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More to Offer: Recent Changes to the Offering Memorandum Exemption in Canada

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National Instrument 45-106 *Prospectus Exemptions* (“NI 45-106”) provides that certain distributions of securities completed pursuant to an offering memorandum (“OM”) are exempt from the general requirement that all distributions of securities be done pursuant to a prospectus. An OM, like a prospectus, constitutes a disclosure document related to a particular distribution of securities. This article provides an overview of OM offerings and compares the requirements of the OM exemption throughout various Canadian jurisdictions in light of certain recent amendments.

History of the Offering Memorandum Exemption Throughout Canada

Historically, there has been a perceived funding gap for small- and medium-sized enterprises that could not afford the high fixed costs of preparing a prospectus, but needed more capital than that available under current prospectus exemptions. The OM exemption was thereby created to permit distributions to a wide variety of potential investors without the large fixed costs of preparing a prospectus.¹

In all provinces other than Ontario, prospectus-exempt distributions by way of an OM have been possible since as early as 2005.² However, on October 29, 2015, the securities regulatory authorities in Alberta, New Brunswick, Nova Scotia, Ontario, Québec and Saskatchewan (collectively, the “Participating Jurisdictions”) published amendments (the “Amendments”) to NI 45-106, which will bring Ontario into the fold and will make certain other changes to the exemption in all Participating Jurisdictions. Subject to the requisite Ministerial approvals, the Amendments come into force in Ontario on January 13, 2016, and in the remaining Participating Jurisdictions on

April 30, 2016. The availability of and requirements for an OM offering in jurisdictions other than the Participating Jurisdictions (the “Non-Participating Jurisdictions”) will not change upon enactment of the Amendments.

Process of Completing an Offering Memorandum Distribution

An OM is significantly less detailed and less expensive to prepare than a prospectus. Further, unlike a prospectus, an OM need not be approved by the securities regulators before the issuer distributes securities. Instead, the issuer prepares the appropriate form of OM, as provided in NI 45-106, and ensures a copy is distributed to each investor at the same time or before the purchase of its securities. The OM must be filed with the applicable securities regulatory authority on or before the 10th day after the distribution.

After the Amendments come into force, in all Participating Jurisdictions: (i) the chief executive officer or chief financial officer, and (ii) either any two additional directors who are not also the chief executive officer or chief financial officer or all the directors of the issuer, must sign a certificate stating that the OM does not contain a misrepresentation. In contrast, officers and directors of issuers conducting a distribution by way of prospectus are required to certify that the prospectus contains “true, full and plain disclosure of all material facts relating to the securities issued or proposed to be distributed,” which represents a much higher standard of disclosure.

Disclosure Requirements After Completing an Offering Memorandum Distribution

Conducting an OM offering does not constitute a “public offering” and therefore does not trigger the costly requirements for “reporting issuers” under securities

¹ Janet Austen, “The Offering Memorandum Prospectus Exemption”, (2014) 29:2 BFLR 216.

² *Ibid.*

laws. Therefore, private issuers who have completed a distribution pursuant to an OM will not need to satisfy timely disclosure requirements, such as issuing material change reports, or periodic disclosure requirements, such as preparing annual information forms.

However, following the enactment of the Amendments, a private issuer who completes a distribution pursuant to the OM exemption in a Participating Jurisdiction will have certain continuous disclosure obligations. The issuer will be required to provide investors with audited annual financial statements, a description of how proceeds pursuant to the OM raised were used (using Form 45-106F6 *Notice of Use of Proceeds*) and, for New Brunswick, Nova Scotia and Ontario only, a notification upon the discontinuation of the issuer's business, a change in the issuer's industry or a change in control of the issuer (using Form 45-106F7 *Notice of Specified Key Events*).

Risk Acknowledgment Forms

In both Participating and Non-Participating Jurisdictions, an issuer must obtain a completed Form 45-106F4 *Risk Acknowledgment* from individual purchasers. This form requires individual purchasers to acknowledge that they, among other things, could lose the full amount of their investment and may never be able to sell the purchased securities.

Upon the enactment of the Amendments, purchasers from the Participating Jurisdictions will also need to complete two additional schedules to Form 45-106F4: Schedule 1 *Classification of Investors Under the Offering Memorandum Exemption* and Schedule 2 *Investment Limits for Investors Under the Offering Memorandum Exemption*. Schedule 1 requires the purchaser to confirm their status as an eligible, non-eligible or accredited investor or an investor who qualifies under the family, friends and business associates exemption. Schedule 2 requires confirmation that the investor participation limits have been complied with (as described in further detail below).

Limits on Investor Participation

As anybody can invest pursuant to an OM, the OM exemption has been considered a true "crowdfunding" exemption. However, the level of participation permitted by various Canadian jurisdictions is not uniform and often depends on whether an investor is an eligible investor. An eligible investor, as defined under NI 45-106, is an investor who meets certain financial criteria.

In British Columbia and Newfoundland and Labrador, there are no limits on eligible or non-eligible investor participation in distributions pursuant to an OM. In the other Non-Participating Jurisdictions, there are no limits on participation in OM distributions for eligible investors. For non-eligible investors, however, the total acquisition cost of the securities purchased pursuant to an OM must

be less than \$10,000.

