Vancouver, British Columbia V7Y 1L2 <i>Attention:</i> Gordon Smith Senior Counsel <i>E-mail:</i> gsmith@bcsc.bc.ca	Autorité des marchés financiers 800, square Victoria, 22e étage C.P. 246, tour de la Bourse Montréal (Québec) H4Z 1G3 <i>Attention:</i> Anne-Marie Beaudoin Corporate Secretary <i>E-mail:</i> consultation-en-cours@lautorite.qc.ca
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Dear CSA Staff:

Re: CSA Staff Consultation Note 45-401 – Review of the Minimum Amount and Accredited Investor Exemptions – Public Consultations (the Consultation Note)

This submission is made by the Exempt Market Dealers Association of Canada (the **EMDA**) in response to the request for comments published by the Canadian Securities Administrators (**CSA**) on November 11, 2011 in connection with the Consultation Note.

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WHO IS THE EMDA?

The EMDA (previously, the Limited Market Dealers Association of Canada) is a not-for-profit association founded in 2002 to be the national voice of dealers and participants in the exempt market. The EMDA plays a critical role in the national exempt market dealer (**EMD**)

registration regime by:

- assisting its hundreds of member firms/individuals to understand and implement their regulatory responsibilities;
- encouraging the highest standards of business conduct amongst its membership across Canada;
- increasing public and industry awareness of the exempt market and its role;
- being the voice of the exempt market dealers locally and nationally to securities regulators, government agencies, other industry associations and the capital markets;
- providing valuable services and cost-saving opportunities to its member firms and individual dealing representatives; and
- connecting its members across Canada for business and professional networking.

Additional information about the EMDA is located on our website at: www.emdacanada.com.

WHO ARE EXEMPT MARKET DEALERS?

EMDs may act in two primary capacities in the capital markets: (a) as a dealer or underwriter for any securities which are prospectus exempt; or (b) as a dealer for any securities, including investment funds which are prospectus qualified (mutual funds) or prospectus exempt (pooled funds), provided they are sold to clients who qualify for the purchase of exempt securities. The qualification criteria for exempt purchasers and exempt securities are found in National Instrument 45-106 *Prospectus and Registration Exemptions* (**NI 45-106**).

EMDs are fully registered dealers who engage in the business of trading in exempt securities, or any securities to qualified exempt market clients. EMDs are subject to full dealer registration and compliance requirements and are directly regulated by the provincial securities commissions. The regulatory framework for EMDs is set out in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) which applies in every jurisdiction across Canada.

EMDs must satisfy the same "Know Your Client" (**KYC**), "Know Your Product" or (**KYP**) and trade suitability obligations as other registered dealers which are IIROC or MFDA members. NI 31-103 sets out a comprehensive dealer regulatory framework (substantially similar for all categories of dealer, including investment dealers) which requires EMDs to satisfy a number of regulatory obligations including:

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- educational proficiency;
- capital and solvency standards;
- insurance;
- audited financial statements;
- know your client;
- know your product;
- trade suitability;
- compliance policies and procedures;
- books and records;
- client statements;
- trade confirmations;
- disclosure of conflicts of interest and referral arrangements;
- complaint handling;
- dispute resolution;
- maintenance of internal controls and supervision sufficient to manage risks associated with its business;
- prudent business practices requirements;
- registration obligations; and
- submission to CSA oversight and dealer compliance reviews.

EMDs may focus on certain market sectors (*e.g.*, oil and gas, real estate, mining or minerals, technology, venture financing) or may have a broad cross sector business model. EMD clients may be companies, institutional investors, accredited investors, or eligible investors who are qualified to purchase exempt securities pursuant to an offering memorandum.

EMDs provide many valuable services to small, medium and large businesses, investment funds, merchant banks, financiers, entrepreneurs, and individual investors, through their ability to participate in the promotion, distribution and trading of securities, as either a principal or agent.

EMDA CONSULTATION PROCESS

The EMDA has responded to the Consultation Note by undertaking a number of activities and initiatives including the following:

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- preparing and disseminating an EMDA survey in connection with the Consultation Note (the **EMDA Survey**);
- organizing Town Hall meetings in multiple cities: Halifax, Calgary and Vancouver to discuss the Consultation Note;
- meeting with commission staff from the Ontario Securities Commission (**OSC**) in Toronto, the British Columbia Securities Commission (**BCSC**) in Vancouver, the Alberta Securities Commission (**ASC**) in Calgary and the New Brunswick Securities Commission (**NBSC**) and Nova Scotia Securities Commission (**NSSC**) in Halifax; and
- holding two meetings of its Board of Directors to discuss the Consultation Note, the first of which included the participation of OSC commission staff.

Our efforts and the feedback we received reflect our belief that this is a high profile and important issue across Canada and requires a cautious approach by the CSA to ensure the right balance is struck between investor protection and efficient and effective capital markets.

EMDA SURVEY AND OUR RESPONDENTS

As discussed above, the EMDA's consultation process involved undertaking an EMDA Survey which we posted on our website and widely distributed to our members and others. The Survey results were one of several sources of input we received in our consultation process.

A copy of the EMDA Survey results are included at **Schedule "A"**.

Approximately 75% of our 87 survey respondents were either EMDs, investment dealers, or portfolio managers (collectively, a **Registrant**) and almost half of our survey respondents were EMDs.

Of those survey respondents who identified themselves as a Registrant (EMDA Survey – Q.2):

- approximately 84% carry on business in Ontario;
- approximately 70% carry on business in British Columbia;
- approximately 60% carry on business in Alberta; and
- approximately 56% carry on business in Quebec.

The responses to the EMDA Survey will be discussed below in the context of each exemption.

MINIMUM AMOUNT EXEMPTION

EMDA Survey Results

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The results of our EMDA Survey involving the Minimum Amount exemption in s.2.10 of NI 45-106 are discussed below. Generally, our survey respondents do not want the CSA to remove or change the Minimum Amount exemption.

- Approximately 41% of survey respondents indicated they sell using the Minimum Amount exemption (EMDA Survey – Q.12)
- Of those survey respondents who indicated they have sold securities using the Minimum Amount exemption, their total sales in the last two years using this exemption were (EMDA Survey – Q.19a):
 - approximately 41% indicated that it represents between 0% and 25%;
 - approximately 9% indicated that it represents between 26% to 50%;
 - approximately 12% indicated that it represents between 51% to 75%; and
 - approximately 35% indicated that it represents between 76% to 100%.
- Approximately 58% of survey respondents indicated that the Minimum Amount exemption should not be retained in its current form (EMDA Survey – Q.13/Q.14).
 - Approximately 91% indicated that the Minimum Amount exemption should not be changed or decreased.
 - Approximately 54% indicated that the Minimum Amount exemption should be decreased.
 - Approximately 36% indicated that the Minimum Amount exemption should not be changed.
- Approximately 88% of survey respondents indicated that the Minimum Amount exemption should not be limited to institutional investors (*e.g.*, not available to individuals) (EMDA Survey – Q.15).
- Approximately 61% of survey respondents indicated that the \$150,000 minimum amount should be adjusted downward when a registered dealer firm (*e.g.*, EMD), who has an obligation to recommend only suitable investments to investors is involved (EMDA Survey – Q.16).
- Approximately 58% of survey respondents indicated that the \$150,000 minimum amount should be adjusted downward when the issuer of the security is a reporting issuer (EMDA Survey – Q.17).
- Approximately 78% of survey respondents indicated that the \$150,000 minimum amount should not be changed or indexed (EMDA Survey – Q.18).

Criticism and Comments on the Minimum Amount Exemption

Notwithstanding our EMDA Survey results discussed above, the EMDA has also heard a number of criticisms and comments of the Minimum Amount exemption which we discuss below.

The minimum investment of \$150,000 is a poor proxy of investor sophistication. There is simply no right answer on whether the minimum threshold amount is too high or too low - it is a bright-line determination of

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an acceptable minimum investment. The CSA and the SEC have agreed that the size of an investment alone does not assure investor sophistication or access to information. At most, the size of the investment may be an indicator of the investor's ability to withstand financial loss.

Whether the minimum investment threshold of \$150,000 should be indexed to inflation or some other economic indicator is a subjective determination. Obviously, an increase in the minimum amount will make it more difficult to raise capital.

The requirement to satisfy the \$150,000 minimum investment threshold may impact the amount an investor chooses to invest and may in fact concentrate risk exposure and negatively impact certain investors who would have benefitted from smaller and more diversified investments.

How widely the Minimum Amount exemption is used is really only known to the CSA, since the exemption requires a report of trade to be filed with regulators and several decades worth of statistics should be accessible to the CSA.

The Minimum Amount exemption lacks certain investor protection safeguards. For example, the Minimum Amount exemption:

- does not require issuers or investors to engage the services of a registrant which has KYC, KYP requirements and most importantly, a suitability obligation which provides investors with some protection against making inappropriate investments;
- does not require any form of offering document with information about the security and/or the issuer;
- does not require an investor to sign or be provided any risk acknowledgement or disclosure form;
- does not prohibit an investor from obtaining a loan to make an investment of \$150,000 or more;
- does not distinguish between simple versus novel or complex investment products;
- does not distinguish between private issuers and public issuers with exchange-listed securities which have publicly available information on SEDAR and price transparency;
- does not prohibit an investor from making an investment of \$150,000 or more in the event of a sudden windfall like an inheritance; and
- may lead investors into making highly concentrated investments which may be not reflect prudent portfolio construction or diversification.

The CSA could add one or more of the above investor safeguards to the Minimum Amount exemption (*e.g.*, requiring a prescribed form of offering document and/or changing the minimum investment amount); however, any such changes would in effect be making the Minimum Amount exemption more like the existing OM exemption as set out in section 2.9 of NI 45-106. This may not be the preferred approach.

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Any changes to the Minimum Amount exemption will have an impact on how capital is raised particularly in different regions of the country where income levels may differ widely from other regions in Canada.

The EMDA has heard during our consultation process that market participants would prefer to retain the Minimum Amount exemption because it has been in place for a significant period of time and offers simplicity and a straightforward exemption solution in scenarios where other exemptions may be more difficult to apply or demonstrate.

Recommendation 1: Retain the Minimum Amount exemption in its current form.

ACCREDITED INVESTOR EXEMPTION

EMDA Survey Results

Generally, our survey respondents do not want the CSA to remove or change the AI exemption set out in s.2.3 of NI 45-1056. Below are the results of the EMDA Survey in connection with questions we asked about the AI Exemption:

- We asked those Registrants who participated in the EMDA Survey whether they sell to clients using the AI exemption. Approximately 92% of survey respondents indicated they sold using the AI exemption (EMDA Survey – Q.3). When survey respondents were asked that percentage of their sales during the last two years were made using the AI exemption:
 - approximately 36% indicated between 0% and 25%;
 - approximately 11% indicated between 26% to 50%;
 - approximately 5% indicated between 51% to 75%; and
 - approximately 46% indicated between 76% to 100%.
- When survey respondents were asked what percentage of their sales during the last two years using the AI exemption were made to individuals who, either alone or with a spouse, beneficially owns financial assets having an aggregate realizable value that before taxes, but net of any related liabilities, exceeds \$1,000,000 (the **Financial Asset Test**) (EMDA Survey – Q.4a):
 - approximately 32% indicated between 0% and 25%;
 - approximately 9% indicated between 26% to 50%;
 - approximately 30% indicated between 51% to 75%; and

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- approximately 27% indicated between 76% to 100%.
- Approximately 94% of survey respondents indicated that the \$1,000,000 threshold for the Financial Asset Test should be decreased or left unchanged (EMDA Survey – Q.5)
- Approximately 80% of survey respondents indicated that the Financial Asset Test should include real estate other than an investor’s primary residence (*e.g.*, cottage, farm, investment property etc.) (EMDA Survey – Q.6).
- When survey respondents were asked what percentage of their sales during the last two years using the AI exemption were made to an individual whose net income before taxes exceeded \$200,000 in each of the two most recent calendar years (or combined with that of a spouse exceeded \$300,000) and who, in either case, reasonably expects to exceed that net income level in the current calendar year (the **Income Test**) (EMDA Survey – Q.4b):
 - approximately 60% indicated between 0% and 25%;
 - approximately 12% indicated between 26% to 50%;
 - approximately 20% indicated between 51% to 75%; and
 - approximately 7% indicated between 76% to 100%.
- Approximately 94% of survey respondents indicated that the \$200,000 and \$300,000 thresholds for the Income Test should be decreased or left unchanged (EMDA Survey – Q.7).
- Approximately 70% of survey respondents indicated that the Income Test should not be indexed and left unchanged (EMDA Survey – Q.11).
- When survey respondents were asked what percentage of their sales during the last two years when using the AI exemption were made to an individual, who, either alone or with a spouse has net assets of at least \$5,000,000 (the **Net Asset Test**) (EMDA Survey – Q.4c):
 - approximately 83% indicated that it represents between 0% and 25%;
 - approximately 9% indicated that it represents between 26% to 50%;
 - approximately 3% indicated that it represents between 51% to 75%; and
 - approximately 3% indicated that it represents between 76% to 100%.
- When asked whether they agree to lower the threshold amounts in the Financial Asset Test, Income Test and Net Asset Test, if there was a capped or maximum investment amount, approximately 60% of survey respondents said yes (EMDA Survey – Q.8).

