



**OFFERING STATEMENTS: REGULATORY CHANGE PROPOSAL**

**A position paper submitted by the Ontario Co-operative Sector Regulatory Affairs  
Committee to the Financial Services Policy Unit, Ontario Ministry of Finance**

## SUMMARY:

1. The Ontario Co-operative sector's Regulatory Affairs Committee (the "Committee"), representing the interest of Ontario co-operatives, recommends the following changes to Ontario Regulation 178 (as amended):
  - a) The number of prescribed security holders for the purpose of subsection 34(1) of the *Co-operative Corporations Act*, R.S.O., c.C.35 (as amended ) (the "CCA") be increased from 35 to 50;
  - b) The requirement to file an offering statement not apply to a co-operative's issue of shares to its members if the value of the shares issued not exceed \$5,000.00 per member in a year and not exceed an aggregate value of \$50,000.00 per member;
  - c) The requirement to file an offering statement not apply to a co-operative's issue of debt obligations to its members if the value of the debt obligations not exceed \$5,000.00 per member in a year and not exceed an aggregate value of \$50,000.00 per member; or
  - d) The requirement to file an offering statement not apply to a co-operative's offering of securities to its members, if the offering does not result in the co-operative having more than \$1,000,000.00 of issued and outstanding securities.
2. The recommended changes in this Position Paper are intended to recognize the risks and benefits of co-operative enterprises by their size, their experience, their resources, their capacity, and, fundamentally, that the overwhelming motivation of investors in co-operatives is not to promote the dominance of capital within the co-operative, but to create and enable an enterprise that responds to their needs and interests (and the needs and interests of the community) without speculation.
3. Investments in co-operatives do not determine the extent of members' financial and governance rights, but are a condition of membership and participation in co-operatives. To the extent that the changes recommended below increase co-operatives' financial means for conducting their business and achieving their objectives, they will also serve to facilitate more opportunity among a greater number of Ontarians to become members of and participate in co-operatives.

## BACKGROUND:

4. The offering statement process for co-operatives has its origin with the 1971 Ontario Legislature's Select Committee *Report on Co-operatives* (the "**Select Committee Report**"), which led to the 1973 adoption of the CCA. This report revealed a clear understanding of co-operatives in the mid-20<sup>th</sup> century, how they did business, and their role and potential for growth in Ontario's economy and communities at that time.
5. When it was drafted, Ontario co-operative legislation was unique in Canada because it recommended a distinct regime for regulating co-operative securities in the province, separate from those businesses incorporated under other legislation and regulated under the Ontario *Securities Act*. Other co-operative legislation, such as Manitoba's *Cooperatives Act (1998)*, now include Offering Statements or similar exemptions from provincial securities regulations.

6. Co-operatives raise capital for their development and operations by offering securities to members and to others who wish to support financially the social and economic objectives of co-operatives in their local, regional and provincial communities. Securities include both shares issued by the co-operative, as well as other instruments like bonds or debentures. These securities are not traded on the open market.
7. Membership shares are available only to those wishing to become members of a co-operative. Under the CCA, preference shares are available for purchase by both members and others who choose not to become members, but who wish to support the goals and objectives of the co-operative. The ownership of preference shares, however, does not mean the holder has the right to vote in the co-operative.
8. The regulatory process in Ontario for co-operative securities is designed to allow prospective purchasers to make informed investment decisions while also ensuring that co-operatives can raise their capital from their members and other supporters without undue cost. When an exemption from offering statement requirements is available, a co-operative can raise funds from the sale of securities with less financial, regulatory and administrative burdens on the co-operative. Even if a co-operative is exempt from offering statement requirements, it is still obligated to provide full disclosure to investors.
9. The CCA was proclaimed in 1974, and the offering statement environment - pioneering in its day - has not been updated in more than 20 years. The financial limits and thresholds below which there is an exemption were prescribed in 1995, and have not changed since that year. They have lost about 50% of their value in that time due to inflation -- \$1,000 in 2014 dollars would be equal to \$642 in 1995 dollars.

