Northern Securities Inc.

Submission to IDA Task Force to Modernize Securities Legislation in Canada

December 5, 2005

Current Inefficient Market for Small Cap and Microcap Private Placements

The private placement market for small cap and microcap issuers ("Small Cap Financings") is not consistent across Canada. The experience with Small Cap Financings can vary considerably across Canada in terms of efficiency, cost, rule-making and document preparation.

These Small Cap Financings are carried out in a highly fragmented manner through friends, relatives, employees, directors, officers, wealthy individuals who are accredited investors, wealthy individuals who are not accredited investors, institutional investors, hedge funds, mutual funds, merchant banks, venture capital firms, and government sponsored entities.

Northern Securities Inc. ("Northern") believes that the main deterrent to an efficient private placement market is the lack of access to capital and the lack of simple, consistent and uniform rules across Canada.

Key is to Protect Downside Risk

Northern believes more Canadians should be given access to the private placement "club", and, based on the various thresholds in the current prospectus exemptions, it is currently an exclusive club.

The key in liberalizing access is to ensure the appropriate balance between investor protection and access to capital. Northern believes that the right balance would create more efficiency in Small Cap Financings by enabling more Canadians to invest. The right balance would also protect Canadians from taking undue risks relative to their current financial means.

The overriding priority must be to provide the investing public with greater access to prospectus exempt financings. More Canadians should have the "right to lose money", as it is only if you have the right to lose money that you ever have the opportunity to make money.

The second balancing priority is to provide protection for investors in terms of downside risk. Northern believes that the clear principle of protection should be to ensure that investors can sustain a complete loss of their investment. That is, not only should investors have the right to lose money, but also securities laws should ensure that investors can afford to lose the money they are investing.

Some of the current standards used to determine whether an investor is eligible to acquire securities on a prospectus exempt basis presume sophistication on the basis of income, net worth, assets or the amount invested. Having money, earning money or having a certain net worth are not necessarily indicative of investor sophistication and definitely do not allow you to ascertain whether an investor can sustain a complete loss of his investment. Northern, recognizes the difficulty in establishing workable proxies for investor sophistication and understands why these particular standards are necessary. However, Northern believes that an additional exemption needs to be added to address those investors that do not fall within the current exemptions but none the less, based on their particular financial situation and the amount they wish to invest should be permitted to have access to these investments. The examples we have set forth in the following section illustrate the prospectus exemption which Northern proposes to address these investors. As you will see this proposal strikes a fair balance between investor protection and access to investments while at the same time remaining straight forward and easy to implement.

We need to get away from pre-conceived notions of the existence of investment know-how because of wealth or income and conversely the lack of investment know-how because of the absence of wealth and income. Short of requiring each investor to pass an investment examination on each investment, there is no way of assessing the investment knowledge of any investor and there is no foolproof way of presuming knowledge with objective criteria such as net worth or income.

Instead the focus should be on the investor's ability to afford to lose the amount of his investment.

Examples of Investor Participation Focused on a Risk of Loss

The following examples are designed to show how a situation where a so-called accredited investor under the current rules should not in fact be accredited, and also to show a situation where a non-accredited investor should in fact be accredited.

Example #1

This first example illustrates how an accredited investor under the current rules has no business making an investment because he simply cannot afford to lose the entire amount of the investment.

Consider an investor (Mr. Debt) who has realized $250,000 in annual income in the past two years (and expects to earn the same or more next year), has no liquid cash resources, carries a $750,000 mortgage on a $1.0 million home but borrows $400,000 to make an investment. Mr. Debt may be brilliant if the investment turns out to be great despite literally betting the house on the investment or Mr. Debt may be very foolish if the investment fails. Either way it is clear that he may not be able to sustain a complete loss of his investment. However Mr.

Debt is an accredited investor when he clearly should not be spending $400,000 on one investment.

Example #2

This second example shows how a non-accredited investor under the current rules should be allowed to participate in a private placement because he can afford to lose the full amount of his investment.

Mr. Cash, an investor who has $900,000 in cash resources, has no debt, rents his home, and makes $100,000 annually and his net worth is $950,000. Mr. Cash wants to invest $25,000 in a private placement. He cannot do so because he is not an accredited investor under the current definition.

Although the current rules do not permit Mr. Cash to invest $25,000 they do provide that he can take part in this private placement by investing at least $150,000 which, given his fact situation, he should likely not do. The result from this example is even worse than in Example #1 as the current rules actually potentially increase the risk to Mr. Cash by requiring him to invest at least $150,000 if he wants to invest at all.

Mr. Cash, although a non-accredited investor, should be allowed to invest $25,000 in the private placement because he can clearly afford a complete loss of his investment.

Access for More Canadians

Northern believes that there is another group of investors that should be permitted to acquire securities in private placements who may not meet the $200,000/$300,000 annual income test, the $1.0 million liquid assets test or that may not want to invest $150,000.

Northern proposes that this group of investors should have at least $200,000 in liquid assets but be limited to investing up to 15% of their liquid assets in a single private placement. Investing $30,000 in a private placement would allow the investor to still have $170,000 left over if he loses the full amount of his investment. The investor would be limited to investing up to 25% of his liquid assets in all private placements

These limitations would apply to an investor who has less than $1.0 million in liquid assets. Once an investor has $1.0 million in liquid assets, the investor becomes an accredited investor under the current rules and can invest that full amount of the $1.0 million in one private placement or a series of private placements.

