

Goodmans^{LLP} Update

Canadian Securities Administrators Propose Nationally Harmonized Crowdfunding Rules

The Canadian Securities Administrators (CSA) recently published a notice and request for comment regarding [Proposed National Instrument 45-110 Start-up Crowdfunding Registration and Prospectus Exemptions](#), (the “**Proposed Instrument**”), as well as the Proposed *Start-up Crowdfunding Guide for Businesses* and the Proposed *Start-up Crowdfunding Guide for Funding Portals* (collectively, the “**Guides**”), which provide plain language information that issuers and funding portals should consider when contemplating a crowdfunding distribution. The Proposed Instrument and the Guides are open for public comment until May 27, 2020.

Background

Crowdfunding is the practice of raising capital by issuing securities to a large number of people in small increments, typically through the internet. To date, the securities regulatory authorities of British Columbia, Saskatchewan, Manitoba, Quebec, New Brunswick, Nova Scotia and Alberta¹ have adopted similar registration and prospectus exemptions permitting businesses in their infancy to raise capital within a tailored crowdfunding framework (the “**Existing Framework**”). The Proposed Instrument would amend the Existing Framework by harmonizing the regulatory regime across Canada (including in those jurisdictions that have not adopted the Existing Framework), expanding issuers’ abilities to access capital via crowdfunding in those jurisdictions and providing investors with additional protection.

Overview of the Proposed Instrument

The Proposed Instrument provides two key exemptions from securities law requirements that are needed to facilitate crowdfunding:

- an exemption from the prospectus requirement that allows a non-reporting issuer to distribute eligible securities through an online funding portal (the “**Prospectus Exemption**”); and
- an exemption from the dealer registration requirement for funding portals that facilitate online distributions by issuers relying on the Prospectus Exemption (the “**Registration Exemption**”).

The Prospectus Exemption would be available to issuers who meet certain conditions, including:

- securities are sold through a funding portal that is relying on the Registration Exemption or operated by an exempt market dealer or investment dealer;
- the aggregate gross proceeds raised by the issuer during the 12 months before the crowdfunding distribution closes does not exceed \$1,000,000 (a significant increase from the \$500,000 annual limit under the Existing Framework);

¹ On May 14, 2015, British Columbia, Saskatchewan, Manitoba, Quebec, New Brunswick and Nova Scotia introduced and adopted start-up crowdfunding registration and prospectus exemptions. On October 2, 2019, the securities regulatory authority of Alberta adopted [Blanket Order 45-521](#), which is a substantially harmonized registration and prospectus exemption for crowdfunding. Ontario is not party to the Existing Framework and instead continues to regulate crowdfunding under Multilateral Instrument 45-108, which varies from the Existing Framework in a number of respects.

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- each purchaser invests no more than \$2,500 unless the purchaser obtained advice from a registered dealer that the investment is suitable for the purchaser, in which case the purchaser may invest no more than \$5,000 (up from the \$1,500 individual limit under the Existing Framework);
- the issuer prepares and provides an offering document through the funding portal's platform that discloses information about the business;
- the closing of the crowdfunding distribution does not occur unless the issuer raises the minimum offering amount stated in the offering document within the 90-day period following the date the offering document is made available in the funding portal's platform; and
- the issuer provides the purchaser with a two-day contractual right to withdraw from an agreement to purchase the security by delivering a notice to the funding portal.

Issuers relying on the Prospectus Exemption are not required to adhere to any continuous disclosure requirements or provide financial statements in connection with the distribution.

The Registration Exemption would be available to funding portals that meet the following conditions, including:

- at least 30 days before the first date the portal facilitates a crowdfunding distribution in each jurisdiction, the funding portal must deliver to the securities regulatory authority or regulator in each jurisdiction (i) Form 45-110F3 *Funding Portal Information*, and (ii) for each principal of the funding portal, Form 45-110F4 *Portal Individual Information*;
- the funding portal or any of its principals must not be, or have been, the subject of certain proceedings in the last 10 years as specified in the Proposed Instrument, including claims related to fraud, theft, breach of trust, illegal distributions, or allegations of similar conduct;
- the funding portal holds each purchaser's assets separate and apart from the funding portal's own property, in trust for the purchaser, and in the case of cash, a designated trust account of a Canadian financial institution;
- the funding portal provides the requisite disclosures and obtains the necessary risk acknowledgement from purchasers;
- the funding portal is not registered under securities legislation; and
- the funding portal does not provide advice to a purchaser about the merits of the investment or receive a commission, fee or other similar payment from a purchaser.

Practical Implications

The Proposed Instrument should make crowdfunding a more viable alternative in Canada for early stage companies without access to capital via traditional means. The Proposed Instrument addresses significant drawbacks of the Existing Framework by harmonizing the crowdfunding rules across Canada and raising the limits on amounts that can be raised. However, while the Proposed Instrument is an improvement over the Existing Framework, it is not obvious that the Proposed Instrument represents a meaningful enough change to the Existing Framework to make crowdfunding a feasible approach to raising capital for a broader group of issuers than is currently the case. According to the CSA, since 2015 a total of only \$3.5 million has been raised by way of crowdfunding. More dramatic changes to crowdfunding regulation may be required to make it a more viable fundraising technique for Canadian issuers.

Please contact any member of our [Corporate Finance and Securities Group](#) to discuss these developments.

All Updates are available at www.goodmans.ca. This Update is intended to provide general comment only and should not be relied upon as legal advice.

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