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- When survey respondents were asked what percentage of their sales during the last two years when using the AI exemption involved providing an offering memorandum (other than a basic term sheet) to investor (EMDA Survey – Q.9):
 - approximately 35% indicated that it represents between 0% and 25%;
 - approximately 8% indicated that it represents between 26% to 50%;
 - approximately 7% indicated that it represents between 51% to 75%; and
 - approximately 48% indicated that it represents between 76% to 100%.
- When survey respondents were asked what percentage of their sales during the last two years when using the AI exemption involved providing a term sheet only (and not an offering memorandum) to investor (EMDA Survey – Q.10) :
 - approximately 73% indicated between 0% and 25%;
 - approximately 1% indicated between 26% to 50%;
 - approximately 1% indicated between 51% to 75%; and
 - approximately 23% indicated between 76% to 100%.

Criticism and Comments on the AI Exemption

During the EMDA’s consultation process, we heard a number of criticisms and comments about the AI exemption, some of which are discussed below.

For example, establishing net asset and net income thresholds for individual investors to participate in the exempt market is not the best way to manage risk and protect investors. These income and financial thresholds, whether raised, lowered, indexed or otherwise revised are a poor proxy for investor sophistication, risk capacity and ability to absorb loss, or indication of an informed investment decision.

Based on income level criteria, the AI thresholds currently exclude nearly 98% of the working population from eligibility to purchase exempt market products. This simple and significant premise is demonstrated by Statistics Canada figures for 2009, which indicate that only 1.6% of Canadians earned more than \$150,000 in annual income while 17.9% earned more than \$65,000. We believe that raising these thresholds will further restrict investors for whom exempt market products may be suitable, particularly in regions of Canada where income levels are lower than in other regions. We also note that in Ontario where the AI exemption is the primary means of access to the exempt market, raising the income thresholds could further

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limit the opportunities to raise early stage capital in the exempt market and further impair economic activity in the province.

Recommendation 2: The CSA should consider easing restrictions on the exempt market to promote access to capital and financing of small and medium size companies in particular while ensuring satisfactory investor protection safeguards are in place.

There is heightened concern over increasing any AI thresholds in the absence of having any meaningful economic study by the CSA that analyzes the impact on capital formation. For example, in March 2003, the OSC published a document titled *One Step Forward – A Study of the Economic Impact of OSC Rule 45-501 Exempt Distributions*. Although this is a study completed after the coming into force of certain prospectus exemptions, it represents a step in the right direction as it undertakes an economic impact analysis as a foundation for policy change.

Recommendation 3: The CSA should undertake an economic impact study (with input from market participants as to the terms of reference of any such study) before making any changes to the AI exemption (including the Maximum Amount exemption discussed earlier).

The CSA does not regulate investors, yet registrants are left feeling they will be held accountable for mistakes or misrepresentations made by investors. After years of high returns, the new normal of low yields has led investors to accept more risk and seek higher yields and in some cases, misrepresent their financial information in order to participate in the exempt market. This is a particular problem in Ontario where the Offering Memorandum (OM) exemption set out in s.2.9 of NI 45-106 is not available. Misrepresentation of financial information by investors will not be remedied by increasing income and asset thresholds to be an AI, and may even increase misrepresentations by investors.

Market participants have advised the EMDA that they are equally concerned about inadvertently selling to non-AIs. Market participants are aware of expressions of concern by certain CSA members in annual compliance reports and other notices that registrants need to do a better job in determining an accredited investor's status (e.g., OSC Staff Notice 33-735 *Sale of Exempt Securities to Non-Accredited Investors*). However, in the absence of explicit rules on the acceptance of investors as AI's, dealers remain uncertain how they may adequately comply with the rules when their determination depends heavily on information provided to them by the investor. The EMDA has heard a clear desire from market participants for the CSA

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to provide further guidance and more practically, provide prescribed checklists and steps for registrants to rely on when determining if an investor qualifies as an AI.

During the EMDA's consultation process, we canvassed whether market participants would prefer if a third party should be required to certify and/or determine whether an investor satisfied the applicable tests for individuals under the AI exemption. The main concerns raised included the unnecessary burden it would place on market participants and investors, and uncertainty around the frequency of certification/verification (e.g., would it have to be done for every transaction, quarterly, annually, etc.) and whether that would impact the sales cycle and delay timely completion of transactions. A further concern relates to the diminishment of the responsibility of the registrant in an exempt market transaction and whether regulatory oversight would be enhanced by effectively placing the accountability for investor qualification outside the scope of regulators by delegating it to third-parties who are non-registrants.

Recommendation 4: The CSA should provide checklists of what information is expected to be requested and kept on file in order to determine whether an investor qualifies as an AI.

On May 13, 2011, the Ontario Securities Commission (the **OSC**) published OSC Staff Notice 33-735 – *Sale of Exempt Securities to Non-Accredited Investor (OSC Staff Notice 33-735)*. OSC Staff Notice 33-735 provides the OSC's views on, among other things, its interpretation of the financial asset test. The OSC explicitly stated in OSC Staff Notice 33-735 that an investor's personal residence or other real estate is not included in the calculation of the Financial Assets Test. The OSC is concerned that dealers are incorrectly including "other real estate" in the calculation of the Financial Asset Test of an individual alone or with a spouse.

Section 1.1 of NI 45-106 states that "**financial assets**" means: (a) cash; (b) securities, or; (c) a contract of insurance, a deposit or an evidence of a deposit that is not a security for the purposes of securities legislation.

The EMDA has no issue in excluding an investor's principal residence from the Financial Assets Test, however, any other real estate such as a cottage, farmland or other investment property should not necessarily be excluded. As discussed above, approximately 80% of EMDA Survey respondents indicated that the Financial Asset Test should include real estate other than an investor's primary residence (e.g., cottage, farm, investment property etc.) (EMDA Survey – Q.6).

There is also increased concern over excluding other real estate from the Financial Assets Test since baby boomers are retiring and may no longer readily satisfy the Income Tests under the AI exemption, thus further shrinking the pool of available investors.

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There is also a concern that investors have to exclude private securities from the Financial Assets Test. As stated in the third paragraph of s.3.5(1) of the Companion Policy of NI 45-106, the term ‘securities’ assumes such securities are liquid or relatively liquid. We believe this interpretation may prevent experienced private equity investors who invest in private companies from continuing to qualify under the Financial Assets Test. Under the current rules, the more private company securities these investors acquire, the less likely they are to qualify for the Financial Asset Test.

Recommendation 5: The CSA should include other real estate assets (other than an investor’s principal residence) in the Financial Asset Test.

Recommendation 6: The CSA should allow illiquid securities in the Financial Asset Test.

The EMDA has canvassed whether education or experience could form the basis of qualifying as an AI under a new branch of the AI exemption. However, we are uncertain whether this can be accomplished in a manner that is clear and unambiguous and accordingly, we believe that any such criteria should not be prescribed. We note that any person seeking such relief should apply for discretionary exemptive relief from their applicable CSA member.

Recommendation 7: The CSA should permit AI status based on an investor’s educational background, work or investment experience on a discretionary basis and the CSA should indicate the factors it would consider in providing such exemptive relief.

We recognize that no prescribed form of offering document is required to be provided to investors under the AI exemption (obviously unlike the OM exemption).

The EMDA has been advised throughout the consultation process that many market participants like using the AI exemption since no offering document is required, although several of those market participants also noted that they may provide voluntary OMs to clients.

However, there appears to be a lack of understanding of what constitutes an OM. We note that some CSA members do not define the term and those that do have slight differences in their definitions. Moreover, CSA members are of the view that while term sheets are not OMs, anything other than a term sheet is an OM. The result of these differences is a lack of clarity and certainty about the boundaries of the OM requirements and what constitutes a satisfactory OM.

Recommendation 8: The CSA should adopt a national and harmonized definition of an OM and provide guidance on: 1) what is and what is not considered an OM for marketing purposes; and 2) whether certain marketing materials may be exempt from the OM requirement.

In sum, it was quite clear from the EMDA consultation process that market participants wanted to keep the AI exemption but would support certain modification as we have recommended above. We discourage the CSA from making changes to increase the qualifying thresholds for individuals or introducing indexing without the CSA having any economic analysis to support its policy change.

Recommendation 9: The CSA should retain the AI exemption.

ELIGIBLE INVESTOR EXEMPTION - NEW EXEMPTION RECOMMENDED BY THE EMDA

In considering certain deficiencies in the Minimum Amount and AI exemption, the EMDA considered adding various investor protection safeguards in attempting to strike the right balance between investor protection and efficient and effective capital markets. While doing so, we realized the more investor protection safeguards we added and changes we made to these exemptions, the more they started looking like a form of OM exemption. Accordingly, we began to look more closely at the OM exemption even though the focus of the Consultation Note was on the Minimum Amount and AI exemptions

Making the OM Exemption Available in Ontario

The EMDA believes it is more difficult to raise capital in Ontario because the province has not adopted any form of offering memorandum exemption. During the EMDA consultation process, we repeatedly heard from issuers and dealers about decisions to leave Ontario for western Canada to take advantage of the superior capital raising opportunities offered under the offering memorandum. We believe this harms Ontario's capital markets and diverts capital raising to other provinces and territories of Canada and has a deleterious impact on investment options for investors.

The same message was heard in western Canada, eastern Canada and in Ontario: there is a general consensus that Ontario should adopt a form of OM exemption. Market participants realize that in adopting the OM exemption in Ontario, additional investor protection safeguards may be required by Ontario, although a preference for a national and harmonized OM exemption was clearly heard.

With that in mind, the EMDA added questions to the EMDA Survey about the OM exemption and whether it Ontario should adopt it. The EMDA Survey results involving the OM exemption are set out below.

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- Approximately 50% of survey respondents indicated they sell to clients using the OM exemption (EMDA Survey – Q.19b).
- When survey respondents were asked if the non-eligible investor¹ threshold under the OM exemption should be changed (EMDA Survey – Q.20):
 - approximately 16% indicated that it should be increased;
 - approximately 20% indicated it should be increased; and
 - approximately 64% indicated no change should be made.
- When survey respondents were asked if the eligible investor threshold should be changed approximately 91% indicated that it should be decreased or left unchanged (EMDA Survey – Q.21).
- Approximately 62% of survey respondents agreed that all prescribed forms of offering memoranda under the OM exemption should be posted and available to the public (EMDA Survey – Q.22a).
- Of those who agreed to the public posting of OMs under the OM exemption (EMDA Survey – Q.22b):
 - approximately 40% indicated the OM should be posted on the issuer’s website;
 - approximately 14% indicated the OM should be posted on the website of a third party provider; and
 - approximately 45% indicated it should be posted on SEDAR.
- Approximately 88% of survey respondents indicated that Ontario should adopt the OM exemption (EMDA Survey – Q.24).

