Goodmans LLP Update

Technology

October 25, 2016

Three Major Developments in the Regulation of Canadian FinTech Companies

1. The OSC Has Unveiled the OSC LaunchPad

As previously discussed in our recent Update, *OSC Announces Launch of Innovation Hub for FinTech Companies*, the OSC has now officially unveiled the OSC LaunchPad, the first innovation hub introduced by a Canadian securities regulator aimed at improving the integration of FinTech companies entering the securities regulatory framework.

The OSC LaunchPad operates in two ways. First and foremost, it provides guidance and assistance to innovative businesses, such as early-stage FinTech companies navigating through the securities regulatory framework. The OSC LaunchPad consists of a team of regulatory specialists who work alongside eligible FinTech companies to provide them with direct support tailored to their unique business models.

"This is an exciting opportunity for Canadian innovators. With OSC LaunchPad, emerging FinTech businesses now have an opportunity to work with securities law experts from day one. This initiative reflects the OSC's commitment to regulation that is in step with innovation," said chair and CEO of the OSC, Maureen Jensen.

The OSC LaunchPad team of specialists will assist innovative companies in understanding how securities regulations apply to their businesses. The OSC LaunchPad effectively provides for a flexible approach to meeting regulatory requirements while upholding the OSC's primary objective of protecting investors. For example, the OSC may, in some cases, consider time-limited registration or exemptive relief for eligible FinTech companies looking to test the product, services and applications.

"There are some requirements that were built in a paper-based environment when you were sitting across a table and that may not work in a technology platform, so we may have to give some type of relief to help these firms be in compliance and at the same time test their business," said the chief of the OSC LaunchPad, Pat Chaukos.

Second, the OSC LaunchPad will establish an advisory committee to gather information to better understand the unique issues facing these companies. The mandate of the advisory committee will be to work toward modernizing the current securities regulatory framework and find ways to ensure new and upcoming business models can fit within and meet regulatory requirements.

According to the OSC LaunchPad website, FinTech companies offering the following services may have securities-related regulatory obligations:

- Digital platforms that connect investors with firms seeking to raise capital;
- Lending platforms that allow investors to fund loans (or portions of loans);
- Technology and/or data-driven investment activities or advice, including online advice;
- Investor networks and organizations, and the platforms that support them.

The OSC LaunchPad is now fully operational and is accepting applications by FinTech companies.

2. AngelList Syndicates Launch in Canada through the New OSC LaunchPad Program

In a second major development in Canadian FinTech, AngelList Syndicates, an American startup funding platform, has received regulatory approval by the OSC to launch in Ontario, pursuant to the OSC LaunchPad initiative.

AngelList Syndicates is a FinTech platform that brings together syndicates of investors with startup companies in need of financing. In the United States, AngelList has provided funding to over 1,000 companies. In Ontario, the OSC's decision approving AngelList's operations provides eligible investors the opportunity to invest in approved incubator programs, which include (i) Creative Destruction Lab, a venture lab based out of the University of Toronto's Rotman School of Management, (ii) NEXT Canada, a Canadian promoter of Canadian innovators building business ventures, and (iii) other incubator programs as approved by the OSC from time to time.

As part of its regulatory approval, the OSC granted prospectus relief to AngelList on the condition that, among other things, investors meet Ontario's accreditor investor criteria, acknowledge the risks associated with angel investing in startups and satisfy AngelList's own screening criteria. Further, the OSC approval applies only to investments in startups that are headquartered, or have significant operations in Canada.

TechToronto Co-Founder, Alex Norman who spearheaded the program said "The prospect of access to AngelList Syndicates across Canada should be exciting news to Canadian entrepreneurs, as it gives them an efficient way to raise capital from credible entrepreneurs on a more cost-effective basis."

3. Canada's First Fully Regulated Peer-to-Peer Lending Platform Available to Canadians

In a third major development for Canadian FinTech companies, particularly peer-to-peer lending platforms, Lending Loop is now available to investors and businesses in all Canadian provinces except Québec. Lending Loop provides access to affordable financing for small-sized companies by connecting them with Canadian investors. It also provides investors with access to alternative investments outside of the stock and real estate markets, allowing further diversification of investor portfolios with small business loans across various industries and geographies.

Regulatory Hurdles – A Short History

Globally, peer-to-peer lending platforms have been operating successfully, but companies offering the product in Canada have faced unique regulatory challenges. On June 19, 2015, the Ontario Securities Commission (OSC) issued a press release noting that peer-to-peer lending websites were starting to conduct business in Ontario and were offering lending products that may constitute a "security" as defined under the *Securities Act* (Ontario) ("**Securities Act**"). The OSC instructed these companies to enter into talks with the OSC if their business involved approaching Ontario investors to fund peer-to-peer loans or loan portfolios. The OSC alerted Canadian FinTech companies offering securities to focus on the requirement to file a prospectus or rely on an exemption from the prospectus requirement, as provided in the Securities Act.

Lending Loop was sidelined by regulators in February of 2016, causing industry insiders to raise concerns about Lending Loop's ability to remain cost-effective while having to meet securities-related regulatory hurdles, which can often be costly and time-consuming. In March of 2016, Lending Loop halted loan requests on its online platform, pending talks with the securities regulatory authorities. At that time, Lending Loop announced that more than 3,000 Canadians signed up to join Lending Loop since October 7, 2015.

Regulatory Success – Canada's First Fully Regulated Peer-to-Peer Lending Platform

Other similar FinTech companies in Canada have avoided the prospectus requirement by restricting their lender pool to those who meet certain income or asset thresholds and fall into the "accredited investor" exemption. Lending Loop, on the other hand, was committed to reaching a broader pool of investors. In light of this goal, Lending Loop worked with the OSC to begin the registration process and become an exempt market dealer. "It's a prospectus exempt product with the offering memorandum that allows us to issue securities to the general public…This is a model we worked with the regulators to create, and it's got their blessing as well" said CEO and co-founder of Lending Loop, Cato Pastoll.

Lending Loop is now the first fully regulated peer-to-peer lending platform in Canada offering its product to a broad range of investors. Its new status as an exempt market dealer allows it to offer securities through an innovative business model and in a regulated manner. "While peer-to-peer lending has been highly successful across the globe, we had to navigate some unique regulatory challenges in order to bring this business model to Canada…It can be challenging for new entrants and regulators to adapt novel business models to existing regulations, and we're extremely proud to be pushing this industry forward. We're bringing a new form of finance to Canada that makes capital more accessible for small businesses while offering a brand new asset class to all Canadians" said Pastoll.

The successful OSC approval of Lending Loop and AngelList Syndicates is the first illustration of how new FinTech companies will find ways to fit into the current regulatory framework.

For further information on how to navigate the regulatory and compliance obligations that apply to Canadian FinTech companies, please contact any member of our Technology Group.

Goodmans Tech Group

To assist clients in the technology sector, Goodmans brings together our acknowledged expertise in corporate/commercial, private equity, corporate finance, mergers and acquisitions, outsourcing, licensing, intellectual property, privacy, regulatory and media, tax, litigation, human resources, corporate restructuring and administrative law.

Goodmans continues to lead in the technology sector and has recently partnered with The DMZ at Ryerson University. The DMZ is a leading business incubator (selected by BMI as the top-ranked university incubator in North America, and third in the world), which connects its startups with resources, customers, advisors, investors, and other entrepreneurs. Through this partnership, Goodmans provides mentorship and networking opportunities to assist startups in maximizing their potential. Members of our Technology Group teach internet and communications law at Canada's largest law schools, are regular lecturers at technology industry events and legal conferences, and have published articles in the technology law field.