Crowdfunding: Enhanced capital raising opportunities for startups

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Equity crowdfunding will soon have a new framework in which to operate in Canada and this is excellent news for investors and startups alike.

On November 5, 2015, the Canadian Securities Administrators announced that regulatory authorities in Manitoba, Ontario, Quebec, New Brunswick and Nova Scotia published the final version of Multilateral Instrument 45-108 - *Crowdfunding* (the "**Equity Crowdfunding Prospectus Exemption**"), which is expected to come into force on January 25, 2016.

Crowdfunding will no longer be limited to advance purchases of goods and services in Canada, as the new Equity Crowdfunding Prospectus Exemption will allow startups to raise capital by issuing and selling securities to the public, using online funding portals, without having to file a prospectus. An offering document that meets regulatory requirements will nonetheless have to be prepared and published on the electronic funding portal. The document must contain certain particular information on the corporation, its officers, and the terms of the offering.

ISSUER ELIGIBILITY CRITERIA

Under the Equity Crowdfunding Prospectus Exemption, eligible issuers may raise a maximum of $1,500,000 per 12-month period. The main eligibility criteria for an issuer are namely that it be incorporated under Canadian laws and headquartered in Canada, that a majority of its directors reside in Canada, and that the issuer is not an investment fund.

SUBSCRIPTION LIMITS FOR EACH INVESTOR

Subscription limits for investors will vary depending on whether an investor is an accredited investor (as defined in the securities regulations) or not. In Ontario only, another category of investors,

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“permitted clients” (as defined in the securities regulations), is subject to its own specific investment limits.

Investments by non-accredited investors will be limited to $2,500 per private placement (up to an annual maximum of $10,000, only in Ontario). Investments by accredited investors will also be limited, albeit to a greater amount of $25,000 per investment (up to an annual maximum of $50,000, only in Ontario).

In Ontario, investors who are classified as permitted clients will not be limited in the amount of capital that they can invest.

LEAD INVESTOR INCENTIVES

It is no coincidence that accredited investors qualify for higher investment limits. The intention is to encourage them to act as lead investors who can set the pace for less experienced, non-accredited investors, by providing skills and expertise in management for the benefit of all investors.

The emergence of lead investors is also encouraged by the fact that issuers will be able to distribute their securities under other prospectus exemptions during the crowdfunding distribution period with different prices, terms and conditions from those being distributed under the Equity Crowdfunding Prospectus Exemption.

This type of model has already proven advantageous in the United States, where equity crowdfunding syndicates have been developed. Such syndicates, which are made up of angel investors and venture capital funds, allow small investors to invest their money in tandem with more experienced investors.

CONTINUOUS DISCLOSURE

Issuers who issue securities pursuant to the Equity Crowdfunding Prospectus Exemption will also be subject to certain continuous disclosure obligations, including the obligation provide the relevant securities commissions with financial statements and to make such financial statements available to investors within 120 days of their financial year end.

The extent of such continuous disclosure obligations will vary in accordance with the total amount of funds raised by the issuer pursuant to one or more prospectus exemptions, from its date of formation to the end of its last financial year, based on the following thresholds:

> $249,999 or less: no requirement
> Between $250,000 and $749,999: financial statements accompanied by an examiner’s report or an auditor’s report
> $750,000 or more: financial statements accompanied by an auditor’s report

In all cases, if the issuer is already a reporting issuer as defined by securities regulations, it will still be subject to any continuous disclosure obligations that already applied.

CONCLUSION

The Equity Crowdfunding Prospectus Exemption will open up markets to investors big and small, and allow them to build valuable relationships with startups early on. It will be interesting to see if the Equity Crowdfunding Prospectus Exemption will generate sufficient lead investors for equity crowdfunding syndicates to be put into place, as they have been in the United States.

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