## RECOMMENDATIONS:

### A. Threshold of Security Holder Exemption Requirements: Regulation 178, Section 11.1

10. Currently, Regulation 178 (as amended) states: "For the purposes of subsection 34 (1) of the Act, the prescribed number of security holders is 35." Co-operatives that create offerings that would result in fewer than 35 security holders do not have to prepare an offering statement to sell securities and raise capital.
11. We recommend that the prescribed number of security holders, for the purpose of subsection 34(1) of the CCA, be increased to **50**.
12. As a general proposition, the goal of securities regulation is achieving a **balance** between protecting investors from unfair, improper or fraudulent practices and fostering fair and efficient capital markets and confidence in capital markets.<sup>1</sup> Both ends of the balance are important. It is submitted that the current regulation of securities for co-operatives, with its current limit of 35 security holders, undermines efficiency in the allocation of capital insofar as it causes persons to avoid adopting the co-operative enterprise model because of the low threshold (35) above which they must incur substantial costs in order to obtain a receipted offering statement.

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<sup>1</sup> See section 1.1 of the *Securities Act*, R.S.O. 1990, c.S.5.

13. Increasing the prescribed number of security holders to 50 will allow more new or small co-operatives to increase their membership base by 44%, allowing them to raise start-up capital from a larger pool of members - and in a more cost-effective manner - before having to consider utilizing an offering statement. This will facilitate a more stable and sustainable co-operative business since there will be fewer restrictions on the membership pool. This will allow the co-operative's membership to be larger, more diverse, and attract a wider range of skillsets and experience.
14. A co-operative issuing securities typically does so to persons either who desire, already, to be members of the co-operative or who (in the absence of desiring to become members) are supportive of the goals and objectives of the co-operative, and who, in any case, generally have a relationship to the co-operative and its social and economic enterprise so that they understand the risks associated with the investment. In this regard, **there is an analogy to the "private issuer" exemption in effect across the country, including in Ontario: to the extent that persons acquiring securities in a co-operative are members of the co-operative and are not likely to base their investment decision on offering statement disclosure** – either they have access to information commensurate with the information contained in an offering statement by virtue of their membership in the co-operative or they may invest regardless of the disclosure in the offering statement because they are committed to social and economic objectives of co-operatives in their local, regional and provincial communities.

## **B. Current Prescribed Offering Statement Exemption Requirements**

### Current Limits

15. Ontario Regulation 178 currently exempts a co-operative from having to file an offering statement if:
- in respect of the co-operative's issue of shares to its members, the value of the shares issued does not exceed \$1,000.00 per member in a year and does not exceed an aggregate value of \$10,000.00 per member;
  - in respect of the co-operative's issue of debt obligations to its members, the value of the debt obligations does not exceed \$1,000.00 per member in a year and does not exceed an aggregate value of \$10,000.00 per member; or
  - in respect of an offering of securities to its members, the offering does not result in the co-operative having more than \$200,000.00 of issued and outstanding securities.

### Recommended New Limits

16. There have been no changes to limits or exemptions in the CCA and Regulations for many years resulting in an erosion of the values due to inflation. Beyond inflation erosion, the current limits are inadequate for co-operatives to prudently and efficiently raise the capital they need in order to capitalize their businesses. The recommendation is to increase these exemption limits by a minimum of FIVE TIMES, as follows:

- a) the requirement to file an offering statement not apply to a co-operative's issue of shares to its members if the value of the shares issued not exceed **\$5,000.00** per member in a year and not exceed an aggregate value of **\$50,000.00** per member;
- the requirement to file an offering statement not apply to a co-operative's issue of debt obligations to its members if the value of the debt obligations not exceed **\$5,000.00** per member in a year and not exceed an aggregate value of **\$50,000.00** per member; or
- the requirement to file an offering statement not apply to a co-operative's offering of securities to its members, if the offering does not result in the co-operative having more than **\$1,000,000.00** of issued and outstanding securities.

