Corporate Securities Law

November 10, 2015

Equity Crowdfunding Exemption Finalized

The Ontario Securities Commission (OSC) and other participating jurisdictions have published Multilateral Instrument 45-108 *Crowdfunding*, which includes a prospectus exemption for equity crowdfunding and a registration framework for funding portals, in final form (the "**45-108 Crowdfunding Regime**"). Subject to ministerial approvals, the 45-108 Crowdfunding Regime will come into force in Ontario on January 25, 2016.

Initially proposed in March of 2014, the 45-108 Crowdfunding Regime is another measure aimed at facilitating access to capital for start-ups and small to medium-sized businesses. It has been introduced in connection with the OSC's exempt market review, which has also given rise to an offering memorandum exemption, a family, friends and business associates exemption and an existing security holder exemption (see our Updates dated April 1, 2014, *Four New Private Placement Exemptions Proposed* and November 3, 2015, *Offering Memorandum Exemption Finalized for Ontario*). It is intended to complement similar measures introduced or proposed by other members of the Canadian Securities Administrators, including Alberta's proposal of Multilateral Instrument 45-109 P*rospectus Exemptions for Start-up Businesses* and blanket orders permitting crowdfunding currently in force in certain other provinces (see our Update dated October 26, 2015, *Further Developments in Private Placement Exemptions for Start-ups*).

Crowdfunding - An Overview

Equity crowdfunding is a method of funding projects or ventures by raising small amounts of money from a large number of investors through a registered online funding portal. Because a distribution of securities in Ontario must either be qualified by a prospectus or fall within an existing exemption to the prospectus requirement, crowdfunding has not historically been possible. The 45-108 Crowdfunding Regime will provide a legal opening for issuers to access limited amounts of capital through crowdfunding, so long as they comply with measures intended to protect investors, particularly those most likely to be at risk from crowdfunding. The 45-108 Crowdfunding Regime is aimed at issuers that are not in a position to complete a prospectus offering.

Securities regulators in foreign jurisdictions have introduced measures in response to a growing trend in crowdfunding. In the United States, for example, the *Jumpstart Our Business Startups Act*, signed into law in April of 2012, created an equity crowdfunding exemption, subject to rules that were adopted by the Securities and Exchange Commission in October of 2015. The crowdfunding regime in the United States is expected to be in place by April of 2016.

Distribution Requirements

Because the 45-108 Crowdfunding Regime aims to facilitate access to capital for start-ups while still ensuring investor protection, it includes various protective measures aimed at those deemed most vulnerable to the risks of crowdfunding. Issuers must:

- prepare an "offering document" that, while less comprehensive than a prospectus, discloses certain information about the issuer and the offering (including a brief overview of the issuer, its business and management, the distribution, the funding portal and investors' rights);
- ensure that crowdfunding investors complete a "risk acknowledgment form" to confirm they understand the risks of investment and the information provided in the offering document;

- distribute securities through a single online funding portal, which must be registered as an investment dealer, exempt market dealer, or restricted dealer; and
- not solicit or advertise the offering (though issuers may provide limited marketing materials through the funding portal).

Investment Limits

Investments and distributions made under the 45-108 Crowdfunding Regime are subject to limits. Investors who do not qualify as "accredited investors" are limited to investing $2,500 per investment and $10,000 in total in a calendar year. Accredited investors (other than "permitted clients") are able to invest up to $25,000 per investment and $50,000 in total in a calendar year. There are no investment limits for a "permitted client". Issuers, meanwhile, are limited to raising up to $1,500,000 under the 45-108 Crowdfunding Regime in any given 12-month period. Because distributions under the crowdfunding exemption are exempt from the prospectus requirements, the securities distributed are not freely tradeable.

Funding Portals

The registered online funding portals through which securities must be distributed under the 45-108 Crowdfunding Regime are subject to their own requirements. These include prohibitions on offering complex securities or securities of a related issuer and requiring the funding portal to review the issuer's disclosure and obtain background checks on the issuer, its directors, executive officers and promoters. A funding portal is required to deny an issuer access to its platform if it decides in good faith that the issuer's business may not be conducted with integrity or the offering document contains a misrepresentation; it may terminate a distribution if it appears that the issuer's business is not being or may not be conducted with integrity.

Continuous Disclosure Requirements

While reporting issuers must continue to comply with their existing disclosure requirements, the 45-108 Crowdfunding Regime places additional obligations on non-reporting issuers. Non-reporting issuers that have used the crowdfunding exemption must provide annual financial statements, disclosure of the use of proceeds, and notice of a discontinuation of the issuer's business, a change in the issuer's industry or a change of control of the issuer. A non-reporting issuer that has raised over $750,000 in the exempt market since its formation will be required to have its financial statements audited; where it has raised more than $250,000 but less than $750,000 in the exempt market, the financial statements may be either audited or reviewed.

Withdrawal and Liability

In an effort to provide further protection to investors, the 45-108 Crowdfunding Regime allows investors to withdraw from any agreement to purchase a security by providing notice to the funding portal within 48 hours after the date of the agreement to purchase. Investors are also provided with rights of rescission or damages for a misrepresentation in the offering document or other materials made available to the investor. While issuer liability is subject to the defence that the investor had knowledge of the misrepresentation, investors are not required to prove that they relied on the statement in making the investment.

For further information regarding crowdfunding, the development of the private placement exemptions and corporate finance in general, please contact any member of our Corporate Securities Group.