National Crowdfunding & Fintech Association

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April 15, 2020
Honourable William Morneau
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario K1A 0G5
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re: Government should collaborate with Fintechs

Dear Minister,

The Canadian government should recognize that FinTech companies can play a central role in distributing capital to small businesses and early-stage companies. Online lending and crowdfunding platforms have invested to build the software for onboarding, screening, approval, distributing and servicing of loans and investments to Canadian small businesses. Canada's regulators and policymakers need to work with our fintech entrepreneurs who have the digital infrastructure to help the Canadian government achieve its goal of saving small businesses and getting the economy get back on track faster.

While NCFA applauds the government's work to help startups and SMEs cope with the liquidity and demand crisis created by the COVID-19 pandemic, more financial support and incentives are needed to help companies and the economy bridge to better times. Specifically, we strongly suggest the government implement the following ASAP:

Recommendations

1. Work with fintechs to administer small business loans to deserving companies

- Government should work with established online lending fintechs to distribute and manage small business loans quickly and cost-effectively.
- Online lenders can process loan applications quickly, onboarding and evaluating borrowers electronically, while proactively identifying risks and monitoring borrowers.
- In the UK, only 1.8% of 300,000 applications to emergency small business loans (CBILS, Coronavirus Business Interruption Loan Scheme) have been approved due to bureaucracy and reluctance to lend based on criteria (here). The UK government has since approved fintechs to help administer loans such as Starling and OakNorth (here)
- In the US, fintechs Paypal, Intuit and Square are now approved to offer loans through the coronavirus paycheck protection program (here)

2. Expedite full harmonization of equity and lending Crowdfunding regulations and widen participation among companies and investors

- Increase issuer caps to $5 million, in line with foreign jurisdictions, and allow a broader range of companies to participate.
  - United States: Companies can raise US$5M under RegCF (here)
  - Australia: Companies can raise A$5M (here)
  - Germany: Companies can raise €8M (here)
- Allow qualified accredited investors to participate fully without caps
- Establish a regulatory regime that recognizes and accepts that the activities of P2P lenders (and simple loan agreements) are inherently different from equity investments and should be regulated differently

3. Establish a two-pronged Capital Raise Funding Program to improve access to capital for earlier stage companies

- **Capital Raise Readiness Reimbursement:** Up to $25,000 per qualifying company to help companies recover the cost of preparing to raise capital such as licensed dealer platform fees, legal and accounting expenses, and strategic consulting.
- **Matching investment program:** Similar to what the BDC is currently offering for matched equivalent VC investments, the government should match investments into early stage and smaller companies raising capital through crowdfunding platforms. These companies would not generally qualify for VC funding at their stage of growth yet supporting these firms will help strengthen entrepreneurs and innovators as we emerge from the pandemic.

4. Tax Relief for equity crowdfunding investors similar to the EIS/SEIS programs in the UK

- SEIS lets investors claim tax relief and Capital Gains Tax exemption for 50% of the investments up to £100,000
- EIS allows investors to claim tax relief, Capital Gains Tax exemption, loss relief for 30% of the investments up to £1,000,000 per year
- The Seed Enterprise Investment Scheme (SEIS) targets early-stage companies that have been trading for less than 2 years and have less than £200,000 of assets
- This program could be piloted for a 2 year period which is long enough to improve access to capital for many start-ups and SMEs negatively impacted by COVID-19, and to review the program with a suitable amount of transactional data for further review

The Startup and Small Business COVID-19 Crisis

Startups, SMEs, and smaller financial service providers in Canada are all facing extinction while in lock-down from the pressures of mounting operating expenses, a vast drop in customer demand, and rapidly closing funding and revenue channels.

Collectively, SMEs are the backbone, and future, of the Canadian economy supporting at least 70% of all jobs across the country and 41.7% of GDP. Businesses with fewer than 10 employees make up 73.5% of the private-sector employers in Canada, and from 2013 to 2018, created 56.8% of all new jobs.

These companies are facing disrupted capacity, broken supply chains, insolvency and high levels of mental stress. In the result, we are facing the loss of all or part of an entrepreneurial ecosystem. Startups in particular need assurance, transparent information and support from government to help navigate the current health and economic crisis, to protect staff and their business, and to ensure their survival once operating restrictions are gradually lifted in the coming months.