*Rationale: Close Member-Investor Links to the Co-operative*

17. With few exceptions, Ontario co-operatives are relatively small enterprises, with a close-knit membership base or source of community support that is strongly connected to their businesses. This membership and community connection reduces the need for disclosure through the offering statement process because, as noted above, the members are not likely to base their investment decision on offering statement disclosure.
18. As noted in the Select Committee Report, “[Securities] issued by a co-operative are not purchased with a view to capital appreciation or to obtaining a high return since the Act [the CCA] limits the rate of dividend which may be paid and in any event most of the earnings of a co-operative after provision for necessary reserves are distributed by way of patronage rebates. Persons become members of a co-operative to avail themselves of its services and not primarily for the purpose of investment.” This statement of the Select Committee is no less true today, as members of co-operatives exhibit a stronger bond and understanding of the business in these enterprises that takes the place of an offering statement.
19. We recognize the importance of the goal of securities regulation referred to, above,<sup>2</sup> but wish to emphasize the principle of measured or proportionate regulation, which recognizes the unique features of the sector of the economy and the economic activity being regulated. While "investor protection" is an important aspect of fostering a securities market that is fair and entitled to public confidence, the principle of proportionality in the context of the co-operative segment of the securities market requires the regulator – government – to recognize the unique features of the investor / member in relation to the co-operative as issuer of securities.
20. As stated, above, the overwhelming motivation of investors in co-operatives is not to promote the dominance of capital within the co-operative, but to create and enable an enterprise that responds to the members' needs and interests (and the needs and interests of the community) without a speculative purpose. People invest in co-operatives because they believe in the importance of the goals and objectives of the co-operative, and of ensuring that the benefits from the co-operative's

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<sup>2</sup> See paragraph 12, above.

enterprise remain in the local and regional economies and communities. They understand how the co-operative is structured and operated to achieve those goals and objectives.

21. While investors in co-operatives are not indifferent to financial return and the risk of financial loss, they are prepared to accept a (legislated) lower rate of return for the use of their money and the risk that some or all of their capital may be lost, in consideration for being a member of and participating in the co-operative's enterprise. Accordingly, the investment limits – established 20 years ago – should be updated to reflect the unique character of the co-operative segment of the economy, the close bond between new (defined as those incorporated five years or less) or smaller co-operatives and their members, and the reasonable expectations that members of, and investors in, co-operatives have of the role of regulators in their oversight of market participants.
22. **CO-OP PERSPECTIVE:** Growth in organics and local food initiatives has grown substantially in the last five years. This has included the development of retail stores to serve small communities (North Central Co-operative) or a defined neighbourhood in an urban area (Karma Food Co-operative, Garden City Food Co-operative, West End Food Co-operative). The development of a retail location for such a project is between \$500,000 and \$1,500,000, depending on the location and size of the store, and to some extent whether or not the building must be built new. In these cases, the members are heavily connected to the creation of these stores because: they are often the only store available in a community or neighbourhood; the stores are seen as a source of local employment; or they are a sustainable and democratic response to larger scale multi-national. This connection ties the members and investors to the co-operative and keeps them involved in the day-to-day activities of the business. For example, Karma Co-operative members have the option to volunteer in the store or on a board committee to reduce the membership fees they pay, giving them knowledge of the co-operative operations that would not exist in the case of a customer shopping at a franchised grocery store. If Karma were to be developed in the current business climate (it was started in 1972) they would likely require an offering statement under the current limits, but not if the limits were increased. Again, the member bond and involvement reduces the need for disclosure for these types of co-operative s and projects
23. **CO-OP PERSPECTIVE – In the words of the Aaron Theatre Co-operative:.** Rural communities are at risk of losing their cultural institutions and co-operatives can provide a model to keep them in the community. The Aron Theatre Co-operative Inc. was formed to first save the theatre (built in 1949) in Campbellford Ontario from closing – by buying it from the long-time private owner – and then working to turn it into a sustainable cultural hub for everyone in the community.

In order to do this successfully, the Aron needed to raise hundreds of thousands of dollars to:

- Complete a feasibility study and business plan.
- Purchase the business (including the land and building).
- Renovate the marquee and replace the old light fixtures with LED lights.
- Upgrade to digital projection and sound technology.
- Replace the theatre seats.
- Install a barrier-free entrance and accessible washroom.
- A current need exists to raise additional capital to replace the old heating system and the roof of the building.

To facilitate the success of this project, it would have been helpful to increase the Offering Statement exemption from the current \$200,000 to \$1 million (as well as the individual member limits of \$1,000 per annum and \$10,000 accumulatively). The current limits are a barrier to raising capital for co-operative projects, including business succession from retiring baby boomer owners.

Because of the \$200,000 Offering Statement limit, the Aron Theatre Co-op had to develop a mixed capitalization model that took much longer to implement (three years from the incorporation date of the non-share co-op). We sold \$166,400 in Aron bonds (within the current Offering Statement exemption of \$200,000), raised \$211,000 in grants (some of which are no longer available from the government of Canada), and levered over \$700,000 in in-kind contributions and volunteer labour from community members, including local businesses. A copy of the co-operative's financial statements is available upon request.

