INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÉRES

Susan Copland, B.Comm, LLB.
Director

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Mr. Gordon Smith
British Columbia Securities Commission
PO Box 10142, Pacific Centre
701 West Georgia Street
Vancouver, BC V7Y 1L2
e-mail: gsmith@bcsc.bc.ca

Ms. Anne-Marie Beaudoin
Directrice du secretariat
Autorité des marchés financiers
Tour de la Bourse
800, square Victoria
C.P. 246, 22e étage
Montréal, QC H4Z1G3
e-mail: consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: Canadian Securities Administrators (CSA) Staff Consultation Note 45-401 Review of Minimum Amount and Accredited Investor Exemptions (the "Notice")

The Investment Industry Association of Canada ("IIAC" or the "Association") appreciates the opportunity to comment on the Notice published on November 11, 2011.

The IIAC Working Group formed to respond to the Notice is comprised of a cross-section of IIAC member firms of various sizes, representing a variety of retail, institutional and issuer clients. This response reflects a majority of the firms' position. However, some of our member firms have taken the position that non-IIROC dealers should be permitted to use the Accredited Investor exemption to sell securities to retail investors at differing income and asset thresholds. These firms will submit individual responses to the Notice.

The Association supports the retention the Accredited Investor prospectus exemption, as it provides a very important means for issuers to raise capital without the significant, and often impractical time and monetary requirements associated with undertaking a prospectus offering. We acknowledge, however, that in some circumstances, use of this exemption may represent risks to certain types of retail investors. Our recommendations seek to balance the need for efficient capital raising mechanisms with the need to protect potentially vulnerable investors.

Given the investor protection concerns that arise with the reduced disclosure and liability when such exemptions are used, it is critical that such registrants are subject to Suitability and KYC requirements. It is important that consistent high standards are applied to all parties selling such securities, and that appropriate monitoring take place to ensure investors obtain the same level of protection by such registrants.

Rather than responding to each specific question posed in the Notice, the following represents a general approach that we believe will address the regulatory and economic concerns articulated by the CSA.

Minimum Amount Prospectus Exemption

The Association recommends that the current $150,000 Minimum Amount prospectus exemption be removed. The ability for an investor to somehow raise $150,000, without reference to their income, assets or actual ability to sustain such a significant loss presents significant potential investor protection issues. We are concerned that the Minimum Amount exemption, designed to demonstrate an ability to withstand loss, may in some cases, result in investors actually taking on more risk than is advisable in order to be eligible to use the exemption. This individual retail investor may be particularly vulnerable where they are not advised by a qualified, independent advisor that has an obligation to consider the suitability of the investment in respect of their specific circumstances.

In addition, we share the CSA's concern that in certain cases, investors may be using the exemption in inappropriate circumstances. This problem was explicitly noted in the Alberta Securities Commission Review of Exempt Market Dealers (released January 12, 2012) and in OSC Staff Notice 31-324 (released June 2011) which found that in several cases, securities were sold under this exemption without proper due diligence.

Accredited Investor Exemption

In respect of the Accredited Investor exemption, we also support the retention of the exemption, and the existing income and asset criteria set out in sections (j)–(m) of the definition of Accredited Investor in section 1.1 of National Instrument 45-106.

These criteria, which enables retail investors to participate in the exempt market, provides issuers with a very important means of raising capital from investors with the means and desire to invest in such securities.

As discussed in the Notice, the income and asset criteria may not always provide a consistently accurate proxy for sophistication. It is, however, very difficult to develop a definitive test for sophistication that is administratively efficient and practical to apply. We do not support the application of the alternative qualification criteria proposed in the Notice. The criteria, which includes investment experience, investment portfolio size, work experience and education is potentially subjective, resulting in regulatory uncertainty, inconsistent application and regulatory risk for those purchasing and selling securities in reliance on the exemption. The income and asset criteria provide an objective test that has a reasonable link to sophistication and the investors' ability to withstand loss.

We acknowledge that in certain cases, these elements of the Accredited Investor exemption have been used improperly, for example, where the investor does not actually meet the criteria, or where it is clear that the investment is unsuitable despite the fact that the investor may have the required resources. This problem is particularly evident where non-IIROC dealers are acting for investors in purchasing these securities, and was specifically noted in the Alberta Securities Commission Review of Exempt Market Dealers and OSC Staff Notice mentioned above. The review found that certain EMDs are not properly ascertaining if retail clients qualify under the accredited investor exemption criteria, nor are they conducting KYC or suitability reviews.

