Comment letter to the ASC from NCFA

In response to ASC Consultation Paper 11-701 Energizing Alberta's Capital Market

National Crowdfunding & Fintech Association

Date: September 22, 2019

Prepared for: Denise Weeres, Director, New Economy,Alberta Securities Commission (new.economy@asc.ca)

Prepared by: National Crowdfunding & Fintech Association of Canada (NCFA)

September 22, 2019
Alberta Securities Commission
Att: Denise Weeres, Director, New Economy
new.economy@asc.ca

Dear Ms. Weeres,

We are pleased that the Alberta government is undertaking this important initiative to the benefit of all Albertans. We acknowledge the substantial background information provided by 11-701. This submission responds to the brainstorming headings pp. 24 – 31 and seeks to fill knowledge gaps with recent consultation data (mainly obtained in Edmonton) and pays specific attention to equity (investment) crowdfunding and peer lending in Alberta.

Key Takeaways

The NCFA recommends that the ASC undertake the following:

- Review and publish a report that evaluates the effectiveness of Alberta's investment crowdfunding and peer lending requirements compared to other jurisdictions in Canada and international competitors such as the UK, US and Australia, including a comparison of the relative cost of capital to other available financing options;
- ASC to take a more active role as a resource for both early stage companies and investors including data collection, market analysis, and information sharing to ensure more fair and efficient capital market formation in Alberta;
- Engage Innovate Edmonton and Platform Calgary following the detailed third-party study by Startup Genome to obtain detailed ecosystem benchmarking data for follow-on analysis of Alberta's funding gaps;
- Support the development of a tax relief program for investors to increase the volume of start-up risk capital allocated to non-traditional sectors (eg. financial technology) similar to the effective programs in the UK: SEIS[1] and EIS[2];
- Work with other jurisdictions to harmonize the crowdfunding regime across Canada (CSA Staff Notice 45-324) with the goal of eliminating unjustified regulatory burden at the same time. We favour BC's regime;
- Modify existing requirements so that they are principles based and outcomes focused to enable businesses to comply in the way that best suits their operations – detailed or prescriptive controls should only be imposed when clearly justified;
- Implement burden reduction amendments for crowdfunding (45-108):
  - Increase the 12 month issuer cap to $5 million or higher;
  - Increase the 12 month investor caps to $10k and allow accredited investors to fully participate;
  - Allow advertising and general solicitation on social media for all crowdfunding;
  - Allow fintech solutions to streamline KYC and suitability tests;
  - Startup crowdfunding business exemption (45-109) – remove lifetime cap of $1 million; or increase lifetime cap to minimum $5 million.

1 https://www.gov.uk/guidance/venture-capital-schemes-apply-to-use-the-seed-enterprise-investment-scheme

2 https://www.gov.uk/guidance/venture-capital-schemes-apply-for-the-enterprise-investment-scheme

Benefits to Alberta will include:

- Increased capital investment in the province and increased economic growth;
- Increased investment options for investors that support small businesses across Alberta;
- Reduced pressure on Albertan startups to raise capital from outside Alberta and Canada;
- Crowdfunding sources remain in Canada;
- More capital and improved access to capital specifically for small businesses, rural businesses, economically challenged sectors, and under-served groups (eg. women and Indigenous business owners);
- More liquidity and transparency in the markets;
- Improved probability of retaining high growth companies in Alberta; and
- Accelerated commercialization of new products and services.

Crowdfunding helps to drive innovation, economic activity and job growth. It fills a critical early stage funding gap ('valley of death'), enables more productive investment in venture markets, and strengthens early stage capital markets. Crowdlending also provides support to more mature companies looking to access capital that may fall outside the parameters of bank lending. And last, but not least, it helps to democratize investment by giving smaller investors direct access to the capital markets.

"Regulation may be the largest constraint to capital markets Fintech development in Canada, as we have not set out many of the same principles as in the U.S. and U.K."[3]

This is not the time for Alberta to hold back.

Thank you for the opportunity to contribute comments. NCFA would be happy to expand on any of the points raised in this submission. We look forward to future developments.

