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CROWDFUNDING EXEMPTION

By Bill Johnstone

The much anticipated Crowdfunding Exemption is scheduled to come into effect in Ontario, Manitoba, Quebec, New Brunswick and Nova Scotia on January 25, 2016. Canadian public and private Issuers will be able to raise up to \$1,500,000 from the public in any 12 month period through a single funding portal in tranches of \$2,500 per investor (unless the investor is an accredited investor), subject to numerous restrictions and conditions. While it is available for private and public companies, it may be of more benefit to private start-up technology and other innovative companies that would have a greater appeal to millennials. The basic criteria for a Crowdfunding Exemption Offering are as follows:

1. an Issuer enters into an issuer access agreement with a registered funding portal and provides completed personal information forms (comprehensive personal disclosure documents) (“PIF”) for each director, executive officer and promoter of the Issuer;
2. the funding portal conducts

background checks on the Issuer and criminal and background checks on each individual providing a PIF;

3. the Issuer prepares a Crowdfunding Offering Document (Form 45-108F1), including the required financial disclosure, which is reviewed by the funding portal to determine that the disclosure is complete and not misleading;
4. once the background checks have cleared and the Crowdfunding Offering Document has been vetted, unless the funding portal makes a good faith determination that the business of the Issuer may not be conducted with integrity, or there is some other specified non-compliance by the Issuer, the Crowdfunding Offering Document and any Additional Distribution Materials (see below) are posted on the portal and the offering commences;
5. the Issuer may make available through the funding portal a term sheet and other documents summarizing the information in the Crowdfunding Offering Document (“**Additional Distribution Materials**”)

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as well as a video provided they are consistent with the disclosure in the Crowdfunding Offering Document;

6. the offering can only be open for subscriptions for a period of 90 days and must close within 30 days after the end of the distribution period after all necessary documentation has been delivered and all rights of withdrawal have expired;
7. a maximum of \$1,500,000 can be raised by an Issuer under the Crowdfunding Exemption in a 12 month period;
8. the following investment restrictions apply to Purchasers under the Crowdfunding Exemption:
 - (a) if the Purchaser is not an accredited investor, the subscription cannot exceed \$2,500 for the distribution; and if the purchaser is an accredited investor, the subscription cannot exceed \$25,000 for the distribution; and
 - (b) in Ontario, non-accredited investors are limited to an acquisition cost of \$10,000 for all distributions under the Crowdfunding Exemption in a calendar year and accredited investors are limited to an acquisition cost of \$50,000 for all distributions under the Crowdfunding Exemption in a calendar year;
9. the Issuer is prohibited from advertising a distribution or soliciting Purchasers under the Crowdfunding Exemption but it may inform Purchasers that it proposes to distribute securities under the exemption and may refer Purchasers to the funding portal facilitating the distribution;
10. the funding portal is also prohibited from advertising a specific distribution or soliciting purchasers under the Crowdfunding Exemption, is limited to making available to Purchasers the Crowdfunding Offering Document and any other materials and must ensure that the information about the offering is presented or displayed on its online platform in a fair, balanced and reasonable manner;
11. the online subscription agreement for Purchasers to subscribe under the offering must include a right of withdrawal by the Purchaser within 48 hours after the date of the agreement of purchase and must provide either a statutory right or a contractual right of action against the Issuer for rescission and damages in the event of a misrepresentation or, in the case of a private issuer, liability for an untrue statement;
12. the funding portal must obtain from each Purchaser, before making a purchase, a risk acknowledgement form (Form 45-108F2) and either confirmation and validation that the Purchaser is an accredited investor, if the acquisition cost is greater than \$2,500, or, in Ontario, obtain and



validate a confirmation of investment limits form (Form 45-108F3) and must also obtain acknowledgments from the Purchaser that there has been no securities regulatory review of the offering, that there is a risk of loss of all or most of the investment and that the Purchaser may receive limited ongoing information about the Issuer or the investment made;

13. no fees can be paid in respect of a Crowdfunding Exemption Offering except to the funding portal and the funding portal is required to prominently disclose the details of the fees paid and payable on the portal with the disclosure relating to the distribution in question; and
14. for a public company, pricing and structure of the financing would be subject to applicable stock exchange rules and the securities issued would be subject to a 4 month hold period.