Upon the enactment of the Amendments, the Participating Jurisdictions will take a more nuanced approach to investor limits, specifically:

- non-individual investors, or individual investors who qualify as accredited investors or under the family, friends and business associates exemption, will have no limit;
- the acquisition cost of all securities acquired in the preceding 12 months by a purchaser who is an individual cannot exceed:
 - \$100,000 for eligible individual investors who have received a positive suitability assessment from a portfolio manager, investment dealer or exempt market dealer;
 - \$30,000 for eligible individual investors; or
 - \$10,000 for non-eligible individual investors.

Limits on Offering Memorandum Availability for Certain Issuers and Certain Securities

The availability of the OM exemption for certain types of issuers and for distributions of certain types of securities is not uniform across Canada. In British Columbia and Newfoundland and Labrador, all investment funds may use the OM exemption. In other Non-Participating Jurisdictions, only investment funds that constitute non-redeemable investment funds or mutual funds that are reporting issuers are permitted to use the OM exemption. Additionally, the Non-Participating Jurisdictions do not permit OM distributions of short-term securitized products.

Upon the enactment of the Amendments, Ontario, Québec and New Brunswick will not permit a distribution pursuant to the OM exemption by any type of investment fund. Alberta, Saskatchewan and Nova Scotia will permit investment funds that constitute non-redeemable investment funds or mutual funds that are reporting issuers to use the OM exemption. Additionally, none of the Participating Jurisdictions will permit the distribution of short-term securitized products, specified derivative products or structured finance products pursuant to an OM.

Liability for Misrepresentations and Cooling-Off Periods

After the Amendments come into force, in both Participating and Non-Participating Jurisdictions, issuers relying on the OM exemption will be subject to liability for misrepresentations contained in an OM. Where the securities legislation of the purchaser's province of residence does not provide a statutory right of action in the event of a misrepresentation, the OM must contain a contractual right of action for misrepresentation. As

the contractual right of action can be superseded by a statutory right of action, various purchasers may have different rights of action depending on their province of residence.

The Amendments stipulate that any marketing materials used by the issuer in connection with the OM distribution must be incorporated by reference into the OM. Therefore, in the Participating Jurisdictions, the certification by the officer and directors of the issuer will also apply to the information contained in the marketing materials.

Further, where the securities legislation of the purchaser's province of residence does not provide a comparable right, an OM must provide the purchaser with a contractual right to cancel the agreement to purchase the security by delivering a notice to the issuer not later than midnight on the second business day after the purchaser signs the agreement to purchase the security. As the contractual cooling-off period can be superseded by comparable statutory rights, different cooling-off periods may apply to various purchasers depending on their province of residence.

The following chart depicts, in summary fashion, the current OM requirements in various Canadian jurisdictions:

Offering Memorandum Requirements in Various Canadian Jurisdictions						
	Non-Participating Jurisdiction		Participating Jurisdictions			
	BC, NL	MB, NT NU, PE, YT	AB, SK	QC	ON, NB	NS
Continuous Disclosure Obligations for Private Issuers Subsequent to an OM Distribution						
Annual audited financial statements	No	No	Yes	Yes	Yes	Yes
Notice on how proceeds raised were used	No	No	Yes	Yes	Yes	Yes
Notice on discontinuation of business, change in industry or change of control	No	No	No	No	Yes	Yes
Risk Acknowledgment Forms for Individual Purchasers						
Risk acknowledgment form	Yes	Yes	Yes	Yes	Yes	Yes
Additional risk acknowledgment schedules	No	No	Yes	Yes	Yes	Yes
Limits on Distributions Pursuant to an OM						
Investment limits for certain investors	No	Yes ³	Yes ⁴	Yes ⁴	Yes ⁴	Yes ⁴
Issuers that are investment funds can use an OM	Yes	Yes ⁵	Yes ⁵	No	No	Yes ⁵
Short-term securitized products can be distributed via an OM	No	No	No	No	No	No
Specified derivative products or structured finance products can be distributed via an OM	Yes	Yes	No	No	No	No
Liability and Cooling Off Periods						
Liability for misrepresentations contained in OM	Yes	Yes	Yes	Yes	Yes	Yes
Officer and directors certify no misrepresentations in OM	Yes	Yes	Yes	Yes	Yes	Yes
Marketing materials incorporated by reference into OM	No	No	Yes	Yes	Yes	Yes
Cooling off period	Yes	Yes	Yes	Yes	Yes	Yes

³ Where the purchaser is an eligible investor, no limit. Where the investor is not an eligible investor, the acquisition cost must be < \$10,000.

⁴ The acquisition cost of all securities acquired in the preceding 12 months by a purchaser who is an individual cannot exceed: (1) in the case of an investor that is not an eligible investor, \$10,000; (2) in the case of an eligible investor, \$30,000; and (3) in the case of a purchaser that is an eligible investor and that received advice from a portfolio manager, investment dealer or exempt market dealer that the investment is suitable, \$100,000. There is no investment limit for accredited investors or for investors that meet the family, friends and business associates exemption.

⁵ The OM exemption is only available to investment funds that are non-redeemable investment funds or mutual funds that are reporting issuers.

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