We believe that these situations can be significantly reduced or eliminated by requiring investors relying on the income and asset tests in (j)–(m) to purchase securities from an IIROC registered dealer.

IIROC registered dealers have robust suitability, know-your-client ("KYC") and product knowledge obligations that help ensure that their clients are properly advised about the nature of the products in which they propose to invest, and whether they are suitable, given their specific circumstances. The IIROC rules require advisors to understand the investor's financial situation, investment knowledge and objectives, as well as their tolerance for risk.

Investor protection will be bolstered with the introduction of the IIROC Client Relationship Model Rules (the "CRM Rules"). The CRM Rules are designed to better inform clients of the nature of their relationship with their advisor. The objective is to increase relationship disclosure, manage and disclose conflicts of interest and enhance suitability obligations. Specifically, the CRM Rules will require that "each Dealer Member shall use due diligence to ensure that the acceptance of any order from a client is suitable for such client based on factors including the client's current financial situation, investment knowledge, investment objectives and time horizon, risk tolerance and the account's current investment portfolio composition and risk level." Furthermore, there will be a number of additional triggers that will give rise to a suitability review, such as a material change in the client's circumstances. These enhanced KYC and suitability

requirements will ensure that all clients will be subject to frequent monitoring of their accounts and more specific conflict management procedures.

In addition, IIROC firms and advisors are subject to rigourous procedural requirements regarding product due diligence, before a product can be sold to investors. The objective of the regulation is to ensure that investors receive informed advice from dealers who understand the specifics of the products they sell, including the reasons that a particular security is appropriate and suitable for them.

Given the investor protection elements in existing IIROC regulation, as well as the prospective CRM Rules, making the use of sections (j)–(m) of the exemption conditional on purchasing through an IIROC registrant will address the concern that the exemption is being used improperly, to the detriment of certain investors. It will also alleviate the problem of two-tiered regulation and protection for clients purchasing under these exemptions. Retail investors should not face different risks when purchasing the same securities from different dealers. In addition, market integrity may be compromised when there is a financial incentive to operate at a lower regulatory standard in respect of selling the same securities to the same investor.

We believe the current income and asset thresholds are appropriate, and provide issuers with much needed access to certain retail investors. Although these thresholds have not been adjusted in some time, members are concerned that increasing the threshold will reduce the number of eligible investors that provide critical funding for issuers. This is particularly true in relation to venture issuers and firms that serve them. Such issuers face significant challenges in funding, and any further restrictions on their ability to do so must be carefully considered in respect of the specific regulatory objective that is sought to be achieved. Further, the rigourous application of KYC, Suitability and product knowledge requirements will help ensure that the product being sold is appropriate for the investor's particular circumstances.

Members agreed that it may be appropriate to consider adding a maximum investment ceiling for those purchasing using any of the asset and income tests. The maximum threshold would be based on a percentage of net assets (15% was suggested). This ceiling, combined with the KYC and Suitability assessments undertaken by the dealer, would provide an additional level of investor protection.

We also support a requirement to have very clear disclosure in about the Accredited Investor criteria included in the subscription agreement, such that investors are clearly informed about the criteria that they must meet to use the exemptions. We suggest the level of disclosure be similar to what was included in sections 2 and 3 of OSC Staff Notice 33-735 *Sale of Securities to Non-Accredited Investors,* which provides details as to what is and is not included in the income, financial asset and net asset tests.

Our recommendations in this submission are aimed specifically at private placements of equity securities. It is important that the CSA specifically examine the application of the exemptions to other exempt products and situations that have entirely different risk profiles, such as pooled products, mutual funds and securities sold pursuant to a portfolio

management arrangement. It may be appropriate to create separate exemptions, carve-outs or other accommodations made in respect such products and circumstances.

In general, however, we believe our recommended approach strikes the appropriate regulatory balance, in that it provides investor protection, while not unduly restricting investor access to financing opportunities which provide an important funding mechanism for small and medium sized issuers.

Thank you for considering our submission. We would be pleased to respond to any questions that you may have in respect to our position.

Yours sincerely,

Susan Copland