¹ The term "**eligible investor**" means: (a) a person whose (i) net assets, alone or with a spouse, in the case of an individual, exceeds \$400,000, (ii) net income before taxes exceeded \$75,000 in each of the 2 most recent calendar years and who reasonably expects to exceed that income level in the current calendar year, or (iii) net income before taxes, alone or with a spouse, in the case of an individual, exceeded \$125,000 in each of the 2 most recent calendar years and who reasonably expects to exceed that income level in the current calendar year, (b) a person of which a majority of the voting securities are beneficially owned by eligible investors or a majority of the directors are eligible investors, (c) a general partnership of which all of the partners are eligible investors, (d) a limited partnership of which the majority of the general partners are eligible investors, (e) a trust or estate in which all of the beneficiaries or a majority of the trustees or executors are eligible investors, (f) an accredited investor, (g) a person described in section 2.5 [Family, friends and business associates], or (h) a person that has obtained advice regarding the suitability of the investment and, if the person is resident in a jurisdiction of Canada, that advice has been obtained from an eligibility adviser.

The term "**eligibility adviser**" means: (a) a person that is registered as an investment dealer and authorized to give advice with respect to the type of security being distributed, and (b) in Saskatchewan or Manitoba, also means a lawyer who is a practicing member in good standing with a law society of a jurisdiction of Canada or a public accountant who is a member in good standing of an institute or association of chartered accountants, certified general accountants or certified management accountants in a jurisdiction of Canada provided that the lawyer or public accountant must not (i) have a professional, business or personal relationship with the issuer, or any of its directors, executive officers, founders, or control persons, and (ii) have acted for or been retained personally or otherwise as an employee, executive officer, director, associate or partner of a person that has acted for or been retained by the issuer or any of its directors, executive officers, founders or control persons within the previous 12 months.

- If Ontario adopted the OM exemption, approximately 84% indicated that Ontario should adopt an eligible investor threshold (EMDA Survey – Q.25).
- When survey respondents were asked if was easier to sell under the OM exemption or the AI exemption and/or the Minimum Amount exemption (EMDA Survey – Q.26):
 - approximately 30% indicated it is easier under the AI exemption and/or the Minimum Amount exemption;
 - approximately 48% indicated it is easier under the OM exemption; and
 - approximately 20% indicated no difference.

Recommendation 10: Ontario should adopt a form of OM exemption and in connection with that policy change, the CSA should develop a nationalized and harmonized OM exemption.

Investor Protection Safeguards and Prospectus Exemption Matrix

In considering the adoption of a form of OM exemption for Ontario, the EMDA considered:

- the “**Basic OM exemption**” as set out in s.2.9(1) of NI 45-106 as adopted by British Columbia, New Brunswick, Nova Scotia and Newfoundland and Labrador, and
- the “**Eligible Investor OM exemption**” as set out in s.2.9(2) of N 45-106 as adopted by Alberta, Manitoba, Northwest Territories, Nunavut, Prince Edward Island, Quebec, Saskatchewan and the Yukon.

We have assumed that in striking the right balance for Ontario, additional investor protection safeguards would be required for any form of OM exemption to be endorsed by the OSC. The investor protection safeguards are set out in a comparative matrix in relation to the following prospectus exemptions: the Minimum Amount exemption; the AI exemption; the OM exemption; and the Eligible Investor exemption (a modified OM exemption for Ontario recommended by the EMDA and discussed below).

Investor Protection Safeguards	Minimum Amount	Accredited Investor	Offering Memorandum	Eligible Investor Exemption
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Minimum amount threshold (money at risk)	\$150,000	None	None	None
Maximum amount threshold (money at risk)	None	None	\$10,000 for non- eligible investor	\$10,000 for non- eligible investor
Individual net asset test	No	Yes	Yes	Yes
Individual net income test	No	Yes	Yes	Yes
Individual financial asset test	No	Yes	Yes	Yes
Required use of a registered dealer or adviser	No	No	No	Yes
Prescribed form of risk acknowledgement form for investors	None	None	Yes	Yes
Prescribed form of offering document for investors	None	None	Yes	Yes
Required filing of offering document with regulators	No	No	Yes	Yes
Required public posting of offering document	No	No	No	Yes
Report of exempt trade required	Yes	Yes	Yes	Yes

Minimum amount threshold (money at risk) – this safeguard is based on a minimum investment amount as a proxy for sophistication and ability to withstand a potential financial loss as the basis for investor protection.

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Maximum amount threshold (money at risk) – this safeguard is a concentration restriction which protects investors from arguably making too large an investment by capping it at a maximum amount.

Individual net asset test – this safeguard is to ensure only those wealthy enough can invest and assumes an ability to withstand a financial loss based on net assets of an individual.

Individual net income test - this safeguard is to ensure only those wealthy enough can invest and assumes an ability to withstand a financial loss based on net income of an individual.

Individual financial asset test - this safeguard is to ensure only those wealthy enough can invest and assumes an ability to withstand a financial loss based on the financial assets of an individual.

Required use of a registered firm - this safeguard protects investors by requiring a registered firm and individual to be responsible for KYP, KYC and suitability and protects and helps investors make investment decisions on an informed basis. It puts the onus on the registered firm, who are regulated, to be responsible and to protect investors. This is one of the strongest investor protection safeguards in the tools available to manage investment risk.

Required and prescribed form of risk acknowledgement form for investors – this disclosure-based safeguard brings risks to the attention of an investor before an investment is made. “Sunlight is the best disinfectant,” a well-known quote from U.S. Supreme Court Justice Louis Brandeis, refers to the benefits of openness and transparency.

Required and prescribed form of offering document for investors – this disclosure-based safeguard brings risks to the attention of an investor to ensure an investment decision is made on a fully informed basis. A prescribed form of written disclosure about an issuer and its securities is also one of the strongest investor protection safeguards in the tools available to manage investment risk.

Required filing of offering document with regulators - this safeguard requires the offering document to be filed with the regulators within a prescribed period of time after the completion of a transaction. This ensures a final form of the document is provided to a third party and capable of review if required and assumes since the regulator receives a copy, it may be a more robust document than if it was not filed.

Required public posting of offering document - this safeguard requires the offering document to be publicly posted and available for review by investor and others. It provides the benefits of openness and transparency and allows others to see the quality and types of offering documents being produced.

Report of exempt trade required - this is important since a report of a trade, if filed electronically, allows the regulators to analyze statistics and prepare public reports on private placements in Canada.

Eligible Investor Exemption

In considering a recommendation to adopt a form of OM exemption for Ontario, the EMDA seriously considered the investor protection safeguards set out above and compared them to safeguards available in other prospectus exemptions.

The EMDA proposes that the following new prospectus exemption be adopted by Ontario in order to increase access to Ontario's capital markets by those inside and outside of Ontario and providing additional investor protection safeguards to Ontario residents. We understand it is not easy to strike the right balance between unfettered access to capital and investor protection safeguards and we have included a risk matrix to demonstrate the limited tools available to strike this balance. Our proposed exemption is what we call the Eligible Investor Exemption.

Recommendation 11: The EMDA recommends Ontario adopt the Eligible Investor exemption and include as components of the exemption: 1) the use of a dealer; and 2) the public postings of OMs.

Why Adopt the Eligible Investor Definition

The EMDA has taken a conservative approach in recommending the adoption of the Eligible Investor OM exemption as the preferred form of OM exemption for Ontario. The Basic OM exemption has been in place for a number of years. We are not aware of any data from those jurisdictions that permit the Basic OM exemption involving concerns about concentration of investment risk or other concerns relating to the absence of an eligible investor threshold. We encourage the CSA to publish a report on such findings or share such information with Ontario in order to consider developing a nationalized and harmonized form of OM exemption for all of Canada.

The EMDA has taken a conservative approach in recommending the adoption of a modified form of Eligible Investor OM exemption as the preferred form of OM exemption for Ontario. In order to strike the right balance, we believe a form of Eligible Investor OM exemption is a prudent and careful approach in adopting a new prospectus exemption for Ontario.

Recommendation 12: The CSA should report on any concentration of investment risk issues or other concerns they have where there is no eligible investor threshold required for the OM exemption.

Why Mandate the Use of a Registered Dealer

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The EMDA recommends that the Eligible Investor exemption require the use of a registered dealer who is accountable for KYC, KYP and suitability determinations. We are not merely advocating this because our members include EMDs, but because these obligations are the core principles of investor protection established under NI 31-103 and reflect the fundamental focus on investment suitability, rather than arbitrary thresholds like income and financial assets. The EMDA believes the introduction of a registered dealer is a useful investor safeguard that strikes the right balance in regulating risk while permitting more investors to participate in the exempt capital market.

We are also concerned about coming demographic changes as baby boomers retire and may fail to satisfy the income or asset tests under the AI exemption. Effectively, this would shrink the available pool of individual investors who can participate in the exempt markets. This should be an important concern to not only the CSA, but to provincial and territorial governments across Canada which are struggling with budget concerns emanating in part from weak economic performance.

Why Require the Public Posting of Prescribed Forms of OMs

The EMDA believes issuers should be required to publicly post OMs on a centralized website where they are easily accessible and searchable by the public. We believe the public posting of OMs will provide greater transparency to the marketplace, increase compliance with the prescribed disclosure and over time improve the quality of OMs. The CSA should also report regularly on such filings and provide statistics involving amount raised, type of issuer, commissions, etc.

Nationalized and Harmonized Eligible Investor Exemption

The introduction of the Eligible Investor exemption, or a form thereof, will nationalize a form of OM exemption across Canada. This is important in order to reduce regulatory arbitrage between jurisdictions and provide all market participants with some form of level playing field.

We were clear during our EMDA consultation process that without providing additional investor protection safeguards, Ontario would be unlikely to adopt a form of OM exemption. The response we heard was that if these additional investor protection safeguards were required by Ontario in order to access a greater pool of capital from market participants across Canada, then it was worth it. Ontario cannot be left behind, especially since it is the largest capital market in Canada.

As the CSA is aware from its participation in IOSCO and extensive involvement in drafting IOSCO principles of regulation, the purpose of securities regulation is not to remove risk from the capital markets, but rather to ensure that there is proper management of that risk. These principles have been followed by the CSA when drafting NI 31-103 and other regulations.

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We believe the EMDA proposal for a new Eligible Investor prospectus exemption strikes the right balance in protecting investors, fostering fair and efficient capital markets, effectively manages risk and is proportionate to its costs to industry and the restrictions it imposes on market participants.

OTHER MATTERS

Exempt Market Statistics are Needed

The EMDA believes that any significant policy review of the exempt market should be founded on: 1) reliable and extensive analysis of the size and character of the exempt market across Canada; and 2) how any changes to the prospectus exemptions will impact the capital markets.

Over 77% of respondents to the EMDA Survey indicated that the CSA should compile national exempt market statistics using Form 45-106F1s and Form 45-106F6 (in BC) and regularly publish such reports (similar to the capital market reports published by the BCSC, ASC and NBSC) (EMDA Survey – Q.29).

We encourage CSA members to aggregate, analyze and report on the information contained in the NI 45-106F1 and NI 45-106F6 (BC) filings – reports of trade. Market participants have provided this information to CSA members for decades (including information in Form 20s), however we are not aware of any publication of such reports on a national, regional and provincial basis.

We commend the BCSC, ASC and NBSC, who have published reports on the exempt market, and strongly encourage other CSA members to do the same. Having such information in a national report by the CSA would be preferred.

We were recently encouraged in what we hope is a move in this direction by the OSC which recently published its 2012 – 2015 Strategic Plan - *The OSC: a 21st Century Securities Regulator* (the **OSC Strategic Plan**). The OSC Strategic Plan outlines six strategies; one of which includes the creation of a dedicated Research and Analysis Group whose purpose is to enhance its capacity to support the right regulation for complex capital markets. The OSC Strategic Plan (pg. 11) states that:

The Research and Analysis Group will play an influential role in the OSC's policy-formulation process. A stronger commitment to using research – and evidenced-based decision-making will ensure that, in the future, policy will rely more heavily on qualitative evidence, while also taking investor perspectives into consideration.

These are definitely moves in the right direction and the EMDA and other market participants welcome quantitative data to support policy making decisions. This is especially important since market participants have not fully recovered from the credit crisis. For example, in our EMDA Survey: (a) approximately 70%

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of survey respondents indicated that the 2008 and 2009 global financial crisis had a negative impact on sales or volume of sales and (b) approximately 50% of survey respondents indicated that, as of the date of the survey, their sales or business volumes have not returned to the 2008 and 2009 levels (EMDA Survey – Q.28).