If this proposal were implemented, Mr. Cash (from Example #2 above) would be permitted to invest up to $135,000 or 15% of his $900,000 in liquid assets in a single private placement. He would also be permitted to invest up to $225,000 or 25% in all his private placements.

The example with Mr. Cash is easy. He is wealthy and should be part of the private placement club.

Let us take another example, this time with a middle income Canadian. An executive with a technology firm, Margo Middle Income Smith is a bright rising star in her company. As Director of Business Development she pulls in a salary of $125,000 annually. She has a home with a value of $250,000 with no mortgage; she has a car loan of $20,000 and cash resources of $200,000. She wants to invest $20,000 in a private placement.

Under the $200,000-15% proposed exemption, she can do so. In fact she can invest up to $30,000 or 15% of her $200,000 in a single private placement. No reason why Sharon cannot be given the key to the club.

Let us go further. Let us talk about the lower income Canadian, Leonard Lower Income Brown. Leonard makes $50,000 annually, has $80,000 in cash resources and has $10,000 in debt, has no home and his net worth is $100,000.

Leonard would not be able to invest in a private placement under the $200,000-15% rule. However, he could borrow $70,000 and invest $150,000 in a private placement. This makes no sense whatsoever. He should not be allowed to invest in this manner. Maybe some day we would look at lowering the $200,000 threshold, but not now.

As can be seen from the foregoing examples, Northern's proposal strikes a balance between investor protection and access to investments. In fact, Northern believes that this proposal actually provides greater protection for investors than many of the current securities law provisions including, the accredited investor exemption, the Capital Pool Company provisions and the TSX Venture Exchange exemption.

Competitive Disadvantage with the United States

In comparison to Canada, the United States will offer substantial advantages to issuers given the more developed marketplace, the broader base of investors, a single securities regulator, the more advantageous tax environment, and the ability to generate more perceived or real appreciation in equity value. Canada must seize any opportunity it can to create an environment that is at least comparable to the competitive position in the United States – the private placement rules is one such opportunity.

Competitively the U.S. is substantially ahead of Canada in the rules for private capital raising.

The key advantages for the U.S. are clear:

1. An issuer can raise US$1.0 million from any number of investors, whether qualified or non-qualified (a Rule 504 offering).

In all jurisdictions other than Ontario, an issuer can sell securities on a exempt basis if an offering memorandum is prepared and investors sign a risk acknowledgment statement. The exemption is not uniform across Canada. In certain provinces the amount an investor can invest is limited to $10,000 unless the investor is eligible. An eligible investor is an individual with net assets of more than $400,000, annual income of $125,000 or have received advice from an eligibility advisor.

2. In the U.S., in Rule 505, a maximum of US$5 million can be raised from any number of qualified investors and a maximum of 35 non-qualified investors. There is a prohibition against a general solicitation or general advertising.

In NI 45-106 the closely-held issuer exemption was removed and the private company exemption was re-instated. The closely-held exemption provided that a maximum of $3 million could be raised from a maximum of 35 non-qualified investors. The private company exemption is a very narrow exemption as it limits sales to persons who are not members of the public and must have some relationship to the issuer.

We are saying in the rules that Canadians who are not rich cannot take care of themselves. Canadians are smarter than the exemptions imply. More participation by Canadians will lead to better value and more liquidity. This is better overall for Canadian markets.

There is a fundamental policy gap between public offerings and private placements with the end result that a large number of Canadians are excluded from profiting from the majority of business deals. There are many more investors in the U.S. who qualify to participate in their private placements due to the sheer size and wealth of their investment community. Canadian small cap companies looking to raise capital by private placement get more value for their company by going to the U.S. To keep opportunities for Canadian businesses and investors in Canada, the disparity between U.S. and Canadian regulations regarding private placements must be addressed.

Failure to Make Private Placement Exemptions Consistent

The objective in NI 45-106 was to make the private placement exemptions consistent across the country. This objective failed. A number of exemptions still remain available in other jurisdictions but are not available to investors in Ontario.

For example, as stated above, the offering memorandum exemption is not available in Ontario.

Also, the TSX Venture Exchange offering exemption is not available in Ontario. This exemption allows a TSX Venture Exchange issuer to raise up to $2 million under the filing of an offering document. There are a number of conditions including that no one investor can purchase more than 20% of the offering.

Finally, the Family, Friends and Business Associates exemption is more restrictive in Ontario than the rest of the jurisdictions.

In addition, to the need for the new prospectus exemption described above, Northern also believes that greater work needs to be done in truly harmonizing the current exemptions such that they can be applied uniformly across Canada.

Ironic Contrast with CPCs

The struggle with finding the right balance between investor protection and access to private placements becomes more evident when one looks at the situation with Capital Pool Companies where securities laws allow all Canadians to invest in what amounts to a shell public company with management but no business, yet we restrict Canadians from investing in Small Cap Financings where there is management, a business and a substantive public disclosure record and where they have the ability to sustain a complete loss of their investment.   .

Northern does not believe it makes sense for an investor to be able to invest without restriction in a company with no business or business plan, yet be denied the opportunity to invest in a company with an established business record.

Conclusion

There is some important work to be done, in Northern's view, to enable participation by more Canadians in private placements. We need to open the door of opportunity to Canadian investors and at the same time protect them with the downside risk rule inherent in the $200,000 and 15% limitations we propose. We believe that this proposal would lead to more efficient capital markets and help in leveling the playing field with the United States while at the same time providing a rational exemption from the prospectus requirements.

Northern Securities Inc.

By:________________________________

Vic Alboini
Chairman and Chief Executive Officer