24. *Rationale: Cost Reduction and Efficiency:* As with all business sectors, the costs of doing business for co-operatives have increased over time, which means that the current offering statement limits now affect many more co-operatives than would have been affected in the early 1990s when these limits were first put in place.

25. The administration costs of proper documentation and compliance in processing membership applications and investments are ever increasing. A co-operative seeking to raise even a modest sum of \$60,000 in a year, to avoid the cost burdens of preparing an offering statement, will have to handle at least 60 investments of \$1,000 each. By having to attract many smaller investments, the co-operative is frustrated in its ability to attract capital at a low cost, due to the higher costs associated with administering the many investments. Put simply, one of the goals of securities regulation -- fostering efficient capital markets -- is sacrificed to the other goal (reducing the risks that investors face), with the result that co-operatives face costs or other disincentives that affect their behaviour regarding their capital-raising choices. Increasing the thresholds 5-fold will represent up to a 75% savings in administration costs for the co-operative as a percentage of the investment, while still being consistent with the original goals and vision of the legislation.

26. Similarly, for the investor, the amount of due diligence required to learn about a co-operative, the business model, the related industry and the investment opportunity do not warrant the return that the investor may be able to receive on a single \$1,000 investment or a cumulative 10-year investment plan totaling \$10,000. The median household income in Ontario in 2010 was \$71,540,<sup>3</sup> and using the RRSP contribution limit of 18% of earned income as a guideline provides a suggested investment amount of \$12,877 per year. Even if a household strives for an investment level of 10% of earned income (that is, an investment of \$7,154), applying the \$1,000 threshold to all investments would result in having to maintain eight different investments in a year in order to place their \$7,154 of capital. By any measure, this would not be an efficient way to allocate and invest such a small sum of money -- having to make eight different investments, with the resulting transaction costs -- nor is it fair to the investor.

27. Organizations in general have seen the need for capital increase substantially since the 1974 proclaiming of the act including investments in technology, automation, efficiency and scale.

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<sup>3</sup> Statistics Canada, *Median Total Income, By Family Type, By Province and Territory (All Census Families)* <http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/famil108a-eng.htm> (Access February 15, 2015)

Notwithstanding the fact that most Co-operatives are small operations, co-operatives compete in an increasingly global competitive business environment. The opportunity to start a co-operative within the current \$200,000 capital exemption varies greatly by industry and the ability to leverage the equity of the members. The renewable energy sector is one with high capital requirements, not unlike many industries.

28. **CO-OP PERSPECTIVE: RENEWABLE ENERGY.** Within the renewable energy sector in Ontario, this leaves a co-operative needing to make a choice: A co-operative can either attempt to fund an offering statement process (which in the case of one renewable energy co-operative cost \$94,000 for legal and accounting reviews) without first establishing operations, asking members to invest in a vision with the hope of becoming a financially viable operation in the future, or, alternatively, the co-operative can try to create a viable operation in the short term, at the risk of not having sufficient capital to grow the organization within a reasonable time period.
29. By way of example, an expected project return (excluding administration) for an individual renewable energy generating project or a few smaller projects that could be purchased with \$200,000 of equity is in the 8-9% range. Involving a lender to provide an accompanying portion through a loan could potentially increase the returns for the equity portion of the investment to the 13% to 15%. In this scenario, the total contribution available from the projects to cover the administrative costs of the co-operative would range from \$26,000 (13% return on \$200,000 of equity) to \$30,000 (15% return on \$200,000 of equity). Professional fees for filing returns, preparing audited statements and other compliance will cost approximately \$10,000 per year at the low end unless pro bono work is involved. Assuming a 5% investment return (interest on member bonds) to the investors would take another \$10,000. This leaves between \$6,000 and \$10,000 of surplus before income tax, if it is possible for all day to day administration of the co-operative to be done through the work of volunteers. At this rate, it would take several years of setting aside surpluses before another acquisition of a renewable energy project could occur which implies a very slow growth rate.
30. Even if surpluses are reinvested into the co-operative rather than paid to members as interest or dividends, the level of working capital is extremely limited and is unlikely to support the hiring of people to dedicated positions. By relying on volunteer time and effort and limiting growth potential, this is relegating the co-operative business model to that of idealists rather than promoting the organization of a co-operative as a competitive business structure. Accessing the same lenders that international developers access with the most favourable rates and terms requires portfolios of projects that often start at \$5 million in value and often need to exceed \$15 to \$20 million in value to be able to cover the fixed costs of legal reviews, due diligence expenses and loan administration expenses. The current limit of \$200,000 for raising seed capital prior to the development of an offering statement makes achieving this scale of a portfolio extremely difficult and adds substantial uncertainty to the process. By increasing the threshold from \$200,000 to \$1,000,000, this provides sufficient working capital to pay people for their efforts, establish an operating track record and further fund the development of an offering statement based on a viable organization.
31. Many co-operatives such as housing co-operatives, agricultural co-operatives and organic food co-operatives have faced a real estate market that has seen property values (an essential component in the