Recommendation 13: **The CSA should review, analyze and report on the exempt market activity information it collects in the NI 45-106F1 report of trades (including Form 45-106F6 in BC), and update this information at least annually.**

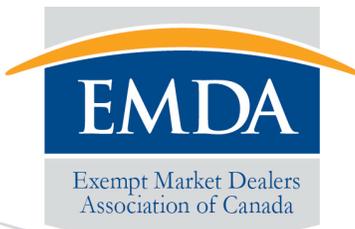
Recommendation 14: **The CSA should conduct a public consultation to review the content of NI 45-106F1 (including Form 45-106F6 in BC) to ensure meaningful regulatory and commercial information is being collected on a national and harmonized basis.**

Recommendation 15: **The CSA should implement electronic filing of the NI 45-106F1 to simplify submission for market participants and provide easier access for analysis and review of the filings by the CSA.**

* * *

The above comments are respectfully submitted by the Board of Directors of the Exempt Market Dealers Association of Canada on behalf of its membership.

We thank you for the opportunity to provide you with our comments on the Proposed Amendments. If you have any questions or concerns, we ask that you direct them to Brian Koscak, Chairman of the EMDA at bkoscak@emdacanada.com or 416-860-2955.



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Yours very truly,

The Exempt Markets Dealers Association of Canada

“Brian Koscak”
Chairman

“David Gilkes”
Director

“Geoffrey Ritchie”
Executive Director

The EMDA 45-401 Comment Letter Committee that prepared this submission included:

Brian Koscak
EMDA Chairman
Partner, Cassels, Brock and Blackwell LLP

David Gilkes
EMDA Director
President, North Star Compliance and Regulatory Solutions Inc.

Geoffrey Ritchie
EMDA Executive Director
National Director, Compliance and Risk Management, BMO Harris Private Banking

Morley Salmon
EMDA Founding Chairman and Director
Chairman, Bloom Burton & Co.

David Brown
EMDA Founding President
Partner, WeirFoulds LLP

** This letter does not represent the comments of the employer or firm of any director and/or officer of the EMDA and is submitted without prejudice to any position taken, or that may be taken, by that individual’s employer or firm on its own behalf or on behalf of any client.*

**SCHEDULE “A”
EMDA SURVEY RESULTS
(please see attached)**

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EMDA Survey: CSA Consultation Note 45-401

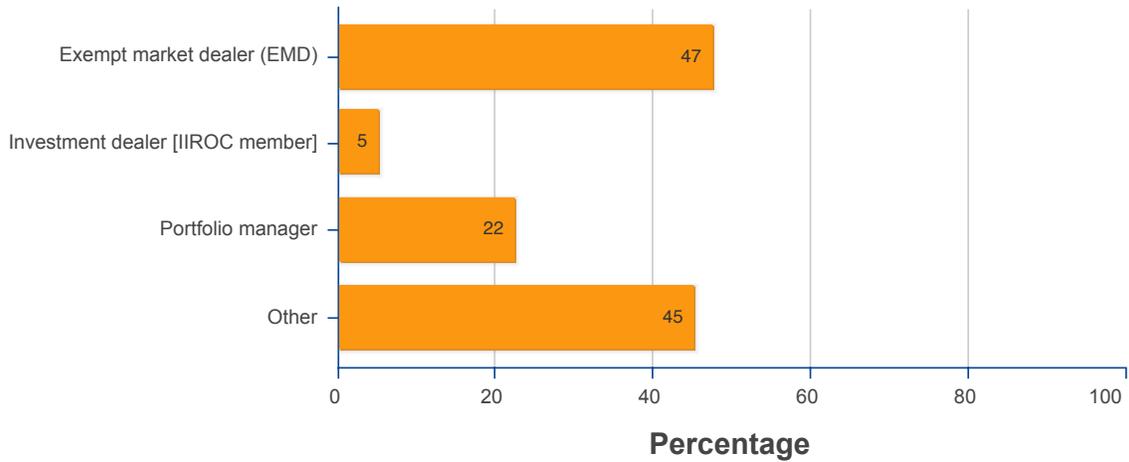
Review of Minimum Amount and Accredited Investor Exemptions



SURVEY RESULTS

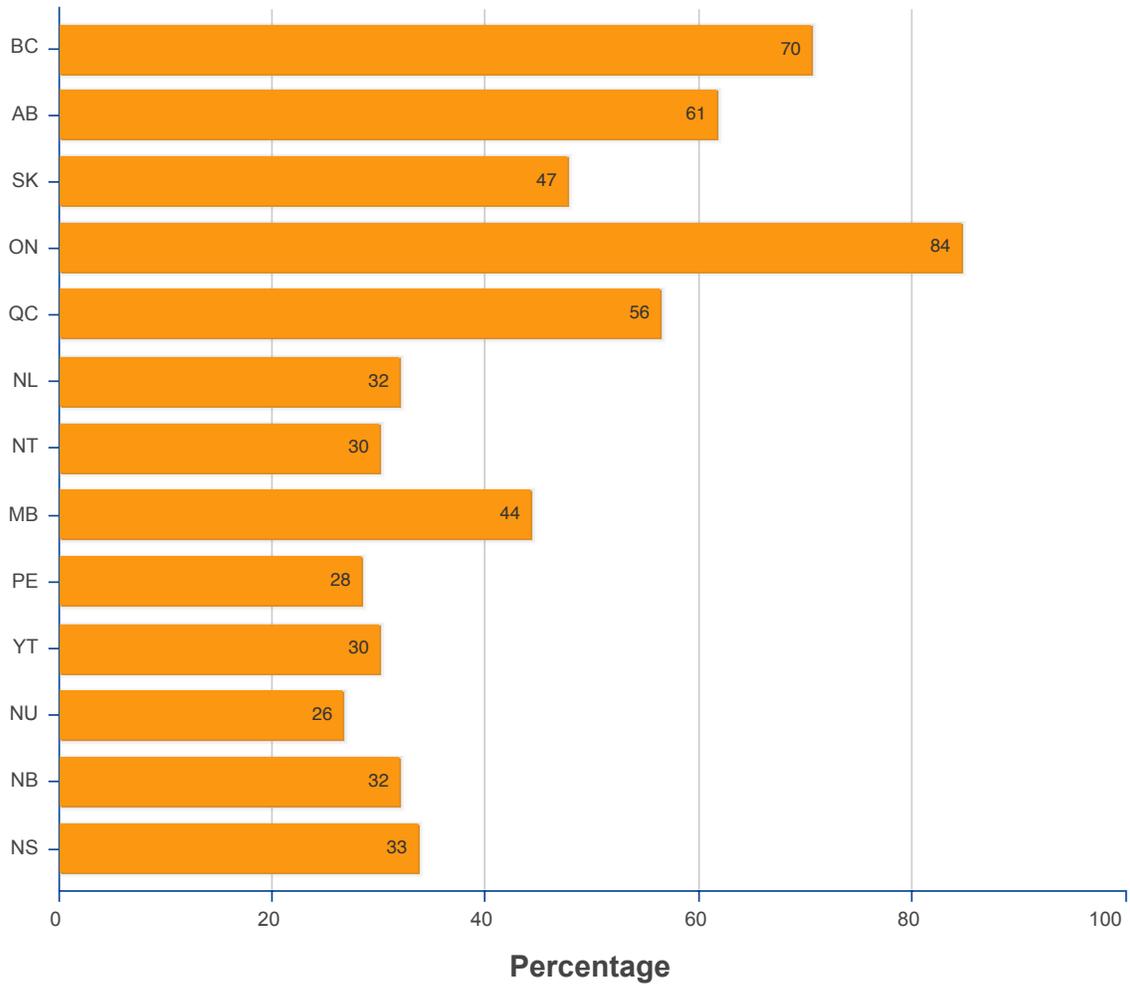
1) What is your primary line of business? [Check all boxes that apply]

- 47.13% (41/87)** Exempt market dealer (EMD)
- 4.6% (4/87)** Investment dealer [IIROC member]
- 21.84% (19/87)** Portfolio manager
- 44.83% (39/87)** Other



2) In what Canadian jurisdictions are you registered to carry-on business?

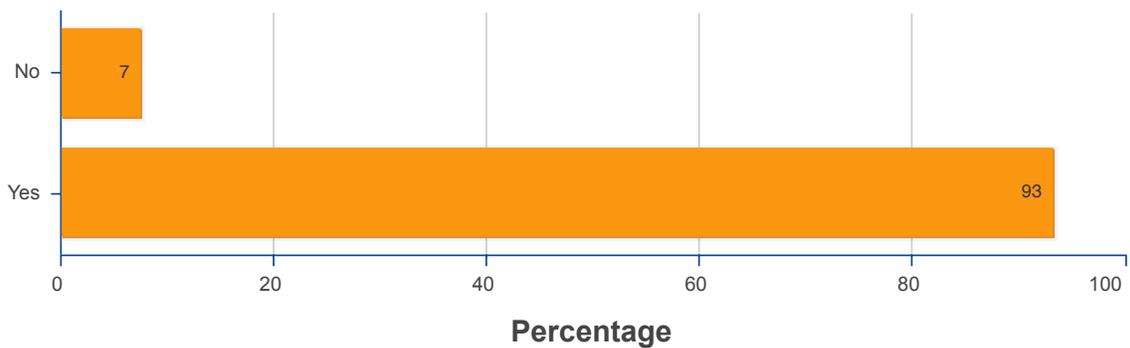
- 70.18% (40/57)** BC
- 61.4% (35/57)** AB
- 47.37% (27/57)** SK
- 84.21% (48/57)** ON
- 56.14% (32/57)** QC
- 31.58% (18/57)** NL
- 29.82% (17/57)** NT
- 43.86% (25/57)** MB
- 28.07% (16/57)** PE
- 29.82% (17/57)** YT
- 26.32% (15/57)** NU
- 31.58% (18/57)** NB
- 33.33% (19/57)** NS



3) Do you sell to clients using the Accredited Investor Exemption?

7.14% (4/56) No

92.86% (52/56) Yes



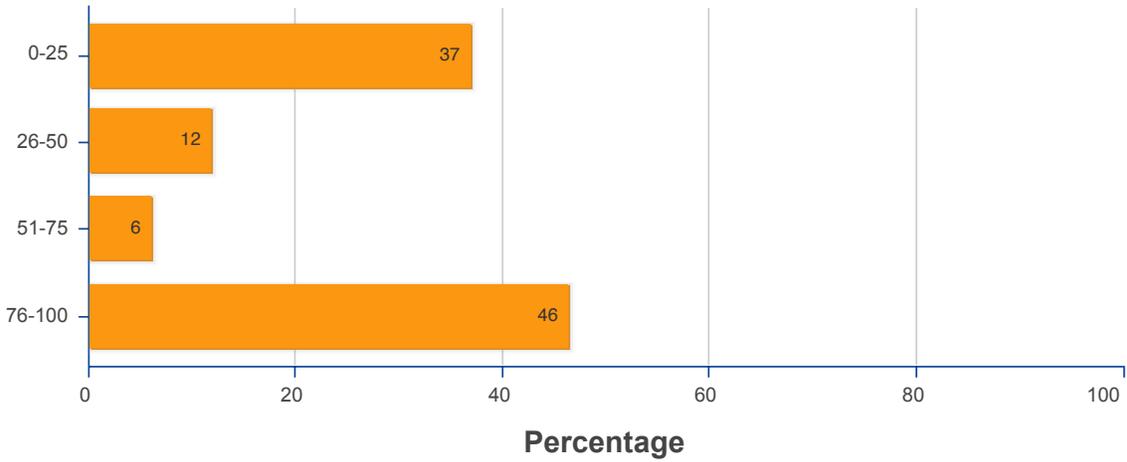
If yes, estimate the percentage of your total sales using this exemption for the last two calendar years.

