



September 20, 2019

**To:** Alberta Securities Commission  
Attention: Denise Weeres, Director, New Economy  
[new.economy@asc.ca](mailto:new.economy@asc.ca)

Dear Sirs/Mesdames:

**RE: ASC Consultation Paper 11-701 – Energizing Alberta’s Capital Market**

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The Private Capital Markets Association of Canada (the “PCMA”) is pleased to provide our comments in connection with the Alberta Securities Commission’s (the “ASC”) Consultation Paper as set out below.

We believe the ASC is demonstrating its continued leadership as a member of the Canadian Securities Administrators (the “CSA”) in examining new and better ways to foster a more vibrant Alberta capital market that can better address the financing needs of emerging and growing Alberta businesses while maintaining important investor protection safeguards.

The PCMA’s comments are in connection with brainstorming ideas (a), (b), (c), (d), (e), (f) and (g).

### **About the PCMA**

The PCMA is a not-for-profit association founded in 2002 as the national voice of exempt market dealers (“EMDs”), issuers and industry professionals in the private capital markets across Canada.

The PCMA plays a critical role in the private capital markets by:

- assisting hundreds of dealer and issuer member firms and individual dealing representatives to understand and implement their regulatory responsibilities;
- providing high-quality and in-depth educational opportunities to the private capital markets professionals;
- encouraging the highest standards of business conduct amongst its membership across Canada;
- increasing public and industry awareness of private capital markets in Canada;
- being the voice of the private capital markets to securities regulators, government agencies and other industry associations and public 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 PCMA is available on our website at [www.pcmacanada.com](http://www.pcmacanada.com).



## Responses to specific brainstorming ideas in the Consultation Paper

- a) **Informational Resources for Alberta start-ups and early stage businesses on capital raising options**
- b) **Informational Resources for Investors investing in Alberta Businesses**

We have combined our response to both brainstorming ideas for issuers and investors. The PCMA strongly supports any ASC initiative to improve resources dedicated to investor education and information for new for Alberta start-ups and early stage businesses on capital raising options in the private capital markets. We believe these resources can be delivered electronically through the ASC website and include YouTube videos, live and recorded webinars and other digital-based media.

### Investor Education and Websites

As investor education resources and tools are common among all CSA members, for your ease of reference, we have identified certain examples of investor information on select CSA member websites that we think are good resources. We have provided select comments and observations in Schedule A. We also reviewed the ASC's current website that it relaunched in 2019, and have similarly provided comments as a means of addressing these brainstorming topics.

#### *ASC Website – Investor Dashboard*

The PCMA supports the continued development of the ASC Checkfirst<sup>1</sup> Investor Dashboard (the “**ASC Investor Dashboard**”). Upon review of the ASC's investor education videos, we believe they can be grouped into two types: Investing 101 Videos - general investor education, and Investment Fraud Videos - warning videos. The first type of videos includes information about RRSPs and TFSAs, developing a financial plan and basic financial concepts. The second type of videos include information about affinity fraud, pump and dump schemes, recognizing and avoiding Ponzi schemes, and victim testimonials.

The PCMA believes that information about the private capital markets and exempt market dealers (“**EMDs**”) is missing and applauds the ASC efforts in creating an Exempt Market Dashboard as discussed below under “*ASC Website – Exempt Market Dashboard*”. It is in the private capital market where start-ups and early stage businesses will likely find options for raising capital. It is the ASC's mandate to develop fair and efficient capital markets as well as protecting investors.

The PCMA believes information on the ASC Investor Dashboard should include, by video or downloadable documents, more information about the private capital markets, including, but not limited to, the following topics:

- What is the difference between the private and public capital markets

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<sup>1</sup> <http://www.checkfirst.ca>



- What are prospectus exemptions and how are they used to finance businesses and create jobs in Alberta
- How the offering memorandum exemption works to raise capital in Alberta
- What is the role of an EMD and its Dealing Representatives in the capital raising process
- What is the role of an issuer when raising capital and how do they work with an EMD
- Risk and reward considerations when investing
- Explaining the purpose of the risk acknowledgement forms
- What documents should an investor read when considering an investment
- How to work with a dealing representative in completing your know-your –client (“KYC”) form and subscription agreement
- Redemptions and liquidity in the private capital markets
- How to read your client statements in the private capital markets (e.g., what ‘not determinable’ means)
- How do you set up a registered plan for private capital market securities

The PCMA would welcome the opportunity to work closer with the ASC in developing topics of interest that can provide investors with better more tailored information about the private capital markets.

As an example of an excellent investor education tool, we acknowledge and appreciate the hard work the ASC has completed, in consultation with the ASC’s Exempt Market Dealer Advisory Committee, in the release of *ASC Notice 31-701 – Account Opening Assistance*.<sup>2</sup> It provided a sample KYC form and account information explaining, among other things, what information a Dealing Representative collects from an investor and why. It is not uncommon for investors to ask why an EMD and its Dealing Representatives have to ask so many questions, including personal financial and other information, when completing a client KYC form and related documents. This is a very helpful tool for Dealing Representatives who can provide this document to investors to support the requirement to provide KYC information.

#### *ASC Website – Exempt Market Dashboard*

The PCMA applauds the ASC creation and further enhancement of its Exempt Market Dashboard (i.e., Tableau Public).<sup>3</sup> We recommend certain enhancements to content, overall usability and user-friendliness, as set out below:

- as this is an Alberta initiative, consideration should be given to showcasing Alberta-based issuers and linking them to Alberta-based EMDs that have approved a particular offering for distribution and sale.

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<sup>2</sup> <https://www.albertasecurities.com/-/media/ASC-Documents-part-1/Regulatory-Instruments/2018/10/5380701-v1-ASC-Notice-31-701-PDF.ashx>

<sup>3</sup>

<https://public.tableau.com/profile/albertasecuritiescommission#!/vizhome/ExemptMarketDashboard/EXDDashboard>



