

July 6, 2015

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**RE: Request for Comment on Proposed Amendments to the Offering Memorandum Exemption**

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FAIR Canada is pleased to offer comments on the proposed amendments to National Instrument 45-106 Prospectus Exemptions regarding the Offering Memorandum as set out in the Nova Scotia Securities Commission Notice and Request for Comment dated May 7, 2015 (the “Notice”).

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit [www.faircanada.ca](http://www.faircanada.ca) for more information.

1. **Harmonization of Offering Memorandum “(OM)” Exemption Requirements**

***Harmonization Premature***

- 1.1. FAIR Canada notes that the Nova Scotia Securities Commission (“NSSC”) has indicated it would like to harmonize its rules regarding the Offering Memorandum prospectus exemption (the “OM” exemption) with those of Alberta, Saskatchewan, Ontario, New Brunswick and Quebec.
- 1.2. It is our understanding that none of those jurisdictions have, to date, finalized their rules regarding the Offering Memorandum. As of today, therefore, it is not clear what rules will be adopted and what rules the NSSC will be determining to harmonize with. In addition, not all of the proposed rules that are set out in the Notice are the same as those of the other jurisdictions. Nonetheless, FAIR Canada commends the NSSC for consulting with stakeholders regarding proposed amendments to the OM exemption.
- 1.3. FAIR Canada urges regulators and governments to approach harmonization with the goal of furthering the key mandate of investor protection and to not engage in a harmonization process at the expense of adequate investor protection.

***Adequate Investor Protection Key to Real and Sustainable Capital Formation***

- 1.4. FAIR Canada reminds securities regulators that their key mandate is that of investor protection, and that this mandate obligates securities regulators to undertake a review of the level of investor

protection afforded under the OM Exemption in the jurisdictions where it is available. Such a review is needed in light of the widespread serious defects in the OMs that are used and a lack of compliance by exempt market dealers (“EMDs”) with their regulatory obligations (including know-your-client and know-your product suitability obligations) and serious conflicts of interest not being avoided, managed or disclosed by the seller.

- 1.5. FAIR Canada has noted in its recent fraud report that there is a lack of empirical data to determine the incidence of fraud, misrepresentation and resulting losses suffered by investors as a result of investing in securities through purported reliance upon prospectus exemptions. However, based on media reports in recent years, there appears to be serious and widespread fraud and financial losses linked to the OM. Three scandals reported in the press in 2013 alone amounted to some \$500 million in retail investor losses. In addition, information from Alberta’s securities commission released with Multilateral CSA Notice dated March 20, 2014 noted that there have been “...numerous complaints from investors that have invested significant amounts under the OM Exemption and incurred significant losses.”<sup>1</sup>
- 1.6. Exemptions should only be permitted if there is adequate investor protection; otherwise real capital formation, where monies are invested in productive assets (leading to increased jobs and economic growth) will not occur. Investor protection mechanisms are not an impediment to capital raising efforts but rather an essential feature of an efficient and effective market in which investors have confidence. Ignoring the need for investor protection will only make the exempt market more inefficient and further reduce investor confidence in our markets.
- 1.7. We urge the NSSC to reform its OM Exemption in a manner that provides adequate investor protection. We have set out in our submission dated June 18, 2014 in response to Multilateral CSA Notice published March 20, 2014<sup>2</sup> and in our submission to the OSC dated June 18, 2014 in response to their Notice and Request for Comments published March 20, 2014<sup>3</sup> comments to improve the proposed requirements so that investors will be better protected and the result will be more efficient markets in which investors have confidence. We urge you to give serious consideration to our recommendations.
- 1.8. We set out below comments on the proposed requirements you have proposed (provided in Table 1 of the Notice) to the extent they differ from those of the other jurisdictions. To the extent they are the same as the proposed requirements of the other jurisdictions, we refer you to our June 18, 2014 submissions for our recommendations.

***Eligible Investors Who Obtain Advice- Need Objective, Independent Advice in Best Interest of Investors***

- 1.9. Under the NSSC proposal, investors who are “eligible investors” and who obtain advice from an EMD, IIROC dealer or portfolio manager would be permitted to invest up to \$100,000. It is not made clear whether this limit is per investment, per calendar year, or annually.