Cash is King

'Cash is King' and they need it to survive. Businesses surveyed by Lending Loop, on average, have less than 30 days of cash on hand to weather this storm. These businesses are in desperate need of resources and funding to stay in business, retain employees (often highly skilled), reduce expenditures, and restructure to survive through this lockdown.

This survey paints a similar picture as estimates from The Council of Canadian Innovators that 82% of Canadian tech CEOs are planning layoffs in the coming weeks. By international comparison, techUK, a non-profit tech association, reported that 30% of surveyed SMEs might have to cease business if lockdown restrictions were in place for a longer period. And 51% believed they were ineligible to receive government support under the current programs, such as the Pay Retention Scheme.

Cards stacked against: Current Government Support is Not Enough

COVID-19 is a momentum and capacity building killer. It's especially disheartening to the Canadian startup community which has been scaling-up and capturing global attention, attracting capital and talent, investing in new resources and infrastructure, and building national confidence and pride.

For some startups, the pandemic may expedite the growth of their business but for most it will be a disaster. As it stands, in a few short months we are at risk of losing an entire generation of early-stage companies who are too small to attract institutional venture capital and whose survival cannot depend on the pocketbooks of friends, families and angel investors.

There are indications that mostly foreign tech giants will use this crisis to consolidate their hold over major parts of the Canadian technology ecosystem by buying up cash-starved smaller firms, or simply picking up the resulting business as they fall by the wayside. The risk of losing this collective private and public investment and the cost of rebuilding (if at all possible) would be more expensive than providing the required support to bridge companies and the economy to better times.

From an investor perspective, public capital markets have become narrower and narrower over the past 18 months as fewer companies are willing to undergo the rigors of a public listing. This situation has reduced the universe of potential investments for the public. The sharp falls and volatility in equity markets in March and early April can only result in greater investor conservatism with less appetite for riskier, early-stage companies that are best positioned to create the jobs of tomorrow.

Much has been done by the government to help large and medium-sized companies cope with the unprecedented situation created by the pandemic. <u>But the current fiscal support is not enough for startups. More needs to be done to improve the chance of survival of these early-stage businesses.</u> Canada is lagging behind the UK, Australia, France, Denmark and the US in its support programs.

The sheer magnitude of the economic and financial crisis requires a comprehensive and complementary suite of measures to enable all of Canada's smaller, earlier-stage companies not only to survive the present trough but also to be fully equipped to move into high gear as soon as possible.

Opportunity for a Paradigm Shift is Now

Fintechs have frontline insights on the pain COVID-19 is inflicting on small businesses and entrepreneurs. These Fintechs can help to distribute financial support more quickly and cost-effectively, complementing the bigger financial intermediaries' players who are slower due to their legacy IT systems. Our Canadian Fintechs have digital infrastructure to identify demand, verify identity and financial suitability, approve investments, and make efficient and secure digital payments. Canadian Fintechs can provide a range of financial options (equity, loans, and other forms of credit) to support consumers, startups, entrepreneurs and SMEs.

Government should support and recognize Canadian fintechs as a key part of the financial solution. The sooner we understand that our regulation and policy frameworks need to holistically include the value that new fintech models and digital infrastructure brings, the faster the economy will get back on track.

Time is of the essence. There is an immediate opportunity for the Canadian government to partner with fintechs to solve the funding crisis that COVID-19 has forced upon all of us. Working together, Canadian Fintechs can deliver government's financial resources using a resilient and efficient electronic platform. It's time for the Canadian government to work with Fintech entrepreneurs and seize this opportunity to work together to protect the Canadian economy.

The time to act is now.

On behalf of NCFA: This open letter is informed by a wide range of voices from within NCFA (About Us, Partners) and the innovation community in Canada and around the globe. Special thanks to those providing specific inputs of the content including Craig Asano (NCFA), Richard Remillard (RCG Group), Robin Ford (Ford Consulting), Michael King (University of Victoria), Cato Pastoll (Lending Loop), Victoria Bennett (BMW Consulting), Peter-Paul Van Hoeken (FrontFundr) and Alan Wunsche (TokenFunder).

Sincerely,

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The **National Crowdfunding & Fintech Association** (NCFA Canada) is a financial innovation ecosystem that provides education, market intelligence, industry stewardship, networking and funding opportunities and services to thousands of community members and works closely with industry, government, partners, and affiliates to create a vibrant and innovative fintech and funding industry in Canada. For more information, please visit: ncfacanada.org