- adding information similar to what is found on the TSX Matrix, but with easy access to information about private capital market investment opportunities and documents for Alberta investors, such as the issuer's offering memorandum, related OM marketing materials and audited annual financial statements.
- consider providing easy access to the ASC's existing database of exempt financings (similar to BCSC eServices) to provide insights on the size and nature of financings being reported to the ASC.
- the ASC states in the Consultation Paper that it seeks comments on whether it should encourage certain limited information to be filed with the ASC about private financings that are not currently required to be reported (*e.g.*, amount raised, price, and security type). The PCMA suggests the option for issuers to provide such information, however, it should not be a requirement. An issuer should be encouraged to provide information for investors that could be used for educational/information purposes rather than providing the ASC with more information which is burdensome to an issuer without a corresponding benefit.
- The website for the ASC Investor Dashboard is slow and does not appear to include all data (*e.g.*, missing some years; when selecting two issuers only one shows up in the search filter).
- Please ensure the ASC portal is compatible for all users. SEDAR for example, will not always display documents on Apple based devices or other PDF viewers, outside of Adobe.
- We believe that the ASC needs to create a dashboard that is developed from the "Eyes of an Investor". The ASC Dashboard should include an issuer-specific site that has all of an issuer's information in one place. For example, if an investor wants to see all filings about Alberta Business Inc., it should be able to go to a specific site within the ASC's portal that has key information about the issuer filed with the ASC including:
  - the same information as on SEDAR for reporting issuers (as applicable)
  - the issuer's offering memorandum (current and past), if applicable, or another document filed with the ASC
  - marketing materials, if available
  - audited annual financial statements (current and past), if available
  - news releases, if available
- Such an issuer centric site would allow investors and market participants to have more information and transparency about each issuer in a use-friendly manner. The PCMA would welcome the opportunity to have further discussions with the ASC regarding this initiative.

The PCMA strongly recommends that the ASC initially focus on developing an investor friendly site dedicated to Alberta investors, issuers and local based registrants.

#### **c) Expanding the Accredited Investor Exemption to include Educated, Experienced Investors**

With the current poor economic situation in Alberta arising from depressed oil prices and otherwise, it is time for Alberta to diversify its economy outside of oil and gas, by increasing capital formation for start-up and early stage businesses which are often referred to as small and medium size enterprises ("SMEs"). This requires an examination of how capital is raised under available prospectus exemptions, including



the accredited investor exemption (the “**AI Exemption**”) as set out in section 2.3 of National Instrument 45-106 – *Prospectus Exemptions* (“**NI 45-106**”).

The PCMA supports the ASC idea to expand the definition of an “**Accredited Investor**” (“**AI**”) under the AI Exemption to increase the pool of capital for Alberta issuers and to provide Alberta investors with increased investment opportunities, while maintaining the required investor protections.

If the AI definition is expanded, it will increase the number of AIs in Alberta and arguably increase: (a) investing by Alberta investors; and (b) employment by Alberta issuers who now have better access to capital to grow their businesses, create jobs and stimulate the economy.

Alberta needs to increase capital formation for SMEs, especially those issuers who have raised less than \$10,000,000 since inception. Such amounts are not necessarily being raised by Alberta EMDs and other Alberta registrants. This is due the cost of a registrant’s compliance burden under securities legislation for the relatively small amount raised in various tranches or rounds of financing. Regardless of the size of the capital raise, the compliance burden does not change significantly.

The ASC’s review of the AI Exemption is consistent with the current review underway by the United States *Securities and Exchange Commission* which released in June 2019 its paper titled, “*Concept Release on Harmonization of Securities Offering*”<sup>4</sup> (the “**US Concept Paper**”). The SEC is also undertaking a review of the definition of AI in the United States and the ways to harmonize its exempt market and this could be a good source of information for the ASC Consultation Paper.

The AI Exemption is premised on an investor having:

- a certain level of sophistication,
- the ability to withstand financial loss, and
- the financial resources to obtain expert advice

Under the current AI definition for individuals, the income and asset tests are based on financial thresholds that assume an individual or with a spouse has the financial capacity to withstand a loss, in whole or in part, of their investment. Based on such financial thresholds, the AI definition assumes the individual has the requisite financial sophistication to carefully consider their investment or will hire an expert to provide such advice. The PCMA believes income and net worth are not the only proxies for investor sophistication and believe there are alternative approaches for determining AI status.

The PCMA believes it is reasonable to view an investor’s financial sophistication as a viable way to assess an individual’s qualification as an AI. We respectfully submit that if an individual has the financial sophistication and the ability to obtain and evaluate the information to make an informed decision including whether and how to much invest; it may not be necessary for the individual to demonstrate the ability to sustain losses.

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<sup>4</sup> <https://www.sec.gov/rules/concept/2019/33-10649.pdf>



The PCMA believes the ASC should expand the AI definition based on individual investors having:

- certain business experience and professional certifications
- certain education and degrees
- completed an examination such as the
  - Exempt Market Product Examination
  - Accredited Investor Examination
- being a member of an ASC approved angel group and successfully completed an Angel Investor Course Exam
- self-certification as a:
  - Sophisticated Investors; or
  - Restricted Investor

Each of the above concepts is discussed below.

#### *Business Experience and Professional Certifications*

The PCMA believes the AI definition should consider an individual's financial and business sophistication and include criteria such as having operated a business, or a certain investment related professional certification.

An individual who has operated a business should be considered an AI if they have satisfied certain criteria that each act as a proxy for 'operational experience' in a business. Factors to be considered include: the length of time an individual has operated the business, what experience or title an individual held within the company to determine their operational experience, consideration of the gross revenues earned by an issuer and other factors.

The PCMA recognizes a challenge could be in determining what is requisite operational business experience but recommend basic criteria could be included in a further ASC proposal and request for industry comment.

Similarly, the PCMA believes certain professional certifications and designations may also provide demonstrable evidence of investor sophistication and such individuals should be included in the AI definition. There are a number of examinations that test an individual's knowledge and understanding in the areas of securities and investing, and individuals must pass examinations to obtain the necessary professional certification. The PCMA submits that individuals having the following professional designations should be included within the AI definition: certain types of lawyers (e.g., those with corporate and/or securities law experience), a Chartered Professional Accountant, a Chartered Financial Analyst; a Canadian Investment Manager; a Certified Financial Planner; and a Life Insurance Agent.

The PCMA recognizes some individuals who obtain certifications and designations may not practice in fields related to the certifications or designations. For these individuals, the validity of the credential as a proxy for financial sophistication could be lessened.



### *Educational Degrees*

The PCMA believes certain educational backgrounds more appropriately reflect investor sophistication than financial metrics. We suggest criteria such as university degrees and advanced degrees in relevant areas to be included within the AI definition.

While certain types of degrees likely imply knowledge in the areas of finance and investing, such matters would require determining which degrees would be sufficient for an individual to qualify as an AI. The PCMA submits the educational degrees the ASC should include within the AI definition could include individuals who have: a business degree from an accredited university, a law degree from an accredited law school and other relevant degrees.

### *Industry Examinations*

The PCMA submits that the ASC should add a new category to the AI definition that includes individuals who have passed certain examinations, such as the Exempt Market Product Exam or a proposed Accredited Investor Examination to be included within the AI definition.

