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Canadian Securities Regulators Adopt Harmonized Crowdfunding Rules to Promote Access to Capital for Startups

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On June 23, 2021, the Canadian Securities Administrators (CSA) announced the adoption of National Instrument 45-110 – *Start-up Crowdfunding Registration and Prospectus Exemptions* (NI 45-110) in an effort to adopt a harmonized national regime for startup crowdfunding. NI 45-110, which comes into force on September 21, 2021, replaces the local startup crowdfunding blanket orders currently in force on a province-by-province basis.

The existing crowdfunding rules allow non-reporting issuers that are not investment funds and have their head office in Canada to rely on exemptions from the prospectus and dealer registration requirements to raise capital by issuing eligible securities through online funding portals (a website connecting the crowdfunding issuers and the investors), provided that certain conditions are satisfied.

The new rules under NI 45-110 will make it easier for startup companies to finance their business and activities by, among other things, increasing the individual investment limits in connection with any distribution in reliance on the crowdfunding exemption and increasing the maximum amount that can be raised in any 12-month period from $500,000 to $1.5 million.

Background

Despite the surge in interest in crowdfunding, particularly among "unseasoned" investors, market participants have suggested that the current regulatory framework is not responsive to the practical realities of equity crowdfunding and that the lack of national, harmonized rules is an important barrier that has stunted the growth of crowdfunding in Canada. In response to such criticism, the CSA published proposed NI 45-110 for comment on February 27, 2020. All commenters expressed support for the harmonization of the crowdfunding rules across Canada to encourage the use of crowdfunding as an alternative method for startups to raise capital.[1]

Prior to the adoption of NI 45-110, equity crowdfunding was available in British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec, New Brunswick and Nova Scotia (collectively, the Blanket Order Jurisdictions) under three separate regimes. The Blanket Order Jurisdictions all adopted a substantially harmonized framework for securities crowdfunding that enacted local crowdfunding blanket orders to enable startups and early stage issuers to raise capital in reliance on exemptions from the prospectus and registration requirements. However, there were notable discrepancies in the crowdfunding rules adopted by the Blanket Order Jurisdictions, including differences in the limits imposed on the amount of equity that could be raised, the maximum amount that a single investor could invest and, exclusively in Alberta, the requirement to use a funding portal and the availability of a registration exemption.

What Is the Purpose of NI 45-110?

NI 45-110 addresses the discrepancies among provinces by harmonizing the rules across Canada while still allowing non-reporting issuers and startup companies to raise capital through online funding portals in reliance on exemptions from the prospectus and registration requirements. The CSA does not consider the changes to the current regime to be "material," given that NI 45-110 is based in large part on the crowdfunding rules applicable in the majority of the Blanket Order Jurisdictions.

What Are the Principal Obligations Under NI 45-110?

As mentioned, many of the principal obligations under NI 45-110 are consistent with the existing crowdfunding rules. In order to avail themselves of the exemption from the prospectus requirement, crowdfunding issuers must, among other things, prepare an offering document using *Form 45-110F1 – Offering Document*, which provides basic information about the business, the offering, the purpose of the crowdfunding and the relevant risks of the business or the project. Crowdfunding issuers must submit their offering document to a funding portal. If they are raising money in Québec, issuers must also ensure that the offering document is written in French or in both English and French.

While issuers are not required to provide financial statements to investors in connection with a crowdfunding distribution, to the extent that financial statements are made available, they must be prepared in accordance with Canadian generally accepted accounting principles. Distributions under NI 45-110 cannot close later than 90 days after the offering document is first made available to potential investors through the funding portal.

Funding portals may be exempt from the registration requirement if certain conditions are met, including that the funding portal has its head office in Canada. The funding portal must hold the investor funds in trust until the minimum funding target is met and the time for exercise of all withdrawal rights has expired. Under NI 45-110, funding portals are not allowed to provide advice to potential investors, and they must ensure that investors acknowledge the risks of their investments.

Following the publication of NI 45-110, the CSA prepared *CSA Staff Notice 45-329 – Guidance for using the start-up crowdfunding registration and prospectus exemptions* (Staff Notice) to assist startup companies as they seek to comply with the new crowdfunding regime.

Modifications to the Startup Crowdfunding Regime

The main changes adopted under NI 45-110 are as follows:

- The maximum aggregate proceeds that can be raised during any 12-month period preceding the closing of the offering will be $1.5 million, which is an increase in some jurisdictions from the maximum of two offerings of up to $250,000 per calendar year.
- The maximum amount that can be invested by a single person in each offering will be $2,500 (rather than the $1,500 limit applicable in a number of provinces under the old regime) or $10,000 if a registered dealer has provided advice to the investor in connection with the offering.
- The definition of "eligible security" will include shares in the capital of an association, removing some of the barriers for federal or provincial cooperatives or associations wishing to crowdfund their operations.
- Crowdfunding issuers will be subject to statutory liability under securities law if their offering document contains misrepresentations. In contrast, the old regime did not provide for express statutory liability for misrepresentations and did not require crowdfunding issuers to provide contractual rights to investors, effectively limiting investor recourse to those rights and remedies available under common law or civil law.
- There will be a "blind pool ban" under which the prospectus exemption will not be available to companies engaged in the identification and evaluation of assets or businesses for the purpose of investing in, merging with or acquiring them, or subscribing for or acquiring securities of one or more other companies. In the CSA's view, other programs, such as the TSX Venture Exchange Capital Pool Program, allow investors to invest in these companies and provide them with greater protection.
- Funding portals relying on the registration exemption will have to certify on a semi-annual basis that they have sufficient financial resources to continue operations for the next six months (as opposed to 12 months under the old regime).

Consequences

The harmonization of rules for crowdfunding across Canada will likely be welcomed by emerging companies and industry professionals in the private capital markets. With advances in technology, many smaller Canadian companies have built extraprovincial businesses and

are looking for ways to reach investors across Canada. A harmonized crowdfunding regime and an increase in the maximum amounts that can be raised under the new rules should help increase access to capital for startup companies and provide an alternative means of raising funds to help sustain their operations.

[1] CSA Notice of Publication of National Instrument 45-110 *Start-up Crowdfunding Registration and Prospectus Exemptions*, June 23, 2021, Annex B – List of Commenters and Summary of Comments and Responses, page 10.

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