The Crowdfunding Offering Document must be certified by the CEO, CFO and two directors (and any promoter) of the Issuer. For junior resource issuers, if technical information is included in the Crowdfunding Offering Document, then National Instrument 43-101 would require a current technical report to support the technical information in the Crowdfunding Offering Document. There is a prohibition against the use of the Crowdfunding Exemption to raise money for a blind pool and the use of the exemption where an Issuer has not complied with the requirements of the Crowdfunding

Exemption. The Crowdfunding Offering Document and the Additional Distribution Materials must be filed with the securities regulators when disclosure is filed with respect to the distribution. On-going financial disclosure obligations are imposed on a private Issuer following the use of the Crowdfunding Exemption until it either becomes a reporting issuer; completes a winding up or dissolution; or the securities of the Issuer are beneficially owned directly or indirectly by fewer than 51 security holders worldwide. There is also an obligation for a non-reporting issuer to file a form relating to certain specified key events (Form 45-108F4).

Due to the fact that the funding portal must be registered and has duties as a registrant, there will be upfront costs to the Issuer for the funding portal's role in items 1 to 4 above. The funding portal will have on-going duties relating to item 12 above as well as its review of any online communication channel and managing the subscription process. There are two categories of registration for a funding portal: a funding portal only registered under the Crowdfunding Exemption (a "**Restricted Dealer Funding Portal**"); and an existing investment dealer or exempt market dealer who acts as intermediary for a distribution through a funding portal (a "**Registered Dealer Funding Portal**"). The funding portal must obtain acknowledgement from the Purchaser regarding the category of registration of the funding portal. A Restricted Dealer Funding Portal is prohibited from providing a recommendation or advice to the



Purchaser in respect of the offering and a Registered Dealer Funding Portal is required to provide advice about the suitability of the purchase of the securities.

The Issuer has virtually no involvement in the offering between the time that the offering is posted on the portal and the earlier of 90 days from that date or the closing of the offering, unless there is an amendment to the offering or the Issuer participates in an online communication channel (see below). The Issuer can distribute securities concurrently under other Securities Act exemptions such as the accredited investor or offering memorandum exemptions but must disclose in the Crowdfunding Offering Document the concurrent financing.

If the funding portal establishes an online communication channel through which Purchasers may communicate with one another and with the Issuer about the distribution, the funding portal is required to monitor the postings and remove any statements by or information from the Issuer that is inconsistent with the Crowdfunding Offering Document or not in compliance with the Crowdfunding Exemption. Although there is a prohibition against advertising, the securities administrators recognize that Issuers may want to harness the “wisdom of the crowd” in a Crowdfunding Exemption Offering and recognize that Issuers may participate in communication channels or discussion boards “to encourage purchasers to discuss the crowdfunding distribution”. Since this line of communication will only occur through

the funding portal, a Purchaser will first have to find the funding portal and will therefore not be solicited by or advertised to pursuant to the communication channel. There is no other guidance at this time on how the communication channel will work and it remains to be seen how effective this will be for Issuers to harness the “wisdom of the crowd”.

Once the investing public is aware of the existence of the funding portals, the Crowdfunding Exemption may become a vibrant and lucrative source of capital. Public or private issuers raising a maximum of \$1,500,000 would acquire at least 600 new shareholders (assuming no accredited investors invest beyond the \$2,500 limit) and the number may be higher. Additional shareholders will result in higher administrative costs for the Issuer and 600 new investors who have invested through the internet may require expansion of an Issuer’s investor relations department as the new investors monitor their investment and make inquiries of the Issuer regarding the status of the activities for which the funds were raised.

Initially, there will be significant uncertainty for an Issuer proceeding with a Crowdfunding Exemption Offering given the 90 day limit on the offering. Assuming funding portals are in fact registered by January 25, 2016, it will be interesting to watch this historic event unfold. For private issuers, the Crowdfunding Exemption provides broader access to capital for a start-up company. For existing public companies attempting to fund or reactivate their existing activities or enter into new clearly defined ventures,



the Crowdfunding Exemption may provide access to the retail market of the future where retail investors invest directly in the company through the internet. Social media may drive interest in an investment in an existing public company through a funding portal to a level where offerings are fully subscribed leaving other interested investors to purchase securities of the Issuer in the secondary market. The Crowdfunding Exemption has the potential to rejuvenate the junior capital markets through an entirely new investor base. With all of its limitations, restrictions and complications, at the end of the day the Crowdfunding Exemption is an exciting new way to raise capital for both private Issuers and junior public Issuers.

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