Having successfully passed an acceptable exam, provides demonstrable evidence of relevant investor sophistication. The subject matter of their examination would satisfy either the proficiency requirement for a dealing representative under applicable securities law or be tailored to what an AI would need to know to make a fully informed investment decision.

Logically, if someone is sophisticated enough to advise others on investing, they should themselves be qualified to invest in them.

As is currently being explored the US Concept Paper, the ASC should allow any individual who successfully passed the Exempt Market Product Exam or the Canadian Securities Course Exam to be an AI. These individuals would be meet the definition of AI if they were employed by an EMD since the current definition of AI includes an existing or former registrant. An individual's integrity or solvency would not be relevant since the ASC would not be considering such individual's fitness to be a registrant as required under applicable securities law (*e.g.*, solvency or integrity matters). The ASC should also consider any individual who has satisfactorily passed the examination to satisfy the proficiency requirements to be a registrant under securities legislation. These courses would include: the Canadian Investment Funds Course Exam, the Investment Funds in Canada Course Exam, the Sales Representative Proficiency Exam, and the Series 7 Exam.

We suggest the ASC create an Accredited Investor Examination (the “**AI Exam**”) which is also contemplated in the US Concept Paper. This could provide a path for individuals who can objectively demonstrate, by passing an examination, that they are financially sophisticated and understand the nature and risks of investing in exempt market offerings to qualify as an AI.



An AI Exam would be available to anyone, regardless of their wealth, educational background, professional experience or any other factor. Individuals who are unable to qualify as an AI under any other criteria could take such an examination as an alternative means to qualify. This approach could enable financially sophisticated individuals to qualify as AIs regardless of their wealth, educational background or professional experience.

An AI Exam could include elements that test investors' knowledge of the risks present in exempt offerings, as well as financial and investing concepts in general. We note that portions of the Exempt Market Product Exam cover these areas and could potentially be used as a model for developing an AI Exam.

An AI Exam would reduce compliance burdens on issuers and registrants, since verification of a passing score would typically not require significant time or cost. Moreover, requiring that examination results be relatively recent (*e.g.*, within five years) or requiring continuing education could help to ensure that investors remain informed of marketplace trends and risks and regulatory changes.

The PCMA believes the ASC should move forward with such an initiative, on its own if required, since it has clearly demonstrated its desire to energize its capital markets. Although, the PCMA is a strong proponent of harmonization, there is a crisis in capital raising in Alberta to raise capital, create jobs and grow Alberta's economy that requires an immediate response.

#### *Experience Investing in Exempt Offerings*

Expanding the AI definition to include individuals with relevant investment experience would recognize an objective indication of financial sophistication and allow experienced investors to maintain their AI status. These individuals presumably have developed knowledge about the private capital markets, including their inherent risks. This experience may include performing due diligence, negotiating investment terms and making valuation determinations.

#### *Angel Investors*

Angel groups provide an important source of very early stage financing. Alberta needs to grow and expand its angel group community. Angel groups screen potential investments, perform due diligence, negotiate investment terms and make valuation determinations. The formation of an angel group and the collaboration among investors demonstrates a certain degree of financial sophistication.

The PCMA submits that the ASC should approve certain angel groups as 'designated angel groups' and allow members of such groups, subject to certain requirements have satisfied the definition of AI. To be a 'designated angel group', the ASC would have to develop standards by which such groups may qualify. A member of a 'designated angel group' would then be an eligible AI provided that they have been a member for at least a specified period of time and taken an Angel Investor Course.



The PCMA believes that as an alternative to an Accredited Investor Exam, angel groups could prepare a qualification exam (*i.e.*, Angel Investor Course Exam), that satisfies the ASC curriculum requirements (to be developed by the ASC in consultation with the National Angel Capital Organization) and, if it such an exam was successfully completed by an individual, they would then be qualified as an AI.

#### *Self-Certified Investors*

Another approach the ASC could consider in changing the AI definition would be to allow investors to self-certify certain matters, as they do in the UK, as discussed below.

The PCMA submits that the ASC should also permit individuals to self-certify they are a sophisticated investor as they do in the United Kingdom (the “UK”) which the PCMA submits should be sufficient to satisfy the AI definition. The UK permits self-certification by an individual who is a “sophisticated investor” and its criteria are set out in Schedule B.

#### *Self-Certified Restricted Investor*

The PCMA submits that the ASC should also permit individuals to self-certify they are a sophisticated investor as they do in the UK which would satisfy the AI definition. This type of AI would be limited in the amount they can invest in any 12-month period and capped to 10% of their net financial assets. It would also provide a bright-line definition of net assets which could easily be derived from the net asset test in the definition of an “eligible investor” under the offering memorandum prospectus exemption as per s. 2.9 of NI 45-106 (the “OM Exemption”). Arguably, this allows investors to invest in start-ups and SMEs but limit their investment risk to a maximum amount that the PCMA submits provides the right balance between investor protection and fair and efficient capital markets.

An example of the type of Restricted Investor Certificate a qualified investor completes in the UK that would have to be tailored for Alberta securities law is set out in Schedule C.

#### **d) Challenges associated with confirming accredited investor status**

The PCMA believes it is important that alternative means be provided to verify that an individual is an AI. Many EMDs have compliance processes used for determining the income and assets of an investor that make up part of their KYC forms. Some EMDs use a spreadsheet as an information gathering tool to obtain more detailed information about an investor’s assets and liabilities to determine whether they satisfy various financial thresholds as an AI under the AI Exemption or an “eligible investor” (“EI”) under the OM Exemption.

Unless there is a glaring red flag, an EMD typically does not request a copy of an investor’s income tax return or notice of assessment. Many investors consider such information ‘highly’ confidential and do not feel comfortable providing it to a third party. Accordingly, despite reasonable efforts of an EMD to correctly verify the AI status of an investor, and the investor signing various documents attesting to being an AI, the investor may provide inaccurate information to satisfy the AI Exemption. The impact of any



incorrect information may adversely impact reliance on the AI Exemption. In such circumstances, doubt would be cast on the EMD's procedures for AI verification which could result in regulatory or enforcement action.

For the above reasons, the PCMA believes the ASC should allow third parties, or the ASC itself, to verify an investor's status as an AI or EI which could be relied upon by an issuer and/or registrant in connection with any trade under the AI Exemption or OM Exemption respectively as applicable.

The PCMA has set out in Schedule D various considerations involving AI verification that the ASC should consider.

**e) Registration exemption for finders**

The PCMA agrees that SMEs raising modest amounts of capital have significant difficulty in attracting a registered dealer, such as an EMD, to sell their offering. We also agree that these difficulties are exacerbated in rural or smaller communities given the geographical distance to a registered dealer.