Sincerely,

On behalf of NCFA Canada, Partners and Affiliates[4]Craig Asano
Founder and CEO
1240 Bay St. Suite 501
(416) 618-0254

3 1 An Overview of FinTech in Canada. Global Risk Institute. March 2018: https://globalriskinstitute.org/publications/an- overview-of-fintech-in-canada/.

4 Thanks to NCFAs many expert advisors, partners and contributors especially Chris Fetterly, Directory Student Innovation Centre, University of Alberta

1. Background and Context

Contrary to the intent of the crowdfunding exemption, Alberta's crowdfunding requirements hinder access to capital for SMEs across many sectors. These requirements have restricted innovative opportunities for retail investors and our members feel the impact of this directly. The potential of opening up regulation is to significantly increase job creation and economic development, as experience in other jurisdictions shows. Alberta's 417,000 small businesses would also benefit from the increased access to capital that crowdlending offers. Canada has fallen behind international competitors like the UK and the US. Crowdfunding now provides the largest investment at the seed stage in the UK and peer-to-peer platforms now provide 15% of all new bank lending to small businesses.

2. Fintech and Crowdfunding are Being Held Back in Canada

Canada's crowdfunding and fintech "ecosystem" should be competitive, be in line with global trends, and enable early stage entrepreneurs to access smaller amounts of capital at a reasonable cost. Unfortunately, it is not and does not. There is a 'funding gap' as smaller companies find it very challenging to raise debt or equity financing in Canada.

There is a 'valley of death' for start-ups at around the $250,000 level. Venture capital funding has increased, but VC dollars are mostly going to expanding firms. Angels are a lot less active than in the US and their investment amounts are lower. Banks generally steer clear of start-ups. This means fewer innovative start-ups, fewer opportunities for investors, lower economic growth and productivity and fewer jobs.

"Regulation may be the largest constraint to Fintech development in Canada, as we have not set out many of the same principles as in the U.S. and U.K."[5] The NCFA has conducted numerous stakeholder consultations which overwhelmingly tell us that regulatory requirements are overly prescriptive, complex and burdensome, disproportionately raising the costs of doing business for start-ups. Entrepreneurs are reluctant to start up in Canada due to high costs (relative to a small financing), along with concerns about ongoing regulatory burdens such as over-reaching and complex reporting requirements and compliance reviews.

Investors are inhibited by restrictions like caps on investment. Many talented entrepreneurs and investors move to (or invest in) overseas jurisdictions that better understand (and support) innovation and the economic potential of start-ups and SMEs. If the NCFA recommendations were to be implemented, the experience of other jurisdictions makes clear that more capital would be raised, especially for under-serviced sectors (e.g. women and minority groups, including First Nations, and rural communities). Investors would have increased confidence and more freedom to invest as they choose – any increase in investor downside risks are anticipated to be low.

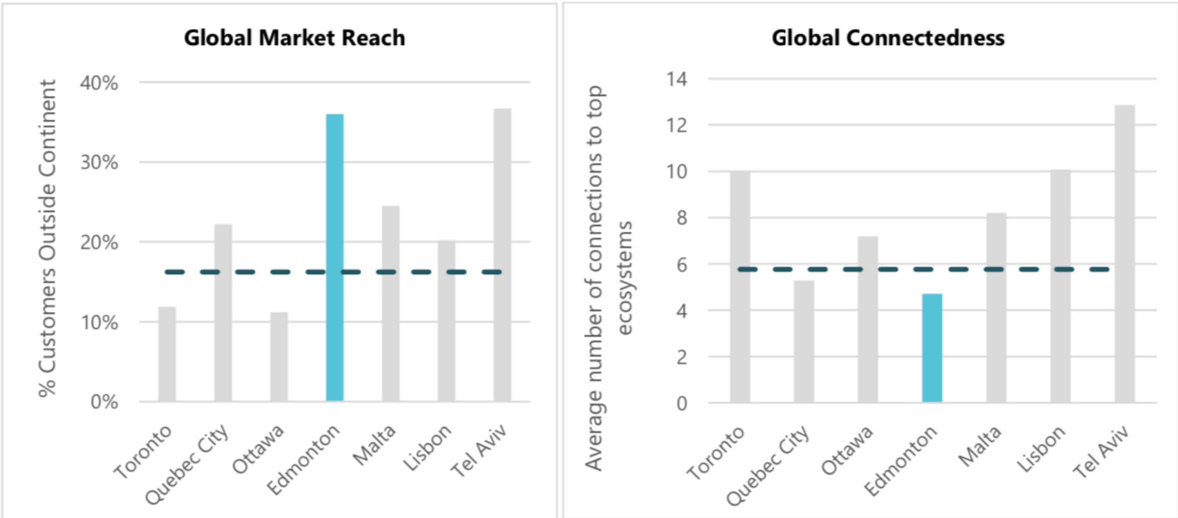
[5] An Overview of FinTech in Canada. Global Risk Institute. March 2018: https://globalriskinstitute.org/publications/an-overview-of-fintech-in-canada/.