36.54% (19/52) 0-25

11.54% (6/52) 26-50

5.77% (3/52) 51-75

46.15% (24/52) 76-100



4) In the last two calendar years, what percentage of your total sales under the Accredited Investor Exemption were made to:

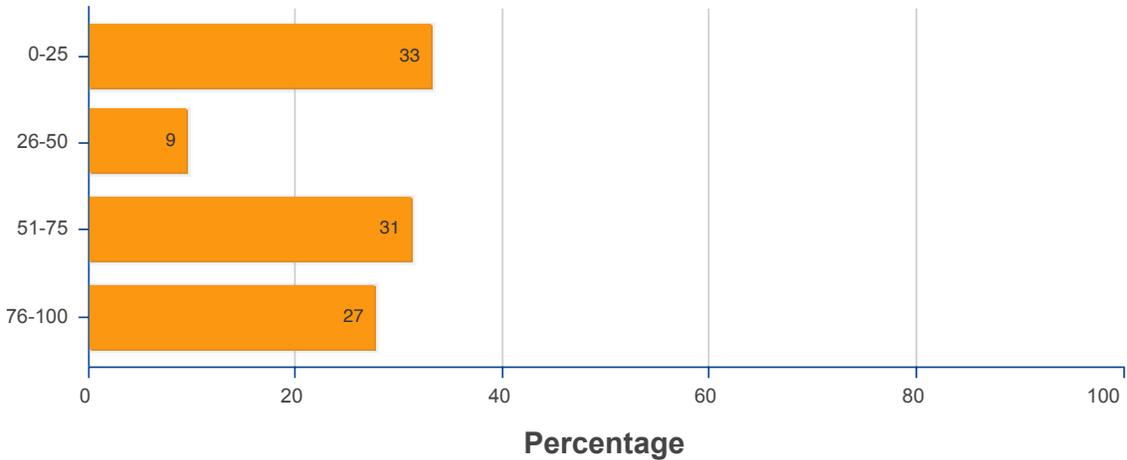
an individual who, either alone or with a spouse, beneficially owns financial assets having an aggregate realizable value that before taxes, but net of any related liabilities, exceeds \$1,000,000 (the Financial Asset Test).

32.73% (18/55) 0-25

9.09% (5/55) 26-50

30.91% (17/55) 51-75

27.27% (15/55) 76-100



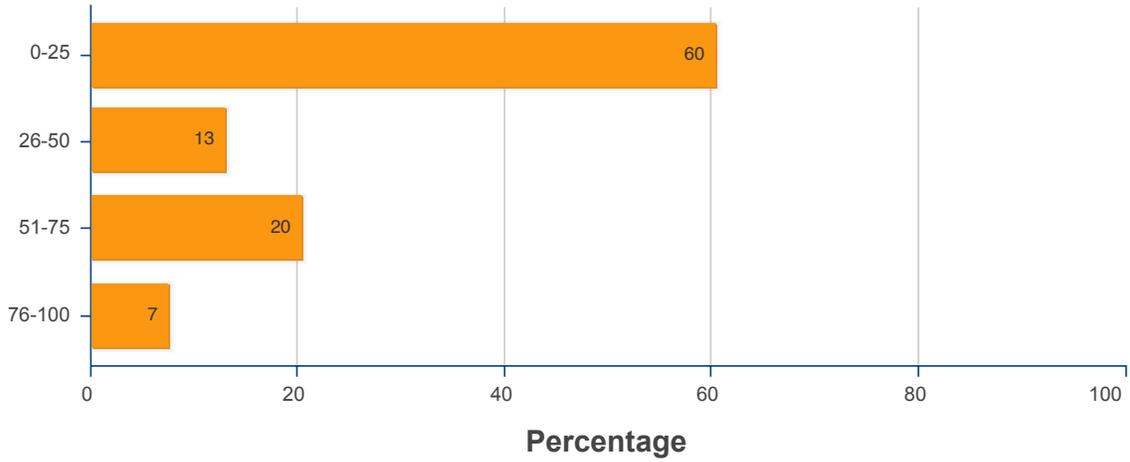
an individual whose net income before taxes exceeded \$200,000 in each of the two most recent calendar years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent calendar years and who, in either case, reasonably expects to exceed that net income level in the current calendar year (the Income Test).

60.0% (33/55) 0-25

12.73% (7/55) 26-50

20.0% (11/55) 51-75

7.27% (4/55) 76-100



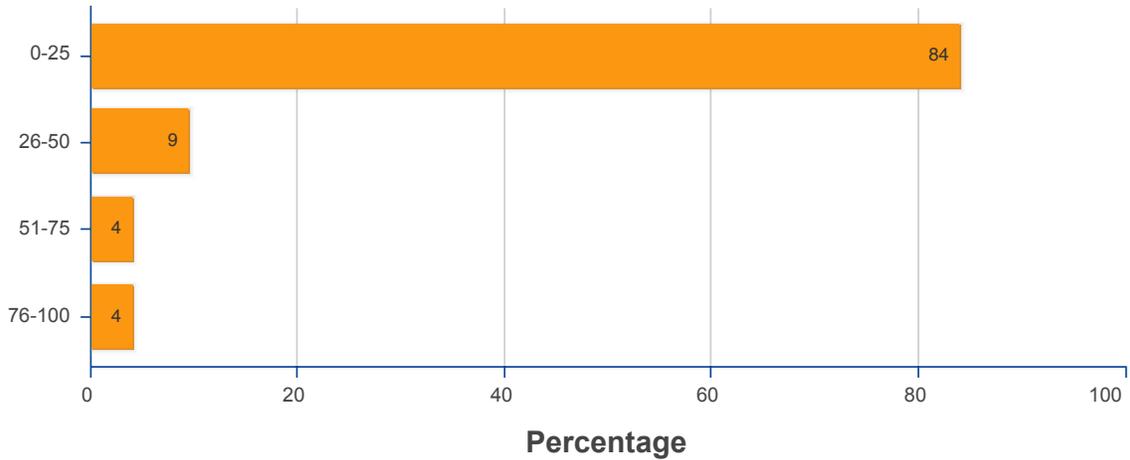
an individual who, either alone or with a spouse, has net assets of at least \$5,000,000 (the Net Assets Test).

83.64% (46/55) 0-25

9.09% (5/55) 26-50

3.64% (2/55) 51-75

3.64% (2/55) 76-100

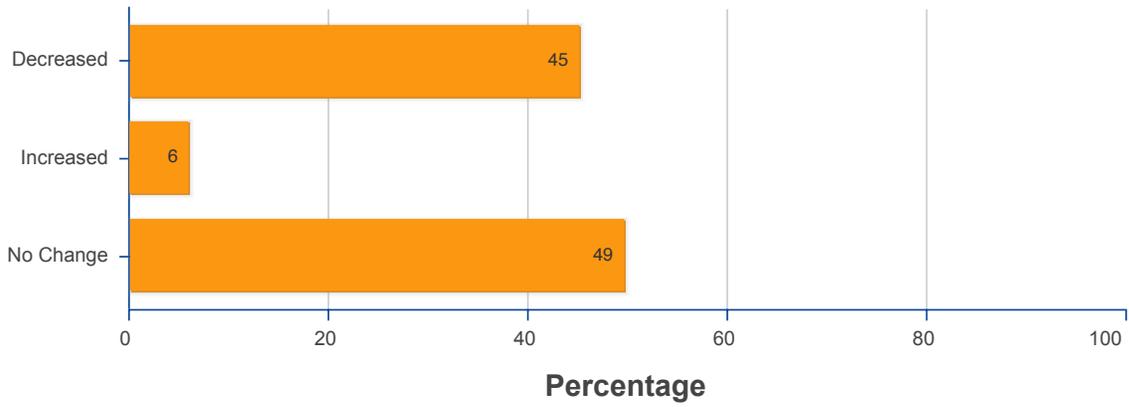


5) Should the \$1,000,000 threshold for the Financial Asset Test be increased or decreased?

44.83% (39/87) Decreased

5.75% (5/87) Increased

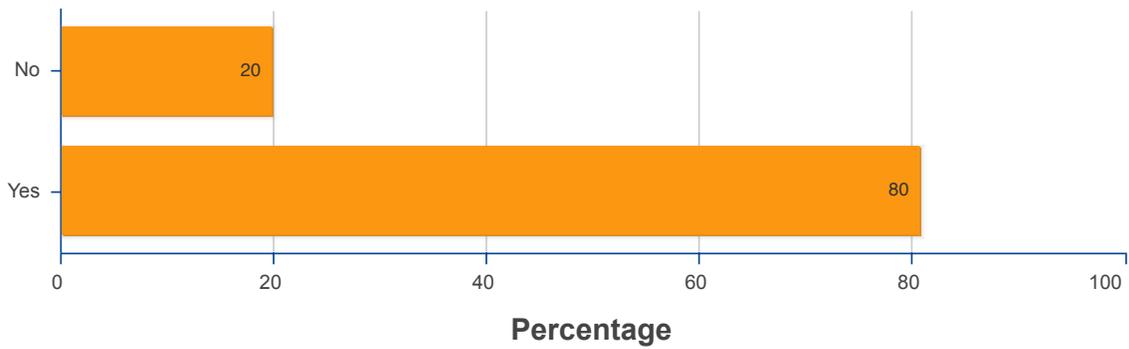
49.43% (43/87) No Change



6) Should the assets allowed in the Financial Asset Test include real estate other than the investor's primary residence [e.g., cottage, farm, investment property etc.]?

19.54% (17/87) No

80.46% (70/87) Yes

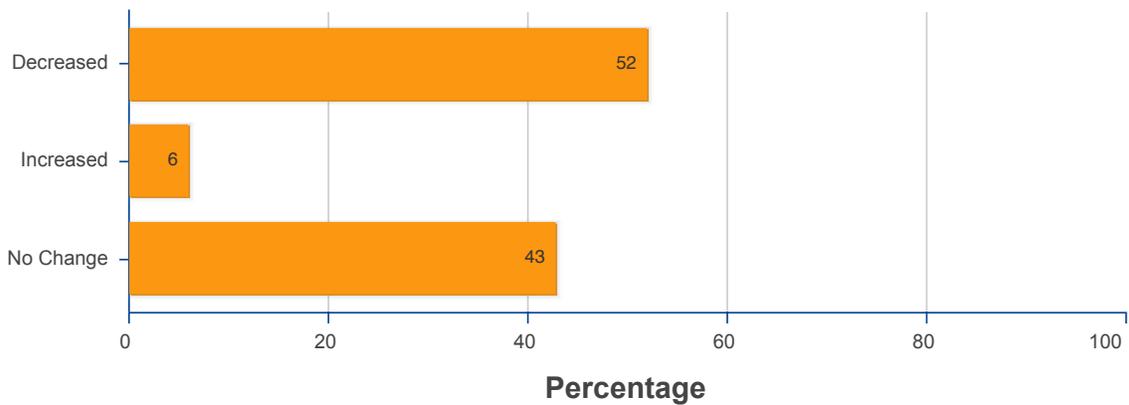


7) Should the \$200,000 and \$300,000 thresholds for the Income Test be increased or decreased?

51.72% (45/87) Decreased

5.75% (5/87) Increased

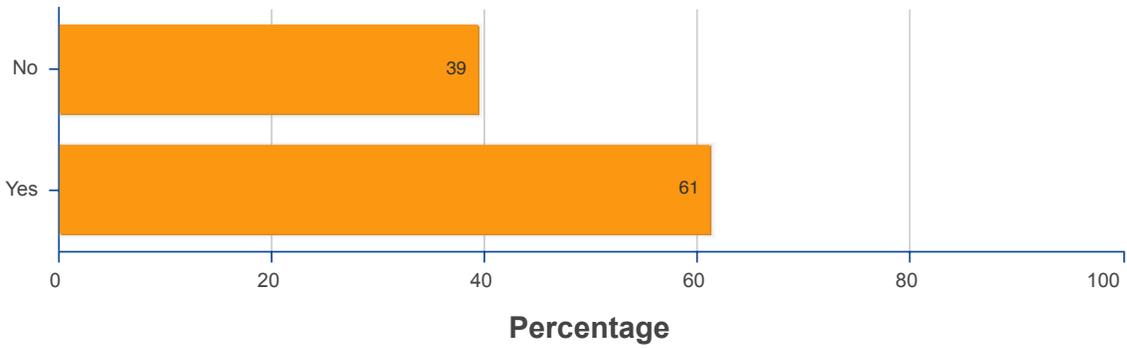
42.53% (37/87) No Change



8) Would you agree with lowering the threshold amounts in the Financial Asset Test, Income Test and Net Asset Test, if there was a capped or maximum investment amount?