The PCMA, however, also recognizes that the regulatory compliance burden placed on EMDs is too great relative to the time, money and effort required by an EMD to raise small amounts of capital for SMEs. It takes considerable effort for an EMD to complete due diligence on an issuer and its offering, albeit a SME, who often cannot afford skilled and experienced legal counsel or auditors to help them with structuring and preparing all offering documents. This will be exacerbated if the ASC and other CSA members implement some or all of the proposed Client Focussed Reforms. Such added compliance burdens are forcing EMDs to look at larger or institutional quality issuers with more experienced managed teams who engage knowledgeable and experienced professionals (*e.g.*, lawyers and auditors) to lower their risk while leaving SMEs to fend for themselves.

EMDs are further challenged working with SMEs since they typically have less experienced management teams (*e.g.*, in understanding the capital raising process and otherwise), have new and often unproven business models and likely inadequate capital to support their existing burn rate.

Based on the foregoing, an EMD's compliance burden is disproportionate relative to the compensation it may receive for its capital raising effort, if successful. This is also a risk in underwriting SMEs offerings and further exacerbated with the "higher-risk investments"<sup>5</sup> that may be associated with these issuers.

In addition, EMDs also have to deal with dissatisfied investors if any investment fails, which failures will arguably increase for SMEs and negatively impact an EMD's reputation and relationship with investors (*e.g.*, investors may not make further investments with an EMD who sold them an offering that failed).

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<sup>5</sup> The PCMA believes within the classification of an investment as "high risk" there are further gradations of low, medium and high risk that can distinguish high-risk products among themselves. For example, a high-risk investment in a private REIT that has a few hundred million in income producing properties that has been paying distributions uninterrupted for seven years is *less risky* than a high-risk investment in a new start-up bio-tech or software application company.



Moreover, if such SME offerings result in a client complaint or OBSI investigation, then the time, money and effort that an EMD has to deal with SME offerings is compounded further.

Lastly, the cost of conducting detailed KYP on a SME becomes a sunk cost for an EMD well in advance of a distribution; whether or not it is successful. Accordingly, EMDs may seek to offset this cost through an up-front fee (which may be too expensive for a SME) or through a commission structure based on capital raised (which may be too costly relative to the amount of capital raised and which is entirely dependent on the success of an offering). Simply put, the regulated KYP process has become too expensive and high risk for EMDs to consider distribution arrangements with SMEs and accordingly, SMEs need to look elsewhere for capital beyond that afforded by a SME's existing investor network.

In sum, there are *bona fide* reasons why EMDs are hesitant to raise capital for SMEs although some EMDs would like to be involved in the process.

Notwithstanding the foregoing, the PCMA recognizes that the status quo is not working. The 'status quo' effectively limits SME to raise capital under existing and very narrow prospectus exemptions, such as the private issuer exemption (s 2.4 of NI 45-106), the close family, friend and business associates exemption (s 2.5, 2.6 and 2.6.1 of NI 45-106), and the AI Exemption (s 2.3 of NI 45-106). However, registering finders is not the answer and, in fact, provides significantly less investor protection.

#### *Northwest Exemption & Unregistered Finders*

On March 19, 2019, the ASC published a notice of its continuation of ASC Blanket Order 31-505 (“**ASC 31-505**”) *Registration Exemption for Trades in Connection with Certain Prospectus-Exempt Distributions* which contains limited relief from the requirement to register for a trade in a security in connection with certain prospectus-exempt distributions known as the “Northwestern Exemption”.<sup>6</sup>

ASC 31-505 is contrary to **Multilateral CSA Notice 32-302**<sup>7</sup> (“**MN 32-302**”) that was published on August 15, 2018 by the securities regulatory authorities in each of British Columbia, Manitoba, Nunavut, the Northwest Territories and the Yukon (collectively, the “**NWE Jurisdictions**”). MN 32-302 states, among other things, that the substantially harmonized registration exemptions in each of the NWE Jurisdictions that form the Northwestern Exemption (the local orders) will cease to be effective in their local jurisdictions on April 30, 2019. Accordingly, Alberta is the only Canadian jurisdiction that continues to retain the Northwest Exemption.

Although the PCMA believes it is important to allow finders to operate in the capital markets since they provide an important function for registrants involved in raising capital, we recognize that some finders engage in the “*business of trading*” and should be registered. We also recognize that the ASC and other

<sup>6</sup> [https://www.albertasecurities.com/-/media/ASC-Documents-part-1/Regulatory-Instruments/2019/03/5445797-ASC Notice Update on BO 31-505.ashx](https://www.albertasecurities.com/-/media/ASC-Documents-part-1/Regulatory-Instruments/2019/03/5445797-ASC%20Notice%20Update%20on%20BO%2031-505.ashx)

<sup>7</sup> Multilateral CSA Notice 32-302 *Notice of Revocation for Certain Local Orders Providing Registration Exemption for Trades in Connection with Certain Prospectus-Exempt Distributions and Update on BC Instrument 32-517 Exemption from Dealer Registration Requirement for Trades in Securities of Mortgage Investment Entities*



CSA members spend significant resources on reviewing the activities of certain finders to determine whether they are engaging in registerable activities. Allowing ASC 31-505 is not the answer to a problem that needs to be resolved in favour of investors and for those EMDs that have gone through the entire process of registration and its continued requirements.

Based on the foregoing, many PCMA members, especially EMDs, recommend the ASC revoke 31-505, as was done in 2018 by the NWE Jurisdictions in connection with the Northwest Exemption (*i.e.*, the local rules in each jurisdiction). The PCMA is of the view that Alberta should harmonize with the other CSA members and rescind 31-105 which is inconsistent with the current state of regulation and provides inadequate investor protection.<sup>8</sup>

### *Regulation of Referral Agents*

Notwithstanding the foregoing, the ASC and other CSA members published in June 2018 changes to NI 31-103 called the “Client Focussed Reforms”<sup>9</sup> that sought, among other things, to eliminate referral agents/finders unless a referral was made by a registrant. The PCMA submitted a comment letter in response to the Client Focussed Reforms and, among other things, did not support any proposed changes to the existing referral arrangement rules under NI 31-103.

The PCMA believes the ASC needs to provide additional guidance involving the Do’s and Don’ts involving unregistered referral agents rather than promoting a registration framework. The existing securities laws in Canada describe what an unregistered referral agent cannot do and, if they engage in such activities, states that they must be registered. In contrast, the PCMA believes the ASC and other CSA members should publish what non-registered referral agents can do, to increase compliance, remove uncertainty and provide better investor protection.