3. Alberta

The call for comments by the ASC is a leap towards positive change in the Albertan capital markets and crowdfunding landscape. While the in-depth background material supplied by the ASC in 11-701 clearly lays out the challenges for Albertan companies, there are updated consultative engagements with the entrepreneur communities in Edmonton and Calgary. These updated reports will be a useful addition to the ASC's decision-making processes. They also provide excellent contacts for ASC's engagement with Alberta's major centers.

(a) Startup Genome Reports

In Edmonton, starting in May 2018, community meetings under the banner of the "Edmonton Innovation Ecosystem Community" engaged members of the innovation community.[6] To date, there have been 11 community consultations with key innovators on a near-monthly basis. The impetus for the first gatherings followed consultation with 50 entrepreneurs in Edmonton to gather their feedback on ecosystem performance. The EEDC engaged Startup Genome to begin measurement of the ecosystem performance. The Edmonton Report brought two key measurement instruments to the ecosystem, Global Market Reach (GMR) and Global Connectedness (GC).



Startup Genome Edmonton Ecosystem Assessment, May 2018

We ask that the ASC review the results of EEDC's more detailed analysis of the ecosystem as part of their assessment of 11-701 responses. Notably, Edmonton lags behind its Canadian peers in attracting resources from within the country. In addition, Edmonton ranked below what the report calls the Globalization Phase Average in Early Stage Funding per Startup, based on data from Crunchbase and Deal Room. The key actionable insights from this early analysis are that Edmonton should focus on increasing early stage funding by (1) widening the funnel and increasing startups with seed funding; (2) supporting the formation of more sources of capital (ie. Angel groups); and increasing access to Series A capital. Calgary has also engaged Startup Genome for ecosystem benchmarking[7].

6 https://edmontoninnovationecosystem.com

7 https://www.calgaryeconomicdevelopment.com/newsroom/measuring-calgarys-startup-ecosystem/

(b) Innovation Compass

Another work product from the EIEC meetings in Edmonton was the Innovation Compass report[8]. Due to perceived low numbers of early entrepreneur engagement, EEDC engaged ZGM Marketing to complete a third-party interview process with Edmonton Entrepreneurs to make recommendations that reflect the voice of Edmonton entrepreneurs. Engagement began in December 2018 and the final report was published June 20, 2019. The report provided community validated recommendations and directions for supporting the city's tech innovation ecosystem. Among 14 recommendations and directions, the top recommendation was: *"Encourage pools of private investors from all sectors to move off the sidelines and start investing in local tech entrepreneurs."*

	% OF PARTICIPANTS WHO SELECTED STATEMENT				
Recommendation & Direction Statement	**Overall**	**Only Entrepre-neurs**	**Only Service Providers**	**Only Service Firms**	**Others**
Encourage pools of private investors from all sectors to move off the sidelines and start investing in local tech entrepreneurs.	**58.12%**	60.91%	55.00%	30.00%	59.38%

Highest priority recommendation from Edmonton innovation ecosystem community members in the YEG Innovation Compass Report.