39.08% (34/87) No

60.92% (53/87) Yes



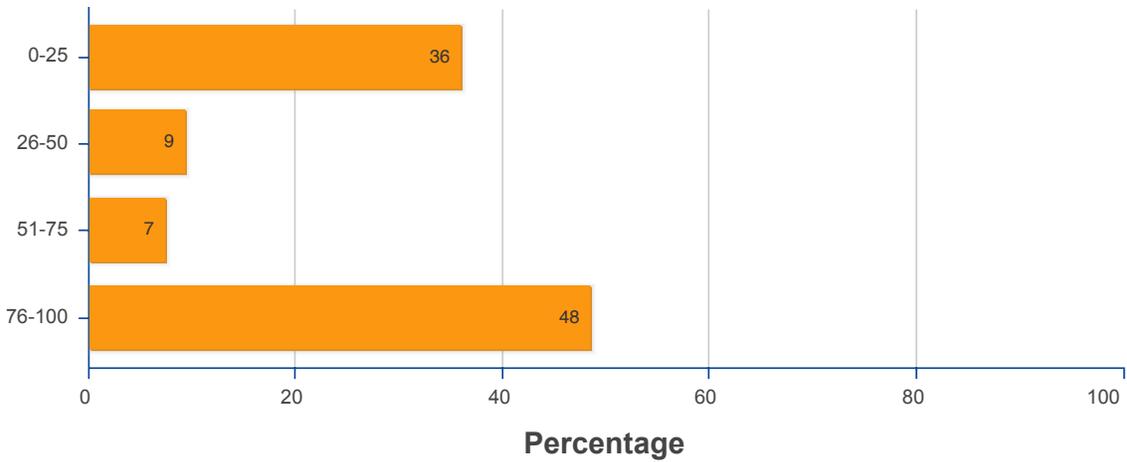
9) When using the Accredited Investor Exemption, what percentage of your total sales involves providing an offering memorandum (other than a basic term sheet) to investors?

35.71% (20/56) 0-25

8.93% (5/56) 26-50

7.14% (4/56) 51-75

48.21% (27/56) 76-100



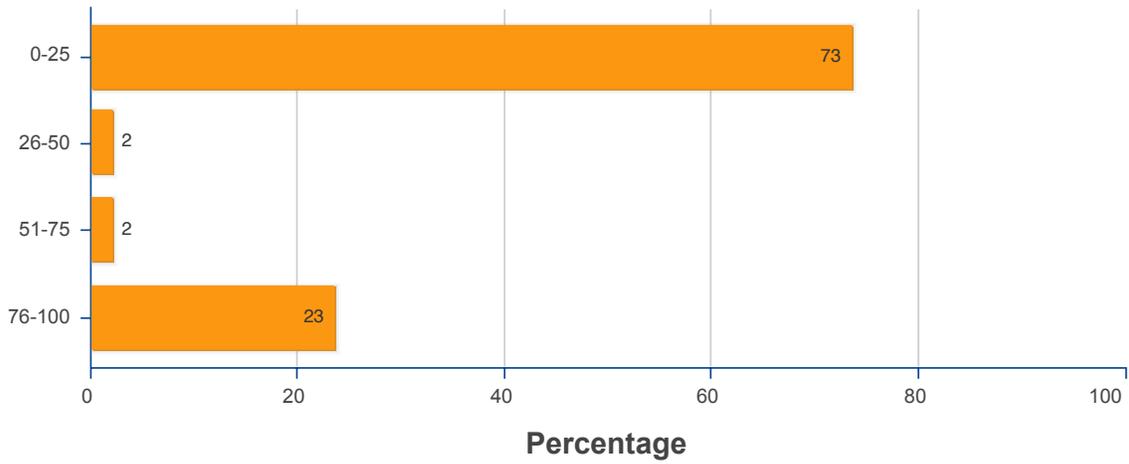
10) When using the Accredited Investor Exemption, what percentage of your sales involves providing a term sheet only (and not an offering memorandum) to investors?

73.21% (41/56) 0-25

1.79% (1/56) 26-50

1.79% (1/56) 51-75

23.21% (13/56) 76-100

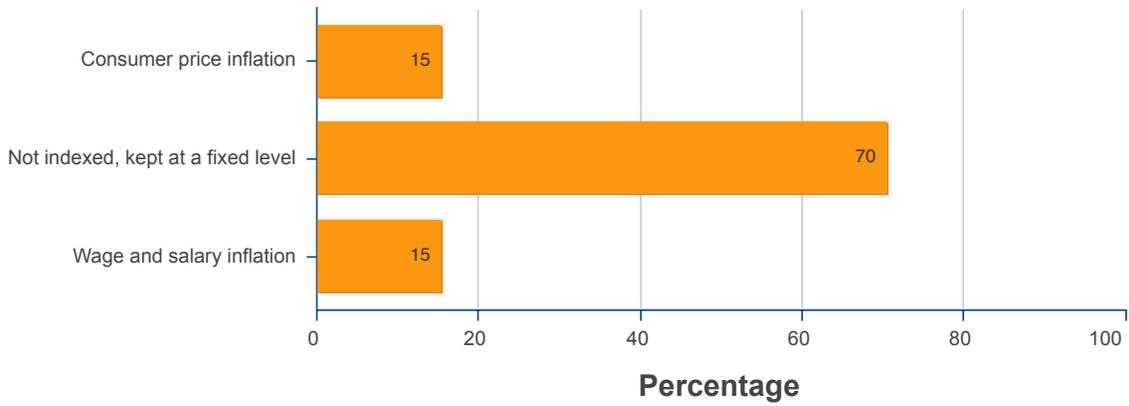


11) Should the Income Test be periodically indexed to:

14.94% (13/87) Consumer price inflation

70.11% (61/87) Not indexed, kept at a fixed level

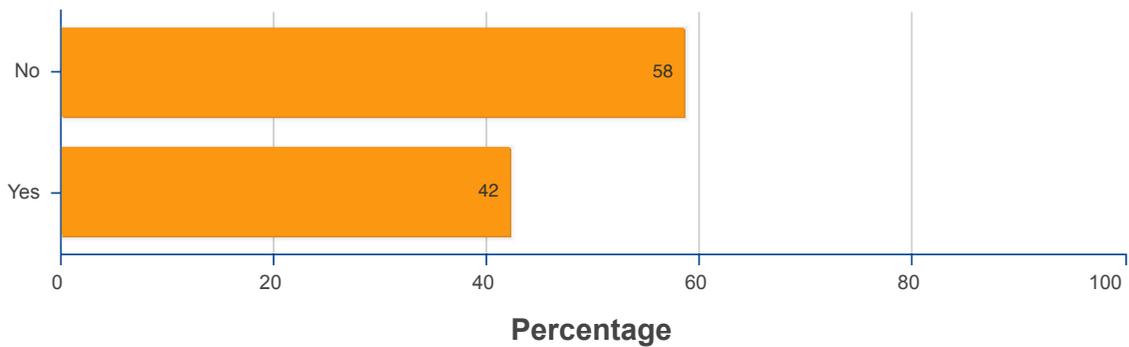
14.94% (13/87) Wage and salary inflation



12) Do you sell to clients using the Minimum Amount Exemption?

58.18% (32/55) No

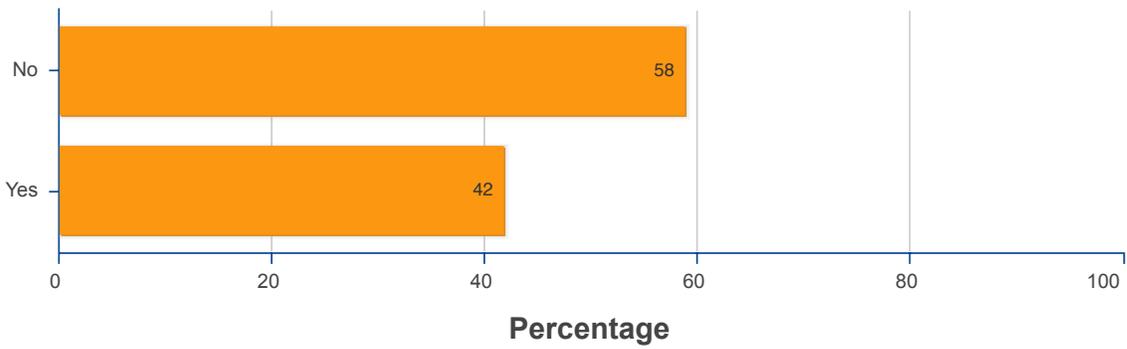
41.82% (23/55) Yes



13) Do you agree with retaining the Minimum Amount Exemption in its current form?

58.49% (31/53) No

41.51% (22/53) Yes

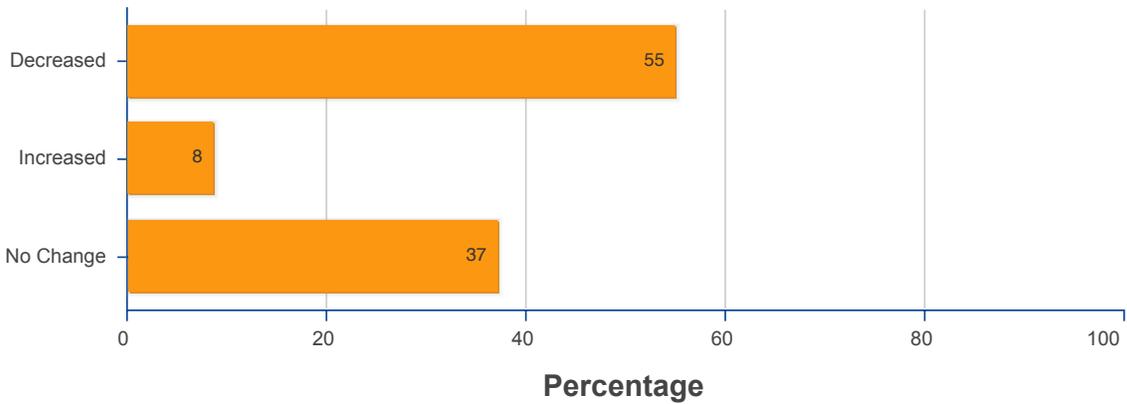


14) Should the \$150,000 Minimum Amount be increased or decreased?

54.76% (46/84) Decreased

8.33% (7/84) Increased

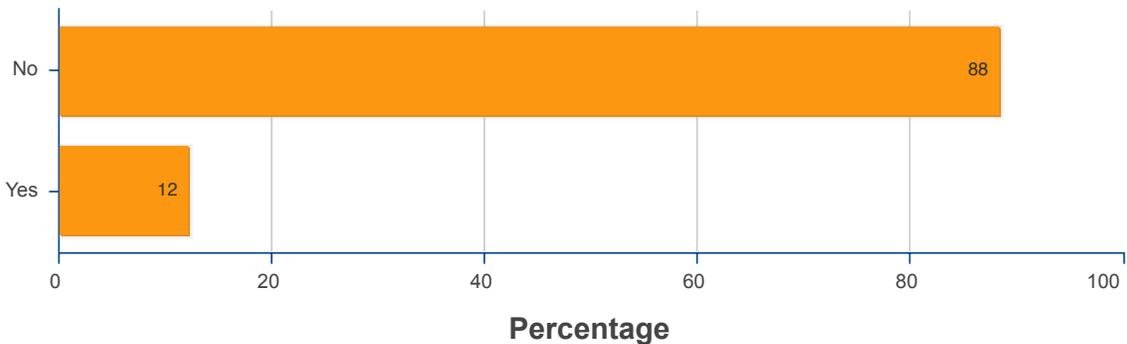
36.9% (31/84) No Change



15) Should the Minimum Amount Exemption be limited to certain investors, such as institutional investors and not available to individuals?

