



Posted on: May 1, 2015

## SECURITIES LAW UPDATE - CHANGES TO THE ACCREDITED INVESTOR, FRIENDS, FAMILY AND BUSINESS ASSOCIATE, AND \$150,000 MINIMUM AMOUNT INVESTMENT PROSPECTUS EXEMPTIONS

### Richards Buell Sutton Securities Law Update

By: Joe C. Chan

Upcoming changes have been announced to the “**accredited investor**,” “**friends, family and business associates**” and “**minimum investment**” exemptions under National Instrument 45-106 *Prospectus and Registration Exemptions* (“**NI 45-106**”) which will have wide impact on private placement financings going forward. These changes will be in effect on **May 5, 2015**; however in Ontario, these changes will be in effect on the later of May 5, 2015 or when the Ontario provincial government proclaims them in force.

We provide a summary of these changes below. **More importantly, we highly recommend that clients contact us prior to using any form of subscription agreements prepared prior to May 5, 2015, as these may no longer be adequate.**

### **Accredited Investor**

The “**accredited investor**” exemption has commonly been used for investors meeting certain net worth or income tests under NI 45-106. Canadian securities regulators have long been concerned that investors relying on the exemption did not fully understand its nature, such that many investors did not actually qualify as “**accredited investors**.”

Under the new changes, the issuer will be required to obtain risk acknowledgment forms from investors falling under the following categories of “**accredited investor**”:

- Individuals who, either alone or with a spouse, beneficially own financial assets having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds \$1,000,000;
- An individual whose net income before taxes exceeded \$200,000 in each of the 2 most recent calendar years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the 2 most recent calendar years and who, in either case, reasonably expects to exceed that net income level in the current calendar year;



- An individual who, either alone or with a spouse, has net assets of at least \$5,000,000.

Two new categories of “**accredited investors**” will also be introduced:

- An individual who beneficially owns financial assets having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds \$5,000,000; and
- A trust established by an **accredited investor** for the benefit of the **accredited investor’s** family members, of which a majority of the trustees are **accredited investors**, and of which all beneficiaries are the **accredited investor’s** spouse, former spouse, or a parent, grandparent, sibling, child or grandchild of that accredited investor or his/her spouse or former spouse.

“**Financial assets**” are defined in NI 45-106 as being cash, securities, a contract of insurance, a deposit or an evidence of a deposit that is not a security for the purposes of securities laws. The new Companion Policy to NI 45-106 (“**45-106CP**”) describes financial assets as “generally liquid or relatively easy to liquidate,” and that the value of an investor’s personal residence should not be included in a calculation of financial assets.

In contrast, the “**net asset**” test contemplates all of the investor’s total assets minus all of the investor’s total liabilities, such that the investor’s personal residence can be included in the calculation, less any liability (such as a mortgage) applicable to the personal residence.

### ***Friends, Family and Business Associates***

Ontario will finally adopt the “**friends, family and business associates**” prospectus exemption, which has been widely used through all other Canadian provinces to date. However, issuers seeking to rely on this exemption for Ontario residents will now be required to obtain a risk acknowledgement form – completed by both the subscriber, issuer, and the person on whose relationship is being relied upon – which must be retained by the issuer for 8 years. (Investors resident in Saskatchewan continue to be required to complete a different risk acknowledgement form.)

New guidance will be added to the 45-106CP as to who exactly will qualify as a “**close personal friend**” or a “**close business associate**”. In each case, the investor who has such a relationship with a director, executive officer, founder, or control person of the issuer should be in a position to assess their capabilities and trustworthiness and to obtain information from them with respect to their investment.

An individual will not qualify as a “**close personal friend**” or a “**close business associate**” solely because the individual is:



- A relative;
- A member of the same club, organization, association or religious group;
- A co-worker, colleague or associate at the same workplace;
- A client, customer, former client or former customer;
- A mere acquaintance, or
- Connected through some form of social media (eg. Facebook, Twitter, LinkedIn).

### **Issuer Policies**

In relying on the “**accredited investor**” or “**friends, family and business associates**” exemptions, the new 45-106CP also makes it clear that the securities commissions no longer deem it satisfactory for an issuer to rely merely on representations and warranties given by an investor in a subscription agreement nor the common ‘**accredited investor** checklist’ in utilizing these exemptions.

Instead, issuers will be expected to take active steps to verify that each investor qualifies for use of these prospectus exemptions, and to implement internal policies regarding same. 45-106CP explains that each issuer (and persons selling on behalf of the issuer) should:

- Fully understand the nature and requirements of each prospectus exemption, so as to be able to explain the prospectus exemptions to each investor and to evaluate whether the investor meets the requirements of the applicable prospectus exemption;
- Establish appropriate policies and procedures to confirm that each person selling securities on behalf of the issuer fully understands the prospectus exemptions, so as to be able to explain them to an investor, and to know what information and documentation must be obtained from each investor to confirm that the requirements of the applicable prospectus exemption are satisfied. **RBS would be happy to assist you in developing these policies and procedures, including checklists to assist you in gathering all necessary information from investors;**
- Keep relevant and detailed documentation to evidence the steps each issuer took to establish that an investor qualified under a prospectus exemption.

### **Minimum Amount Investment**

To date, issuers were able to rely on the “**minimum amount investment**” prospectus exemption for those persons making a single investment, as principal, of at least \$150,000.

The new changes no longer allow individuals to rely on the “**minimum amount investment**” prospectus exemption. “**Individuals**” are defined under the *Securities Act* (British Columbia) as being natural persons,



RICHARDS  
BUELL  
SUTTON

*Established in 1871*

i.e. human beings. In practical terms, this new limitation may have an impact on individual “retail” investors who do not qualify under any other prospectus exemption.



700 - 401 W GEORGIA ST.  
VANCOUVER, BC V6B 5A1  
CANADA

TELEPHONE  
604 682 3664

FAX  
604 688 3830

[RBS.CA](http://RBS.CA)