(c)Edmonton Advisory Council on Startups (EACOS)

During the early meetings of the EIEC, it was recognized that a body completely separate from EEDC that reflected the voice of Edmonton entrepreneurs was needed. The Edmonton Advisory Council on Startups was formed with members representing all stages of entrepreneurship to ensure diversity. EACOS is comprised of 13 individuals representing students, seed, startups and scale-up stage companies, and investors. EACOS has published three position papers[10] aimed at increasing the size, throughput, energy, and success of the Edmonton startup community. EACOS has identified a number of community priorities and access to capital is top of mind. EACOS has recommended:

"Intensified efforts to engage local investors into investing into local technology companies. Investors who have built capital through traditional means, like real estate and energy, need to be effectively engaged, educated, and presented with the portfolio opportunities of technology investments."

8 https://www.innovationcompass.ca/home/

10 https://www.eacos.ca

4. Comparison: British Columbia

BC and some other jurisdictions have less burdensome crowdfunding requirements[11] that allow small firms to raise up to $250,000 per offering (twice a year), with participation from other provinces. While still not ideal, these less burdensome exemptions have proven to be much more effective than MI 45-108 in Ontario.

For background on exemptions in Canada see:
https://www.bcsc.bc.ca/Securities_Law/Policies/PolicyBCN/PDF/BCN_2018-01__February_14__2018/.
(This BCSC Notice expresses well many of the points we raise in this submission)

5. Canada's Uncompetitive Position

Canada has fallen behind international comparators such as the UK. In the UK, crowdfunding platforms were involved in 24% of all equity deals in 2017, but with 30% of seed stage deals in 2017.[12]

To see the advantages of a uniform, cross-border, and flexible crowdfunding regime, one need look no further than Regulation D in the US. The following are quotes from the recent Crowdfunding Capital Advisers Report.[13]

"2018 saw triple digit growth in unique offerings, proceeds and investors. More importantly, start-ups are successfully using Regulation Crowdfunding to raise meaningful capital in a relatively short period of time and at costs that are less than a typical Regulation D offering.

"Unlike venture capital, where less than 6.5 percent of start-ups successfully raise funds, the success rate in Regulation Crowdfunding hovers around an impressive 60 percent. A key data point for industry followers is that the average raise ($270,996) helps start-ups hurdle the "valley of death" they often face after expending their internal or personal capital.

"Regulation Crowdfunding is proving to be a jobs engine (creating on average 2.9 jobs per issuer), economic generator (pumping over $289 million of revenues into local economies)... There is still a lot of room for growth with Regulation Crowdfunding offerings as they equate to only 1.2 percent of all Regulation D offerings and only 4 percent of all capital raised under Reg D.

"The fact that the velocity of capital into funded offerings continues to be steady without signs of abnormal activity or irrational investor behaviour is a healthy indicator. Meanwhile, the rapid increase in the number of offerings and investors proves there is continued appetite for Regulation Crowdfunding from both issuers seeking capital as well as investors looking to diversify. This is true across the [US].

"Regulation Crowdfunding is also proving efficient. If we compare the average days to close (113) in 2018 and average raise ($250,635) of a successful Regulation Crowdfunding

11 the 'Start-up Crowdfunding Registration and Prospectus Exemptions – https://www.bcsc.bc.ca/45-535_[BCI]_09212017/.

12 https://www.british-business-bank.co.uk/wp-content/uploads/2018/07/Equity-Tracker-Report-2018.pdf

13 Https://venturebeat.com/2019/01/30/regulation-crowdfunding-performed-solidly-in-2018-heres-the-data/

campaign to a traditional Regulation D offering, Regulation Crowdfunding most likely represents the most efficient, cost effective way to raise capital for start-ups and SMEs."

The type of (published) data collection and analysis provided by the above report is rare in Canada, which is another serious impediment to decision making in this area. To back its recommendations, NCFA (and others) must rely largely on anecdotal evidence from its members.