88.1% (74/84) No

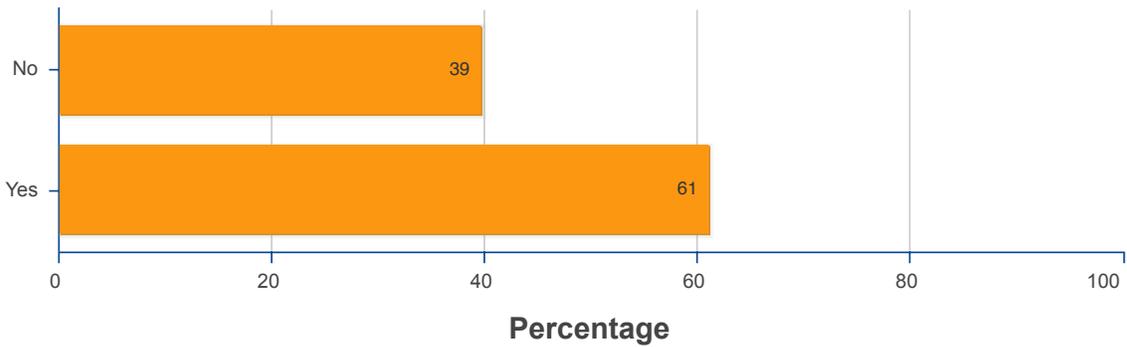
11.9% (10/84) Yes



16) Should the \$150,000 Minimum Amount be adjusted downward when a registered dealer firm (e.g., an EMD) who has an obligation to recommend only suitable investments to investors?

39.29% (33/84) No

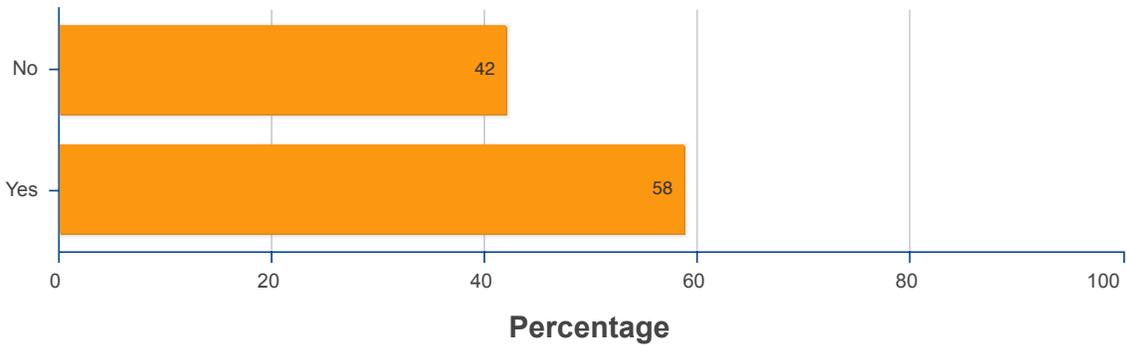
60.71% (51/84) Yes



17) Should the \$150,000 Minimum Amount be adjusted downward when the issuer of the security is a reporting issuer (i.e., a public company)?

41.67% (35/84) No

58.33% (49/84) Yes

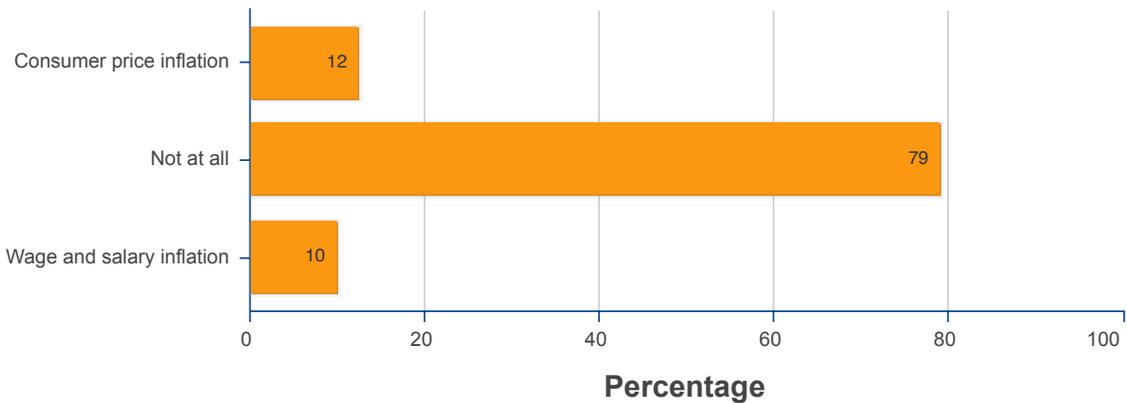


18) Should the \$150,000 Minimum Amount be periodically indexed to:

11.9% (10/84) Consumer price inflation

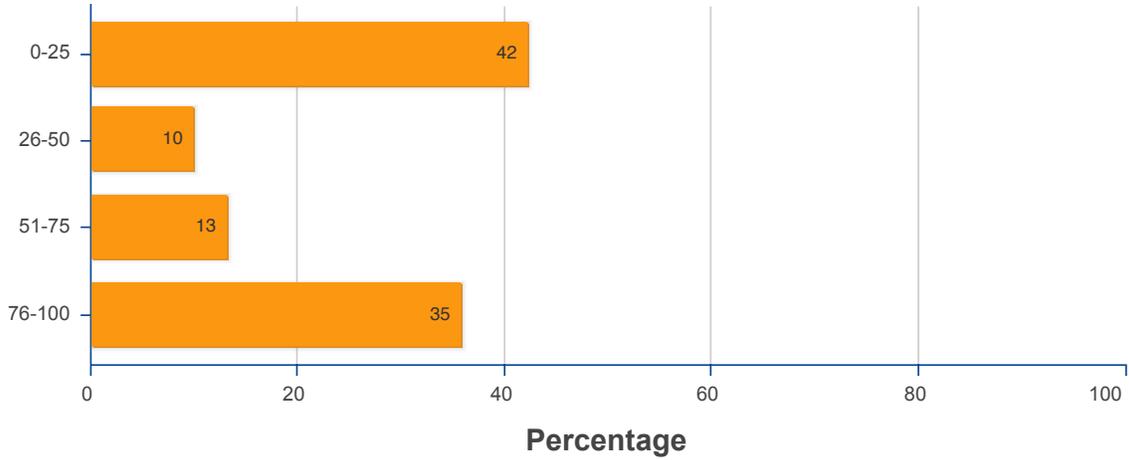
78.57% (66/84) Not at all

9.52% (8/84) Wage and salary inflation



19) If yes, estimate the percentage of your total sales using this exemption for the last two years.

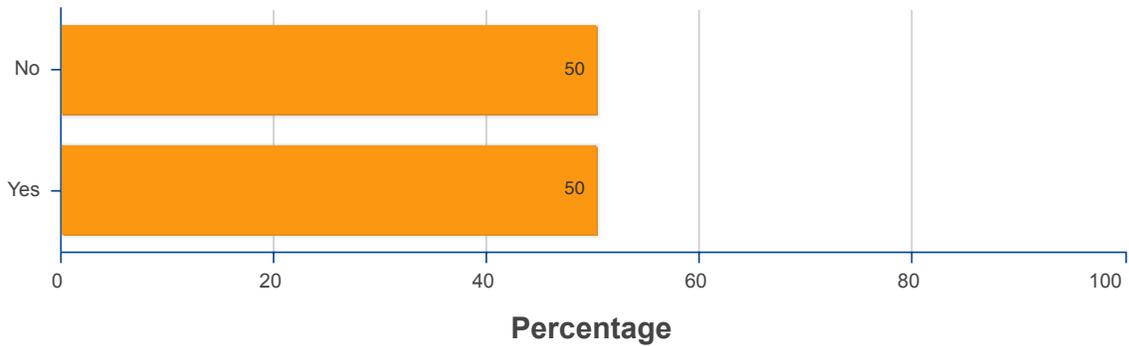
41.94% (13/31) 0-25
9.68% (3/31) 26-50
12.9% (4/31) 51-75
35.48% (11/31) 76-100



Do you sell to clients using the Offering Memorandum Exemption?

50.0% (28/56) No

50.0% (28/56) Yes

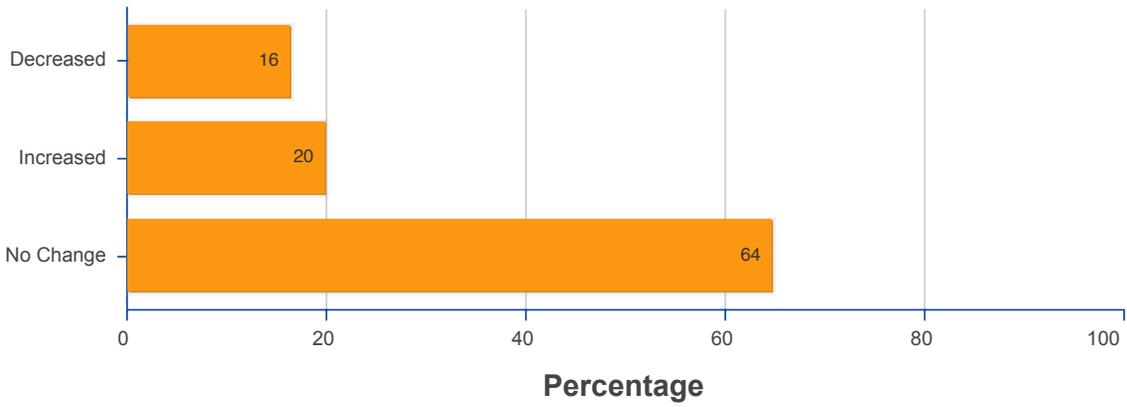


20) In Alberta, Manitoba, Northwest Territories, Nunavut, Prince Edward Island, Quebec, Saskatchewan and the Yukon, ?eligible investors? can invest more than \$10,000 under the Offering Memorandum Exemption. An investor in British Columbia, New Brunswick, Nova Scotia and Newfoundland and Labrador can invest any amount regardless if he/she/it is an ?eligible investor?. Should the non-eligible investment threshold for Alberta, Manitoba, Northwest Territories, Nunavut, Prince Edward Island, Quebec, Saskatchewan and the Yukon be changed?

16.09% (14/87) Decreased

19.54% (17/87) Increased

64.37% (56/87) No Change

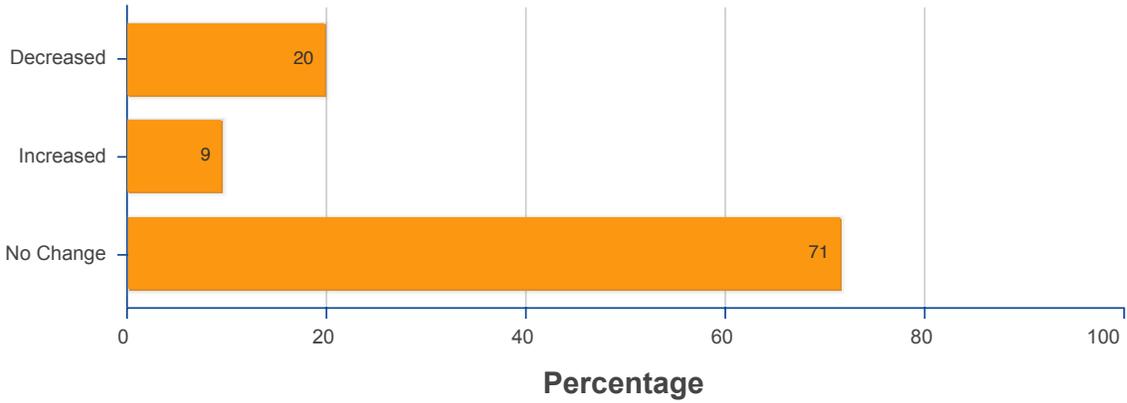


21) Should the financial thresholds for ?eligible investors? be changed?

19.54% (17/87) Decreased

9.2% (8/87) Increased

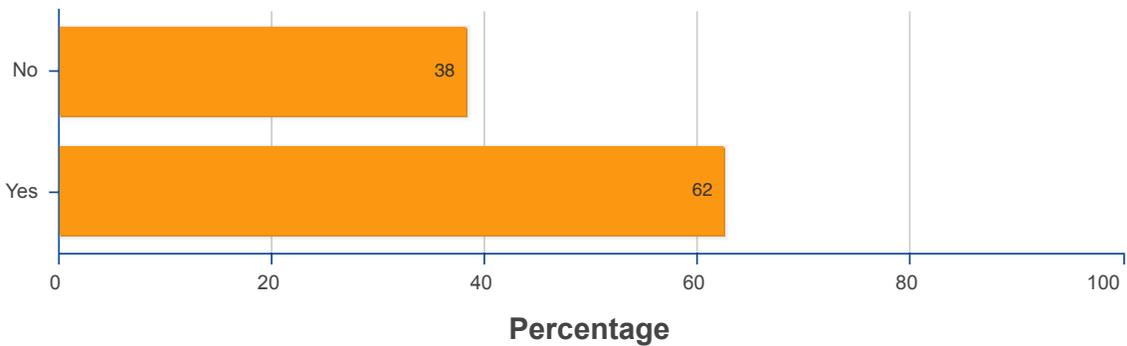
71.26% (62/87) No Change



22) Should all prescribed forms of offering memorandum under the Offering Memorandum Exemption be posted and available to the public?