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<sup>1</sup> Multilateral CSA Notice of Publication and Request for Comment Proposed Amendments to National Instrument 45-106 Prospectus and Registration Exemptions Relating to the Offering Memorandum Exemption, published March 20, 2014, at Annex B; available online at Annex B; available online at <http://www.lautorite.qc.ca/files//pdf/reglementation/valeurs-mobilieres/45-106/2014-03-20/2014mars20-45-106-avis-cons-om-en.pdf>.

<sup>2</sup> FAIR Canada submission to the Alberta Securities Commission, the Autorité des marchés financiers and the Financial and Consumer Services Commission dated June 18, 2014, available online at <http://faircanada.ca/wp-content/uploads/2011/01/140618-final-comments-to-CSA-re-OM-exemption-2.pdf>.

<sup>3</sup> FAIR Canada submission to the OSC dated June 18, 2014; available online at <http://faircanada.ca/wp-content/uploads/2011/01/FAIR-Canada-submission-re-OSC-Proposed-Prospectus-Exemptions-v1.pdf>.

- 1.10. FAIR Canada recommends that the advice must come from a registrant who has an obligation (either statutorily or contractually) to act in the client's best interest. In addition, to qualify, the proposed exempt investment should be recommended by the registrant as an investment that is in the best interest of the retail investor who is an "eligible investor". This requirement should be monitored by requiring the provision of information to the commission on the use of the qualifying criteria including the name of the registrant who provided the advice.
- 1.11. If such requirement is going to be pursued in the absence of a best interest duty, FAIR Canada does not support allowing EMDs to discharge this obligation to provide advice given:
- (1) EMDs may distribute securities of "related issuers" and "connected issuers" and thus are subject to conflicts of interest which involve misaligned incentives (that is, frequent conflicts of interest between that of the EMD and the investor) and, as a result, investors will not obtain objective "advice";
  - (2) compliance reviews by CSA members have found significant deficiencies in how EMDs address conflicts of interest with 21% of registered firms that were sampled being deficient in how they address conflicts of interest including:
    - Registered firms considered themselves to operate independently, and assumed that they did not have relationships that could potentially present a conflict of interest requiring disclosure, but this was not the case.
    - Registered firms indicated that their policies and procedures manual or other internal policies described their conflicts, but acknowledged that they did not disclose these conflicts to clients.
    - EMDs indicated that the issuer's offering documents adequately described the conflicts of interest, but this was not the case.
    - Registered firms disclosed that they had conflicts, but they did not describe the conflicts or explain how they were addressing them.
    - Registered firms provided an insufficient or unclear explanation about their conflicts and did not discuss the potential impact on clients.
    - Registered firms disclosed the conflicts of interest at the individual dealing or advising level, but did not consider and disclose conflicts of interest at the firm level.
  - (3) EMDs have a low level of compliance with existing know-your-client and know-your-product obligations, as found in compliance sweeps by regulators;
  - (4) There is no published report which indicates from the securities regulators that the above-noted problems have been adequately addressed; and
  - (5) EMDs are not members of an SRO, which would provide some level of protection to investors.

In light of the foregoing, EMDS are inappropriate registrants to discharge this obligation.

We commend the NCC for recognizing that the current requirements do not provide adequate investor protection and for proposing changes to make its capital market more efficient and one in which investors have confidence.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Neil Gross at 416-214-3408/ [neil.gross@faircanada.ca](mailto:neil.gross@faircanada.ca) or Marian Passmore at 416-214-3441/ [marian.passmore@faircanada.ca](mailto:marian.passmore@faircanada.ca).

Sincerely,



Canadian Foundation for Advancement of Investor Rights

CC: British Columbia Securities Commission  
Alberta Securities Commission  
Saskatchewan Financial Services Commission  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
New Brunswick Securities Commission  
Registrar of Securities, Prince Edward Island  
Superintendent of Securities, Newfoundland and Labrador  
Superintendent of Securities, Northwest Territories  
Superintendent of Securities, Yukon Territory  
Superintendent of Securities, Nunavut