operation, whether leased, rented or owned) increase at rates well beyond the rate of inflation. Using Ottawa as an example, in 1974, an average home cost \$46,661, whereas the average home in 2013 cost \$357,348, a more than 7-fold increase.<sup>4</sup> In 1974, the average price for farmland in Ontario was \$1,700 to \$1,800 per acre<sup>5</sup>, while in 2014, average land prices in Southwestern Ontario was \$11,000 per acre<sup>6</sup>, a 6-fold increase overall, but doubling in cost in just the last 5 years.

### C. Recommended Changes to Regulation 178

32. Based on the foregoing, therefore, we recommend the following amendments be made, respectively, to sections 11.1 and 12.6 of Regulation 178:

"11.1 For the purposes of subsection 34 (1) of the Act, the prescribed number of security holders is ~~35~~ 50.  
O. Reg. 414/07, s. 2. "

"12.6 Subsection 34 (1) of the Act does not apply to the following shares and debt obligations of a co-operative:

1. Shares issued to members if the value of such an issue does not exceed ~~\$1,000~~ \$5,000 per member in a year and does not exceed an aggregate value of ~~\$10,000~~ \$50,000 per member.
2. Debt obligations issued to members if the value of such an issue does not exceed ~~\$1,000~~ \$5,000 per member in a year and does not exceed an aggregate value of ~~\$10,000~~ \$50,000 per member.
6. Securities issued by the co-operative to its members, if the offering does not result in the co-operative having more than ~~\$200,000~~ \$1,000,000 of issued and outstanding securities."

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<sup>4</sup> [http://www.agentinottawa.com/1956 - Present Prices/page\\_491704.html](http://www.agentinottawa.com/1956 - Present Prices/page_491704.html)

<sup>5</sup> <http://www.uoguelph.ca/catprn/PDF-TPB/TPB-11-01-Weersink-Deaton-Bryan-Meilke.pdf>

<sup>6</sup> <http://valcoconsultants.com/20102014LandValuesStudy.pdf>

## **CONCLUSION:**

In concluding, we note the report of the Auditor General of Ontario to the Speaker of the Legislative Assembly of Ontario (Fall 2014), in which she reported, among other things, on the Financial Commission of Ontario's role and functioning in exercising oversight of co-operatives, in particular reviewing and receipting offering statements. Among her recommendations is that FSCO should consult with the Ontario Securities Commission on "... the benefits of sharing or transferring the responsibility of reviewing offering statements [from co-operatives]" (page 145). FSCO's response, as reported in the Auditor General's report, is that FSCO will initiate further discussions with the OSC about the implications of transferring the responsibility for reviewing co-operatives' offering statements to the OSC. Further, we note that FSCO is currently undergoing a review of its mandate.

The process for Offering Statement certification at FSCO is working well. Presently FSCO does not handle a large volume but the Offering Statements it does receive are reviewed using a much more comprehensive standard than previously. FSCO's current interpretation of the regulations surrounding Offering Statements has now stabilized. There are trained and experienced staff managing the function well at this point.

The receipting (approval) of Offering Statements should not move to the Ontario Securities Commission (OSC) or to any other agency unless the full complement of staff and resources move currently at FSCO moves as well. In particular, the OSC's priorities and shareholder-based expertise would have a negative impact on this community-oriented financing model that co-operatives increasingly utilize.

The Ontario Co-operative Association has been invited to participate in discussions and consultations before any decision is made to transfer the responsibility for reviewing co-operatives' offering statements to the OSC – or any change to FSCO's mandate is made - to ensure that the views and concerns of the co-operative sector are communicated to government. We see no reason why changes to the *Co-operative Corporations Act* cannot continue to be made while these discussions continue.