The PCMA submits that the ASC and other CSA members should provide bright-line rules on what non-registerable activities can be undertaken by referral agents and request input from referral agents to create better guidance. The ASC can easily publish permitted and non-permitted referral agent activities, including FAQs that can be updated from time to time.

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<sup>8</sup> As stated in Multilateral CSA Notice 32-302 by those CSA members in the NWE Jurisdictions unregistered finders do not protect investors, where it states, among other things, the following, “*We are of the view that those purchasing securities in the private placement market require enhanced investor protections, in particular, the protections that are afforded by dealing with a registrant. Today, when investors in the participating jurisdictions invest in the private placement market from someone relying on the exemptions, they lose the benefit of receiving advice from a registrant, including the benefit of a registrant’s advice about whether the investment is suitable for them in their circumstances. Further, these investors lose the protection offered by the due diligence a registrant must perform on the security to determine if it is suitable. With the removal of the local orders and BCI 32-517 (the exemptions), these investors should also benefit from the additional protections of the registration regime.*” [bold added for emphasis]

<sup>9</sup> [https://www.osc.gov.on.ca/documents/en/Securities-Category3/rule\\_20180621\\_31-103\\_client-focused-reforms.pdf](https://www.osc.gov.on.ca/documents/en/Securities-Category3/rule_20180621_31-103_client-focused-reforms.pdf)



The PCMA also requests that the ASC and other CSA members review and rationalize certain case law involving referral agent activities that cross the line into registerable activities. The PCMA and others in the exempt market are very concerned with a 2018 decision by the BCSC *Re Liu, 2018 BCSECCOM 372*<sup>10</sup>. In this matter the British Columbia Securities Commission scrutinized the details of certain referral arrangements and determined that some of the referral agents engaged in registerable activities. The British Columbia Securities Commission disregarded the guidance on referral arrangements in the Companion Policy to NI 31-103 which is both concerning and highly confusing. The purpose of the Companion Policy is to provide the interpretation of the regulators with respect to the application of securities legislation.

The PCMA believes that burden reduction involves clear and easy to understand regulations to increase compliance. The continued emphasis by the ASC and other CSA members on what cannot be done and broad-based principles that are used against referral agents is unhelpful and increases the regulatory burden, even on Commission staff who are responsible for investigating such matters that can and should be simplified. Accordingly, the PCMA requests better guidance and information on permitted and non-permitted activities by referral agents. Such certain will increase compliance and may provide greater comfort for others to act as referral agents without the worry and risk of contravening applicable securities law.

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<sup>10</sup> BCSC decision involving Chien-Hua Liu, also known as William Liu, NuWealth Financial Group Inc. and CPFS Professional Financial Services Inc. located at: <https://www.canlii.org/en/bc/bcsec/doc/2018/2018bcseccom372/2018bcseccom372.html>



### *Closely-Held Issuer Exemption*

The ASC should consider Ontario's former closely-held issuer prospectus and registration exemption if it wants to consider new ways of raising capital. Simply, with prescribed disclosure and investment limits that protect investors, it allows issuers to raise up to \$3,000,000 from no more than 35 non-AIs that are not required to have any prescribed type of relationship with an issuer's officer, directors or otherwise.

This former OSC exemption had its roots in what was called the "seed capital" prospectus exemption that allowed a private issuer to solicit investment capital from no more than 50 prospective purchasers, provided sales are made to no more than 25 purchasers.

The PCMA supports a type of Closely Held Issuer Exemption or hybrid model incorporation aspects of Ontario's former seed capital exemption. Select aspects of the Closely Issuer Exemption is set out in Schedule E.

#### **f) Reducing compliance costs for registered dealers when dealing with Accredited Investors**

As stated in the Consultation Paper, securities regulation currently allows "permitted clients", as defined in NI 31-103, to waive certain investor protections involving a registrant's KYC and suitability obligations under applicable securities law. The PCMA supports the introduction of a similar waiver of a suitability assessment for AIs in Alberta as proposed in the Consultation Paper.

If the ASC and the Alberta Government are truly committed to making it easier to raise capital for SMEs while protecting investors, a better balance between capital formation and investor protection needs to be achieved. One means would be the introduction of an AI suitability waiver that allows certain investors to invest as they chose, without Government regulation, while protecting investors by limiting such a waiver to AIs (i.e., not retail investors).

The PCMA believes that AIs should be allowed to waive suitability and certain suitability-related KYC processes. However, a registrant, such as an EMD, would still have all other responsibilities towards an investor, as imposed by applicable securities law, including duties of care, registrant proficiency, know-your-product, conflicts of interest obligations, complaint and dispute resolution obligations, pre and post-trade disclosure, books and record retention and financial solvency and bonding/insurance requirements. Suitability and other KYC, obligations, to the extent they are required (the determination of suitability) are some of the few registrant duties that are directly tied to an investor's own sophistication and risk tolerance. As AIs have already been deemed to have a certain amount of sophistication and risk tolerance under the principles of NI 45-106, it is not incongruous to allow an AI to waive these obligations for the purposes of an NI 31-103 regulated transaction so long as it is their decision voluntarily made with full disclosure of all information necessary to make an informed investment decision.

We note that AIs can currently request a client directed trade ("CDT") under applicable securities law, however, that is based on a registrant undertaking a full suitability analysis at first instance and finding the investment unsuitable. Only after a registrant has determined that a trade is unsuitable can an investor



direct/instruct a registrant to complete a trade. Therefore, the benefits of a suitability waiver, in contrast to a CDT, is that no suitability determination would be required of a registrant at all. The option would remain open to any AIs that they are not required to waive suitability rather it is their choice. However, for those Accredited Investors that desire to make their own investment decisions, a suitability waiver would enable them to take control of their own investment decisions and disclosure.

The PCMA does not believe the ASC needs to link any AI waiver of suitability to investment experience since that is highly subjective and would complicate the process. Furthermore, we are of the view that the AI Exemption in NI 45-106 has already purported to establish deemed sophistication for this class of investor and investment experience is unnecessary and inconsistent with established principles.

The ASC has requested comments on whether it would be appropriate to impose some limit on the amount that could be invested, *e.g.*, the greater of \$30,000 and 5% of an AI's net worth. The PCMA does not object to imposing a form of Investment Limit, and recognizes that this may be an effective means of differentiating between the obvious differences between an AI and a Permitted Client. However, we strongly recommend that the ASC undertake further research and consultation on whether such limit is high enough given that the investor is an AI. The PCMA notes that the ASC does not include any "net income test" for an Investment Limit. We believe that including a net income test to determine any Investment Limit is consistent with the definition of accredited investor.