37.93% (33/87) No

62.07% (54/87) Yes

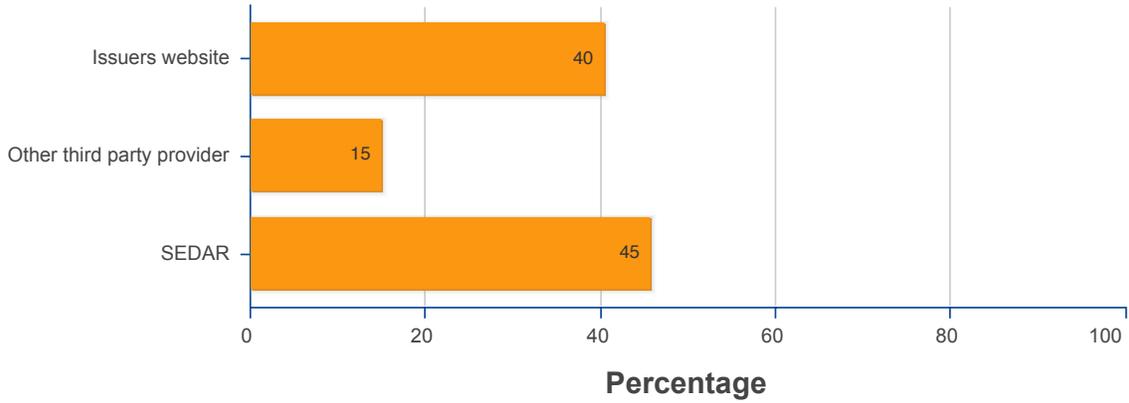


If yes to Question 22, where should an offering memorandum under the Offering Memorandum Exemption be publicly posted?

40.0% (22/55) Issuers website

14.55% (8/55) Other third party provider

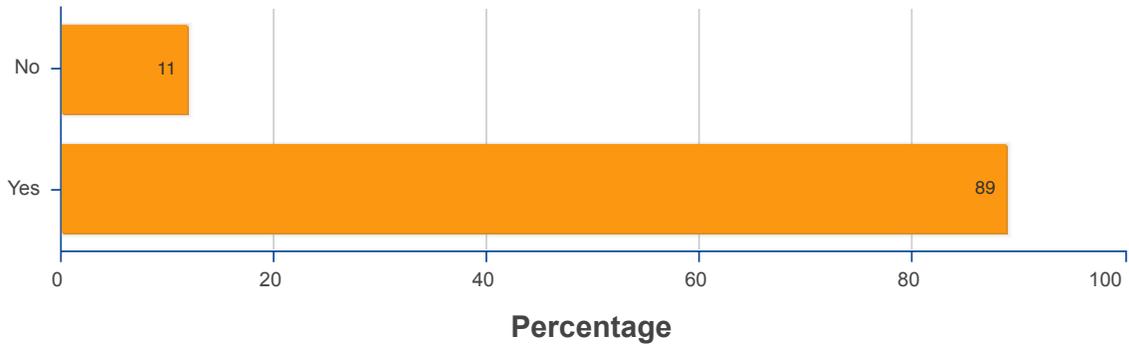
45.45% (25/55) SEDAR



24) Ontario is the only province which does not use the Offering Memorandum Exemption. Should it be adopted in Ontario by the Ontario Securities Commission?

11.49% (10/87) No

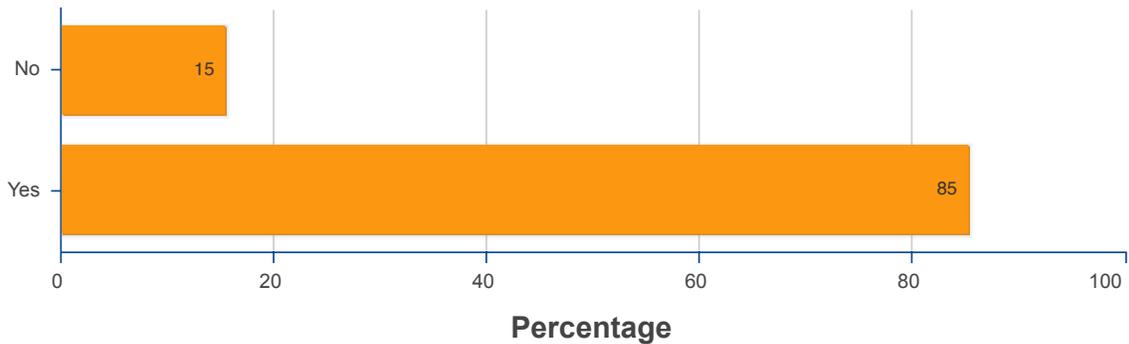
88.51% (77/87) Yes



25) Alberta, Manitoba, Northwest Territories, Nunavut, Prince Edward Island, Quebec, Saskatchewan and the Yukon require an investor to be an ?eligible investor? in order to invest under the Offering Memorandum Exemption. Should Ontario require investors to be ?eligible investors? if it adopts the Offering Memorandum Exemption?

15.12% (13/86) No

84.88% (73/86) Yes



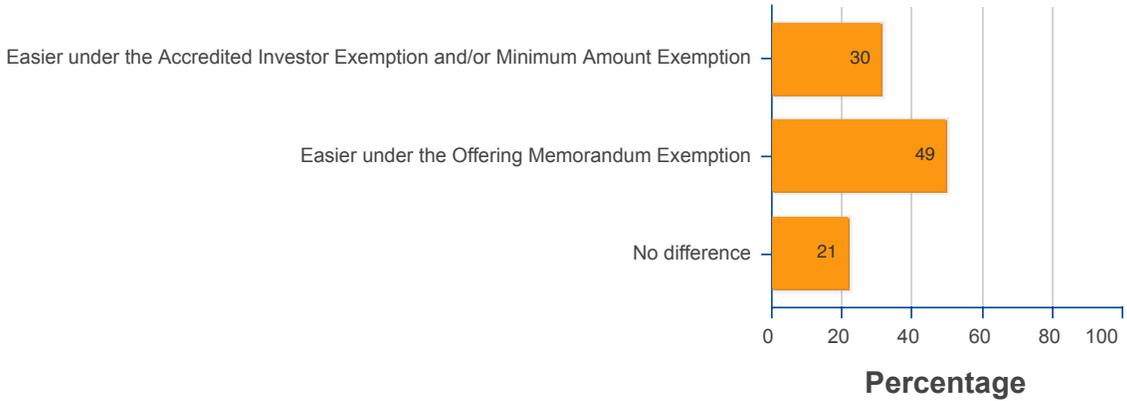
26) Do you think it is easier to raise capital under the Offering Memorandum Exemption or the Accredited Investor

exemption and/or the Minimum Amount Exemption?

30.23% (26/86) Easier under the Accredited Investor Exemption and/or Minimum Amount Exemption

48.84% (42/86) Easier under the Offering Memorandum Exemption

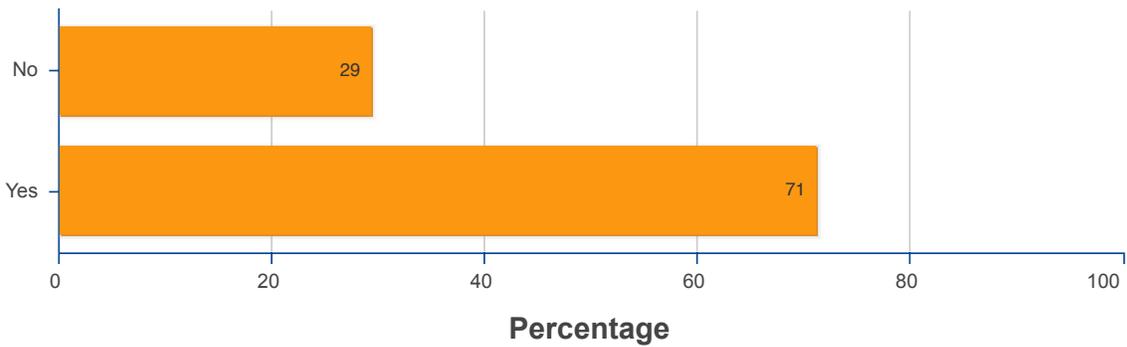
20.93% (18/86) No difference



27) In 2008 and 2009, did the global financial crisis and resulting international regulatory developments have a negative impact on your sales or volume of business?

29.09% (16/55) No

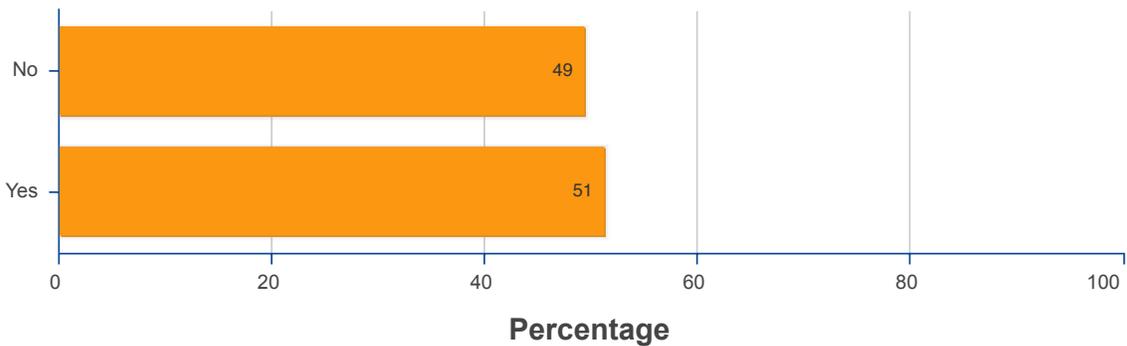
70.91% (39/55) Yes



28) As of the date of this survey, have your sales or business volumes returned to pre 2008 and 2009 levels?

49.09% (27/55) No

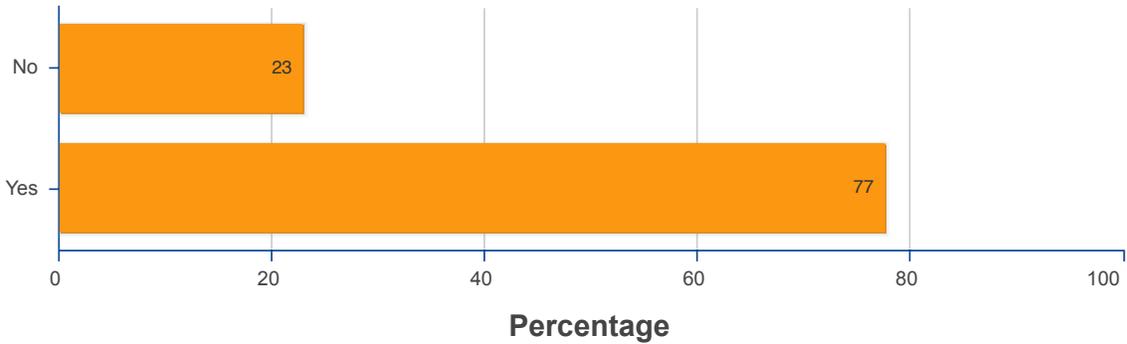
50.91% (28/55) Yes



29) Should the CSA compile national exempt market statistics using Form 45-106F1 Report of Exempt Distribution and Form 45-106F6 British Columbia Report of Exempt Distribution (used in BC only) and regularly publish such a report (similar to the capital markets reports published by the British Columbia Securities Commission, Alberta Securities Commission and the New Brunswick Securities Commission)?

22.67% (17/75) No

77.33% (58/75) Yes



30) Are there other regulatory reforms options the CSA should consider when examining the Accredited Investor and the Minimum Amount Exemptions? Should they substitute an entirely new alternative exemption, and if so what should it be?

53.03% (35/66) No

46.97% (31/66) Yes