6. Canada's Competition Bureau

As the Competition Bureau has pointed out[14], a more flexible approach to regulation and better government support would provide significant economic benefits by freeing entrepreneurship. It would also help to keep our entrepreneurs in Canada (along with the related jobs), boost GDP (especially by improving productivity), and encourage the commercialization of new products and services generally. It is well-documented that overly complex, prescriptive regulation is a much higher burden for smaller firms and so is inherently anti-competitive. For a disappointing progress report on the Bureau's recommendations of Dec 2017. See: http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/04392.html

7. ASC Brainstorming Ideas and Comments

(a) Information resource for Alberta start-ups and early stage businesses on capital raising options

- Raising capital shouldn't be a 'black box'. Companies and investors would benefit if the ASC could:
    - provide a roadmap to the various financing options including use of exemptions, what typical companies (and investors) that qualify look like, average time to market, related costs and effort, and capital flows;
    - publish sample templates of the expected quality of good offering documents;
    - work with industry to develop a transparent resource database that is widely available.
- Dovetailing with EACOS recommendations on entrepreneur preparedness, more information on successive financings would benefit the Alberta tech ecosystem. The ASC could consider hosting this data in an anonymized format so that Alberta startups could learn about their local comparables.

(b) Information resource for investors in Alberta

Some market participants have suggested there might be a role for the ASC in increasing investor understanding respecting the exempt market and considerations when investing in start-up and early stage businesses

- The ASC assuming an educational role could only be beneficial to Albertan investors, especially those that are seeking to diversify outside of real estate or oil and gas. An equity crowdfunding or peer lending platform operating in Alberta could then easily point to this resource as a third party unbiased educational resource for investors.
- In addition to local investors, ASC could work with economic development agencies

[14] http://www.competitionbureau.gc.ca/eic/site/cbbc.nsf/eng/04322.html

to provide education on exempt market trends and developments to international investors and funds with a new focus on emerging technology as a means to diversify the Alberta economy.
- Highlighting a range of companies by sector and capital raised in private markets would help investors understand high growth SME opportunities.

(c) Expanding the accredited investor exemption to include educated, experienced investors

What are the right combinations of education and experience? For the educational component, should we consider courses such as those offered through the CVCA Canadian Private Capital Investment School or the NACO Academy for those investing in private markets?

- The accredited investor exemption if expanded to include educated and experienced investors would unlock latent capital in Alberta while increasing opportunities for qualifying investors and allow for greater portfolio diversification.
- Any expansion of the accredited investor definition should aim to ensure that investors understand the risks involved with investing in private market securities such as reduced disclosure and lack of liquidity and provide education on the evolving trends of online financing such as peer lending, investment crowdfunding, and digital assets.
- Education should be tendered and open to all private capital market training bodies, associations, licensed exempt market dealers, and investor-orientated groups and structured to be flexible and allow a wide range of participation to enable:
    - the right balance of training expertise and collaboration;
    - wide program accessibility;
    - current and relevant training content updated on an annual or periodic basis;
    - range of "textbook" and experiential training delivery;
    - certification and listing for public verification on an ASC database; and
    - capture of investor risk acknowledgement such as ability to withstand loss
- The certificate of training could then be used by equity crowdfunding and lending exempt market dealers and portals to validate investor training in a streamlined manner (rather than have investors go through the same process with various dealers and portals time and time again).

Given that the policy rationale for the accredited investor exemption is 'ability to withstand loss', would it be appropriate to impose some limit on the amount that can be invested by an educated/experienced investor that is not otherwise an accredited investor e.g., the greater of $30,000 and 5% of their investment portfolio?

- Accredited investor and qualifying experienced-educated investors should be allowed to fully participate without caps in investment crowdfunding and peer lending offerings.
- Accredited investors should be encouraged to invest in or along-side a Start-up Business Exemption campaign. The participation of accredited investors at higher levels will provide non-accredited investors with added value as the investment group

will perform greater due diligence than investors only investing the minimum threshold amount in a Start-Up Business Exemption offering.

(d) Addressing the compliance challenges associated with confirming accredited investor status

The central party could then confirm, through a unique investor identifier, to any business or dealer to whom the investor provided the unique identifier, that based on the information provided, the investor qualifies as an accredited investor, without the need for the investor to reveal all of their personal information.

- This is a logical and reasonable solution that mirrors recreational licensing and even academic author identification systems (see Orcid ID).
- Unique IDs could be used as part of a background check which will help reduce the number of days required to verify ID prior to being permitted to participate on equity crowdfunding or peer lending platforms.
- There are numerous 'regtech' solutions now in the market that can be assessed by the ASC for potential use and deployment.
- Any investor verification system should be neutral to avoid a single group monopolizing a provincial (or national)system.