The ASC's desire to energize the Alberta capital markets is a laudable objective. Allowing for Accredited Investors to waive their registrant's suitability obligations is a fundamental step towards allowing the marketplace to organically drive this objective because of the options it creates.

#### **g) Other registered dealer compliance burdens**

We appreciate the discussion about the compliance challenges/burdens of EMDs, particularly smaller EMDs. This is a topic that we believe requires further examination to improve the balance between fair and efficient capital markets (*e.g.*, the compliance burden) with investor protection. The PCMA believes the compliance burden is currently out of balance for EMDs, particularly smaller EMDs.

#### *Outsourced Chief Compliance Officers*

There is a shortage of qualified CCOs in the Canadian capital markets, including Alberta. The biggest issue is finding someone who has the requisite industry experience, while at the same time, being able to adequately compensate such individual for their knowledge and experience. A smaller EMD may not be able to afford the services of the type of CCO they would like to hire since they are too small and have insufficient capital.

However, if a CCO could provide its services to more than one EMD (*i.e.*, act as part-time CCO for more than one EMD), then efficiencies and economies could arguably be achieved. This would be consistent with the US which allows CCOs to be independent contractors and work for more than one investment firm. The idea of having an individual act in part-time capacity for a registrant is not new in Canada.



IIROC allows part-time Chief Financial Officers for an investment dealer as an example of part-time services being provided by a registered individual to multiple registrants.

It would be the responsibility of each EMD and CCO to determine how much time the CCO should be working on-site (and, if applicable, at what intervals on-site work should be scheduled) in order for the EMD and CCO to comply with their regulatory obligations and meet the needs of the business. A CCO who routinely works off-site or with multiple EMDs needs to be prepared to devote more time to a particular EMD or spend more time on-site as needs and situations arise.

Whether regularly working on-site or not, the CCO would, amongst other of his/her supervisory responsibilities, participate in executive management meetings and inquire about and review relevant contracts, ongoing liabilities, future commitments and operational matters that may impact the EMD's business balance sheet and capital position. An EMD would need to provide a part-time CCO with unrestricted access to its books and records.

The part-time CCO is to be apprised of all relevant commitments under consideration by the EMD, including but not limited to, contracts under negotiation, corporate finance transactions in progress, etc. If the CCO is working off-site, it is expected that he/she is in regular communication with the EMD, remaining current on management and financial matters.

An EMD engaging a part-time CCO (including a CCO who routinely works off-site or with another EMD) should continually evaluate the growth and development of the business and consider whether a part-time CCO continues to be appropriate for the scale and scope of the business activities being undertaken. We note that the regulatory obligations of a part-time CCO are exactly the same as the regulatory obligations of a full-time CCO. The duties and responsibilities of a part-time CCO are not attenuated if the CCO works off-site or if the CCO works with a number of EMDs.

#### *Associate CCO*

As part of obtaining the requisite industry experience, the PCMA believes the ASC and other CSA members should permit the designation of an Associate CCO similar to the concept of an Associate Advising Representative. The designation of an Associate CCO would permit an individual to develop the skills and experience of working under the direction of an actual EMD CCO, including a part-time CCO. This would improve the talent pool and number of available and qualified CCOs that could act as a CCO for an EMD.

The small talent pool of available and qualified CCOs is a barrier to entry where an individual is approved based on the view of a CSA member. The process needs more transparency and if an individual has experience while acting as an Associate CCO for an EMD and the requisite knowledge, including taking a specialized CCO Exam for those in the EMD space, then investor protection would be dramatically enhanced while also reducing a current barrier to entry. In addition, an Associate CCO could be on-site in circumstances where the EMD had a part-time CCO who was not on-site on a full-time basis.



### *EMD Specific CCO Exam*

The PCMA believes that the ASC should encourage and participate in the development of a CCO exam specific for EMDs. There needs to be greater engagement by the ASC and other CSA members in curriculum design tailored to the exempt markets. The CCO Course offered by the Canadian Securities Institute is an excellent course, however, the role of a CCO in the exempt market is quite unique and needs to be more fully addressed.

The PCMA believes the preparation and launch of such a course requires funding that is currently unavailable in the private capital markets. Accordingly, we believe the ASC and other CSA members should allocate the necessary resources in the development of a CCO Examination for the private capital markets.

### *Registrant Portal*

The PCMA believes the timing and scheduling of any CSA member reviews and sharing of comment letters and responses should all be located on a single Registrant Portal. This Registrant Portal should allow registrants to upload documents in a safe and secure manner that they are required to provide CSA members, including the ASC in connection with a review. PCMA members have sometimes noted that certain CSA members do not have a portal or change portals which increasing the time, money and effort to upload documents.

A Registrant Portal ensures that both CSA members, including the ASC, and an EMD have access to the same information, including comment and response letters, especially when there is a change in staff at a CSA member or EMD firm.

In addition, if information has previously been provided, then a CSA member can limit their requests to any updates. For example, if an EMD has previously uploaded a KYC form (individual, joint or entity KYC form), a CSA member can simply inquire whether the form has been updated and if so, request an EMD to upload the revised form. If not, no further action is required. This will make such document requests more efficient and effective for all parties.

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In conclusion, we thank the ASC for the opportunity to provide our comments and look forward to meeting with ASC staff for in-person discussions.

Regards,

**COMMENT LETTER COMMITTEE MEMBERS**

<p><b><i>Craig Skauge</i></b> Vice Chair and Member of the Executive Committee</p>	<p><b><i>Brian Koscak</i></b> Vice Chair and Member of the Executive Committee and Chair of Advocacy Committee</p>
<p><b><i>Nancy Bacon</i></b> Director Co-Chair of Dealing Representative Committee</p>	<p><b><i>Martha Kane</i></b> Director</p>

**PCMA EXECUTIVE**

<p><b><i>Frank Laferriere</i></b> Chair</p>	<p><b><i>Georgina Blanas</i></b> Executive Director 416 301-2677 Georgina.blanas@pcmacanada.com</p>
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cc: PCMA Board of Directors



## SCHEDULE “A”

### PCMA COMMENTS ON CSA, BCSC AND OSC WEBSITES

#### CSA Website

The CSA website includes a search tool that allows investors to verify the registration of an individual or firm. It also provides related information such as, disciplinary history of the registrant and the terms and conditions imposed any registration. This data is valuable in helping to protect investors.<sup>11</sup>

- The PCMA believes it is difficult to quickly find information such as the Chief Compliance Officer or Ultimate Designated Person of a registered firm. We believe these two positions should come up on the top page in the registration search.

