

PRE-BUDGET CONSULTATIONS SUBMISSION

MINISTRY OF FINANCE

January 2020

Ontario Co-operative Association

The Ontario Co-operative Association develops, supports, educates and advocates for Ontario's over 1,500 co-operative businesses. Our goal is a sustainable province built on growing and thriving communities that are providing social, environmental and economic wellbeing to all Ontarians.

Co-operative enterprises in the province of Ontario employ 57,000 people and generate \$6 billion for the economy every year. One in four Ontarians is a member of a co-operative.

Thank You

The co-operative sector is very pleased with the commitment from the provincial government to modernize the co-operative legislation, detailed in Bill 138 tabled in fall 2019.

Co-operative businesses in Ontario advocated for the modernization of our Co-operative Corporations Act to better meet the needs of communities across the province. This government heard from many of our co-operatives through a consultation process in January of this year and responded with improvements that will reduce red tape and provide stable jobs to many Ontarians. Thank you for hearing from our members and modernizing our legislation.

Our success will most significantly be measured in economic impact. We estimate, based on the success modernization has had in other provinces, that we will see a 10-15% increase to annual growth in our sector. This growth will create as many as 5,000 new jobs and \$250 million in revenue per year in Ontario.

Modernization of Regulations Still Needed

The current Offering Statement limits have not been reviewed since 1995 and are inadequate for co-operatives to raise the money they need in order to capitalize their businesses. The members of the Ontario Co-operative Association are asking for a fivefold increase to the limits to account for inflation and the countless changes to business capitalization over the past twenty five years.

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Recommendation

OCA's membership recommends government increase the limits related to members purchasing securities and the total amount of issued securities to the following:

1. A member purchases securities for a total price of not more than **\$5,000** per year and **\$50,000** in total.
2. All securities issued to members are not more than **\$1,000,000** of issued securities.
3. Increase the prescribed number of security holders from 35 to 50.

Background

Co-operatives raise capital for their development and operations by offering to sell securities to members and non-members. 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, rarely fluctuate in value and may only be transferred with the approval of the board of directors. They are not purchased with a view to capital appreciation or to obtaining a high return.

The regulatory process in Ontario for co-operative securities is called an "Offering Statement," and is designed to provide up-to-date information so that prospective investors have the right information to make an informed decision while also ensuring that co-operatives can raise their capital from their members and other supporters without undue cost. When an exemption from Offering Statements is available, a co-operative can raise funds from the sale of securities with fewer financial, regulatory and administrative burdens on the business. Even if a co-operative is exempt from Offering Statement requirements, it is still obligated to provide full disclosure to investors.

The Offering Statement process was created due to the fundamental difference between co-operatives and other forms of business: those other forms are funded by those wishing to earn profits from that business, while co-operatives are funded by those who benefit from the services offered by the co-operative to its members. The requirements for oversight in the former are considerable, and onerous, as they need to be. The potential for abuse in co-operative securities marketing is minimal, as the experience of the past 45 years has demonstrated.

As per the current limits contained in the Regulations, a co-operative is exempt from submitting an offering statement to the Financial Services Regulatory Authority (FSRA) if:

- A member purchases securities for a total price of not more than \$1,000 per year and \$10,000 in total;
- All securities issued to members are not more than \$200,000 of issued securities; or
- The number of security holders is below 35.

Investor Limits

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 the members are not likely to base their investment decision on Offering Statement disclosure.

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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 Co-operative Corporations Act (CCA).

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.

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.

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 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.

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.

Number of Security Holders

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. 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.

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

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pool. This will allow the co-operative's membership to be larger, more diverse, and attract a wider range of skillsets and experience.

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.

Inflation

These limits were set when the regulation was last amended in 1995. Over the last 25 years the average annual rate of inflation was 1.84%. A basket of goods that cost \$200,000 in 1995 would cost \$310,000 in 2019 – a percentage change of 55%.

25 Years of Significant Change

In the 25 years since the Offering Statement regulations were last amended, the entire world of business has changed from offline to online. Regulatory environments have been updated to reflect the modern world, including a world where peer to peer lending through crowdfunding platforms is commonplace.

In a new world where the internet provides many new opportunities for public scrutiny of business practices, co-operatives have maintained their extremely low investment risk profile. The latest consumer research statistics reveal that only 10% of people have a lot of trust and confidence that businesses behave ethically and only 5% of people believe corporations "do right by the consumers they serve". In stark contrast, more than two out of three Canadians agree that co-operatives are a trusted place to do business.

However, with the growth of the social economy and the opportunities for new business development that the internet has created, the growth of the co-operative movement has been stagnant. A raise of less than \$1 million for a small or new co-operative business requires the same high accounting and legal costs and the need for expensive outside consultants that a raise of much larger amounts for an established co-operative requires. Combine these costs with the uncertainty of using a lesser known corporate model and the time it takes to learn it and the barriers to incorporating a co-operative for new businesses and producing an offering statement are high.

Raising the first million dollars from dedicated founding supporters with a clear understanding of the business goals should be on par with the private issuer exemption; family, friends and business associates exemption; crowdsourcing exemption and the offering memorandum exemption. The crowdsourcing and offering memorandum exemptions allow for individual investments of up to \$10,000 annually and up to \$1.5 million total through crowdfunding annually while the others set participation limits to less than fifty people.

A comparison of the risk profile of an investment through crowdfunding and an investment in a co-operative business puts co-operatives well ahead. Twice as many co-operatives remain in business after

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ten years as compared to all other business enterprises. Therefore, commensurate treatment of individual investor risk profiles should be considered.

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