(e) Registration exemption for finders

We are interested in feedback on a dealer registration exemption for sales to investors that are accredited investors who also meet certain education and/or experience criteria. We are interested in how such an exemption could be tailored to adequately protect investors but help address the issues associated with smaller financings that are not being serviced by registered dealers.

- We agree that a registration exemption for qualified 'finders' would help expand the pool of investors and supply more capital to early stage companies.
- Finders should be required to notify the ASC of their identity or could be required to associate with registered dealers or engaged by investment platforms.
- Finders not associated with registered dealers could be required to report periodically on their investor prospecting activity using technology to streamline communications. This would not only provide employment opportunities for finders but also minimize unreported finder type activity that occurs anyway while increasing the transparency in the exempt market for smaller financings.

(f) Reducing compliance costs for registered dealers when dealing with accredited investors

This applies across the piece in the crowdfunding sector. Each requirement should be cost justified by regulators.

(g) Addressing other registered dealer compliance burdens

For crowdfunding related burden reduction examples we encourage the ASC to review NCFAs submission to the Ontario Securities Commission of March 1, 2019 –

burden reduction.[15]

(h) Facilitating angel investment funds

Should we consider adviser registration exemptions where accredited investors have a limited amount of capital at risk?

- Yes, especially if accredited investor status is expanded to include well educated and experienced investors. In this scenario, with small amounts of capital deployed and a demonstrated ability to withstand a specified loss, barriers to obtaining capital from multiple crowd sources would be reduced.

(i) Facilitating the development of a retail, publicly-traded fund focused on innovative businesses

- We feel this is best answered by VCs and institutions.

(k) Facilitating a semi-public market that allows secondary retail trading by non-public companies

- The illiquid nature of exempt market securities is often cited as a major concern of prospective investors so anything that assists secondary trading is welcomed.
- A secondary market for exempt securities would also benefit early employees of start-up companies by allowing them to liquidate holdings pre-IPO and thus help early stage companies to offer creative compensation packages and attract a wider range of employees to help them grow.[16]
- A semi-public market should be open to all types of exempt securities from crowdfunding to security tokens to allow fair and efficient markets to form.

(m) Fostering crowdlending and peer-to-peer lending

- Peer-to-peer (P2P) lending is providing SMEs with financing in many jurisdictions, including the US, the UK, New Zealand and Australia, at rates which are considerably lower than those offered by competitors.
- The popularity of P2P lending in the UK has increased exponentially in recent years, with nearly £10 billion being transferred through such platforms in the past ten years and approximately £1.2bn having been transferred through P2P platforms in the second quarter of 2019 alone.
- The current securities regulatory regime in Canada imposes costs and burdens that create significant impediments to the success of any P2P platform and by extension the availability of financing to Canadian SMEs.
- The current regime in Canada is not suited to allowing companies to raise debt financing as it treats them as issuers. The regulatory requirements for becoming an issuer are simply too burdensome for small loan sizes (for example a $50,000 loan).
- The sheer magnitude of P2P lending and its positive impact on the economies of advanced jurisdictions elsewhere suggests that it would be beneficial for Canadian SMEs if the regulators in Canada were to adopt a regime specific to P2P

15 https://ncfacanada.org/march-1-2019-ncfa-submission-to-the-ontario-securities-commission-on-regulatory-burden/

16 https://corpgov.law.harvard.edu/2018/10/09/cashing-it-in-private-company-exchanges-and-employee-stock-sales-prior-to-ipo/

lending. A regime modeled on those successfully implemented in jurisdictions, like the UK, where P2P lending has been proven to provide much needed funding to SMEs while ensuring an appropriate level of protection for investors.

About the NCFA

The National Crowdfunding and Fintech Association of Canada (the Association) represents over 2,000 fintech SMEs and individual members that support financial and capital market innovation, small businesses and technology. We are pleased that the Alberta government is undertaking this important initiative to the benefit of all Albertans.