#### BCSC Website

The BCSC via their **InvestRight**<sup>12</sup> website provides investors with online tools and information to help them make investing decisions and protect themselves against unsuitable or potentially fraudulent investments. Furthermore, the BCSC also has a database called “**BCSC eServices**”<sup>13</sup> that publishes exempt distribution reports and related materials, including offering memoranda filed by BC-based issuers that have distributed securities worldwide, and other issuers that have distributed securities in BC.

- The PCMA believes that it would be more investor-friendly if it provided better ways of searching the database, including key-word searchability within certain documents.

#### OSC Website

Similar to the BCSC and the ASC, the Ontario Securities Commission (the “**OSC**”) has also launched a platform with the purpose of providing tools and resources to both investors and market participants called “**Get Smarter About Money**”.<sup>14</sup>

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<sup>11</sup> See: <https://www.securities-administrators.ca/investortools.aspx?id=1128>

<sup>12</sup> See: <https://www.investright.org/investing-101/the-basics/private-placement-market/>

<sup>13</sup> See also: <https://eservices.bsc.bc.ca/eder/formsearch.aspx>

<sup>14</sup> See: <https://www.getsmarteraboutmoney.ca>



## **SCHEDULE “B”**

### **SELF-CERTIFIED SOPHISTICATED INVESTOR**

In order to be a Self-Certified Sophisticated Investor under applicable UK securities law, an individual would have to satisfy one of the listed criteria set out below.

#### **Statement For Self-Certified Sophisticated Investor**

I declare that I am a self-certified sophisticated investor for the purposes of the *Financial Services and Markets Act (Financial Promotion) Order 2005*.

I understand that this means:

- a. I can receive financial promotions that may not have been approved by a person authorised by the Financial Services Authority;
- b. the content of such financial promotions may not conform to rules issued by the Financial Services Authority;
- c. by signing this statement I may lose significant rights;
- d. I may have no right to complain to either of the following—
  - i. the Financial Services Authority; or
  - ii. the Financial Ombudsman Scheme;
- e. I may have no right to seek compensation from the Financial Services Compensation Scheme.

I am a self-certified sophisticated investor because at least one of the following applies—

- a. I am a member of a network or syndicate of business angels and have been so for at least the last six months prior to the date below;
- b. I have made more than one investment in an unlisted company in the two years prior to the date below;
- c. I am working, or have worked in the two years prior to the date below, in a professional capacity in the private equity sector, or in the provision of finance for small and medium enterprises;
- d. I am currently, or have been in the two years prior to the date below, a director of a company with an annual turnover of at least £1 million.

I accept that I can lose my property and other assets from making investment decisions based on financial promotions.

I am aware that it is open to me to seek advice from someone who specialises in advising on investments.

Source: <https://www.fjpinvestment.co.uk/appendix-b/>



## SCHEDULE “C”

### SELF-CERTIFIED RESTRICTED INVESTOR

In order to be a Self-Certified Restricted Investor under applicable UK securities law, an individual would have to satisfy one of the listed criteria set out below.

I make this statement so that I can receive promotional communications relating to non-readily realisable securities as a restricted investor.

I declare that I qualify as a restricted investor because:

- (a) in the twelve months preceding the date below, I have not invested more than 10% of my net assets in non-readily realisable securities; and
- (b) I undertake that in the twelve months following the date below, I will not invest more than 10% of my net assets in non-readily realisable securities.

Net assets for these purposes do not include:

- (a) the property which is my primary residence or any money raised through a loan secured on that property;
- (b) any rights of mine under a qualifying contract of insurance; or
- (c) any benefits (in the form of pensions or otherwise) which are payable on the termination of my service or on my death or retirement and to which I am (or my dependants are), or may be entitled; or
- (d) any withdrawals from my pension savings (except where the withdrawals are used directly for income in retirement).

I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested.

I am aware that it is open to me to seek advice from an authorised person who specialise in advising on non-readily realisable securities.

Source: <https://www.fjpinvestment.co.uk/appendix-c/>



## **SCHEDULE “D”**

### **AI VERIFICATION – CONSIDERATIONS**

There are a number of considerations involving AI verification that the PCMA has identified below.

#### **Checklist of Information to be Submitted/Reviewed**

- There should be a checklist of required documents and information to be provided that validates the AI status of an investor (and his/her spouse if such matters are being determined on a household basis)

#### **Eligibility of an AI Verification Service Provider**

- The ASC should clearly set out the qualifications and requirements to be an AI Verification Service Provider

#### **Education and Training of an AI Verification Service Provider**

- The ASC should clearly set out the education and training requirements for personnel involved with an AI Verification Service Provider.

#### **Accredited AI Verification Provider List to be Publicly Available and Maintained by ASC**

- The ASC should maintain a publicly available list of AI Verification Providers on its website.

#### **Maintenance of E&O Insurance by an AI Verification Service Provider**

- The ASC should require each AI Verification Service Provider to maintain minimum amounts of errors and omission insurance in the event they have negligently determined an individual is an AI when they are not.

#### **Unique AI Investor Identifier**

- The ASC should require each AI Verification Service Provider to maintain a unique AI investor identifier that the individual can use with any registrant in connection with a trade.

#### **Form of AI verification Representation Letter**

- The ASC should prepare a form of AI verification letter that is to be provided by an AI Verification Service Provider to a registrant in connection with a trade.



### Currency of an AI Verification Letter

- An AI verification letter should be valid for a period of 16 months (January of Year 1 to April 30 of Year 2 when the prior year's tax returns are to be filed with the Canada Revenue Agency). Afterwards, an individual investor would have to reapply to obtain a new AI verification.

### Use of Technology for AI Verification

- The PCMA supports the use of technology to provide such services.

## SCHEDULE "E"

### SELECT ASPECTS OF C-H ISSUER EXEMPTION

#### Select Aspects

Select aspects of the C-H Issuer Exemption are set out below for your ease of reference:

- (i) Share transfer restrictions – restrictions on the transfer of shares must be contained in the issuer's constating documents or in one or more agreements among the issuer and its shareholders.
- (ii) Limitation on number of investors - A C-H Issuer can have no more than 35 investors (i.e., retail investors) exclusive of:
  - AIs,
  - current or former directors or officers of the issuer or of an affiliated entity of the issuer
  - current or former employees of the issuer or of an affiliated entity of the issuer, or current or former consultants, who in each case beneficially own only securities of the issuer that were issued as compensation by, or under an incentive plan of, the issuer or an affiliated entity of the issuer

*The C-H Issuer exemption broadens the scope of potential investors to include members of the public. Further consideration must be given to determine how use of the C-H Exemption does not prevent and can coexist with the private issuer exemption under NI 45-106.*

- (iii) Limitation on the amount of capital that can be raised - trades made in reliance upon the C-H Issuer exemption cannot exceed \$3,000,000 (the "**Maximum Limit**") based on the aggregate of all proceeds received by the issuer at any time from trades made in reliance upon the C-H issuer exemption. Simply put this is "once in a lifetime" exemption to be relied upon by an issuer.



Proceeds received by the C-H Issuer from trades made in reliance upon other prospectus exemptions, are not relevant. However, if the C-H Issuer has not filed a report of trade by an AI made in reliance on the AI Exemption, it will be presumed that the trade was made in reliance upon the C-H Issuer Exemption, in which case the proceeds of that trade must be counted for purposes of the aggregate proceeds limit.

The ASC should consider whether the Maximum Limit should be increased to a higher amount, such as \$5MM to reflect the Alberta Governments desire to increase capital raising for SMEs.

- (iv) No selling and promotional expenses - no selling or promotional expenses are paid or incurred in connection with the trade, except for services performed by a dealer registered under securities legislation. However, this does not prohibit legitimate selling or promotional expenses, such as printing, mailing and other administrative or *de minimis* expenses incurred in connection with the trade.
- (v) Offering document – there is no prescribed form of offering document required to be provided to an investor.
- (vi) Information statement to be provided by seller - the seller shall provide an information statement substantially similar to *Form 45-501F3* (attached as **Schedule “F”**) to the purchaser of the security at least *four days* prior to the date of the trade unless, following the trade, the issuer will have not more than five beneficial holders of its securities.

This document arguably would be similar to the Form 45-106F4 provided to investors under the OM Exemption. However, it goes further and poses questions investors should seek to understand as part of their investment decision.

- (vii) Report of Trade – there is no report of trade filing required to be made by an issuer or selling securityholder.

### **Additional Information**

For more information about the C-H Issuer Exemption, we refer you to:

- (i) a link to the C-H Issuer Exemption as set out in in the OSC Bulletin dated September 14, 2001 (OSC Bulletin (2001) 24 OSCB 5544) that can be viewed at:
  - [https://www.osc.gov.on.ca/documents/en/Securities-Category4/rule\\_20010914\\_45-501\\_nmicpf.pdf](https://www.osc.gov.on.ca/documents/en/Securities-Category4/rule_20010914_45-501_nmicpf.pdf)



(ii) an article written in 2001 by then Cassels Brock & Blackwell LLP lawyers, Brian Koscak and Peter Dunne, titled, “*Revised OSC Rule 45-501- Ontario's New Exempt Distribution Regime*” that can be review at:

- [https://www.casselsbrock.com/Doc/Revised OSC Rule 45 501 Ontario s New Exempt Distribution Regime 210](https://www.casselsbrock.com/Doc/Revised%20OSC%20Rule%2045%20501%20Ontario's%20New%20Exempt%20Distribution%20Regime%20210)



## Schedule “F”

### **FORM 45-501F3 FORM OF INFORMATION STATEMENT**

#### **Introduction**

Ontario securities laws have been relaxed to make it easier for small businesses to raise start-up capital from the public. Some potential investors may view this change in securities laws as an opportunity to “get in on the ground floor” of emerging businesses and to “hit it big” as these small businesses grow into large ones.

Statistically, most small businesses fail within a few years. Small business investments are among the most risky that investors can make. This information statement suggests matters for you to consider in deciding whether to make a small business investment.

#### **Risks and Investment Strategy**

A basic principle of investing in a small business is: **NEVER MAKE A SMALL BUSINESS INVESTMENT THAT YOU CANNOT AFFORD TO LOSE IN ITS ENTIRETY**. Never use funds that might be needed for other purposes, such as a post-secondary education, retirement, loan repayment or medical expenses, and never borrow money to make such an investment. Instead use funds that you already have set aside and that otherwise would be used for a consumer purchase, such as a vacation.

Never believe that the investment is not risky. Among other risk factors, small business investments generally are highly illiquid. In particular, until the company goes public there are significant restrictions on the resale of its securities. Even after a small business goes public there may be very little liquidity in its shares. This lack of liquidity means that, if the company takes a turn for the worse or if you suddenly need the funds you have invested in the company, you may not be able to sell your securities.

Also, it is important to realize that, just because the proposed offering of securities is permitted under Ontario securities law does not mean that the particular investment will be successful. Neither the Ontario Securities Commission nor any other government agency evaluates or endorses the merits of investments.



### **Analyzing the Investment**

Although there is no magic formula for making successful investment decisions, certain factors are often considered particularly important by professional venture investors. Some questions to consider are as follows:

1. How long has the company been in business?
2. Is management putting itself in a position where it will be accountable to investors? For example, is management taking salaries or other benefits that are too large in light of the company's stage of development? Will outside investors have any voting power to elect representatives to the board of directors?
3. How much experience does management have in the industry and in operating a small business? How successful were the managers in previous businesses?
4. Do you know enough about the industry to be able to evaluate the company and make a wise investment?
5. Does the company have a realistic business plan? Does it have the resources to successfully market its product or service?
6. How reliable is the financial information, if any, that has been provided to you? Is the information audited?
7. Is the company subject to any lawsuits?
8. What are the restrictions on the resale of the securities?

There are many other questions to be answered, but you should be able to answer these before you consider investing. If you have not been provided with the information you need to answer these and any other questions you may have about the proposed investment, make sure that you obtain the information you need from people authorized to speak on the company's behalf (e.g., management or the directors) before you advance any funds or sign any commitment to advance funds to the company. It is generally a good idea to meet with management of the company face-to-face.

### **Making Money on Your Investment**

There are two classic methods for making money on an investment in a small business: (1) through resale of the securities in the public securities markets following a public offering; and (2) by receiving cash or marketable securities in a merger or other acquisition of the company.

If the company is the type that is not likely to go public or be acquired within a reasonable time (i.e., a family-owned or closely-held corporation), it may not be a good investment for you irrespective of its prospects for success because of the lack of opportunity to cash in on the investment. Management of a successful private company may receive a return indefinitely through salaries and bonuses but it is unlikely that there will be profits sufficient to pay dividends commensurate with the risk of the investment.



## **Conclusion**

When successful, small businesses enhance the economy and provide jobs for its citizens. They also provide investment opportunities. However, an opportunity to invest must be considered in light of the inherently risky nature of small business investments.

In considering a small business investment, you should proceed with caution and make an informed investment decision based on your circumstances and expectations. Above all, never invest more than you can afford to lose.