PROVINCIAL INITIATIVE TO CREATE POLICY FRAMEWORK AND AMEND LEGISLATION TO SUPPORT COMMUNITY BONDS

A BRIEF TO THE PARTNERSHIP PROJECT FROM MEMBERS OF THE ONTARIO SOCIAL ECONOMY ROUNDTABLE (OSER)

Written by Beth Coates, Canadian Alternative Investment Co-operative

Centre Canadien pour le renouveau communautaire (CCRC)
Canadian Community Economic Development Network (CCEDNET)
Centre for Social Innovation (CSI)
Ontario Co-operative Association (On Co-op)
Ontario Nonprofit Network (ONN)
Toronto Enterprise Fund (TEF)

October 2010
Introduction

The Ontario Social Economy Roundtable (OSER) is a network of independent and connected organizations that have been working with and supporting the social economy sector in Ontario. The Canadian Community Economic Development Network (CCEDNet), Ontario Co-operative Association (On Co-op), Centre for Social Innovation (CSI), Toronto Enterprise Fund (TEF), Ontario Nonprofit Network (ONN) and Centre Canadien pour le Renouveau Communautaire (CCRC) are partnering around a series of briefing papers to the Partnership Project that are related to improving access to capital for nonprofit organizations and other social finance issues.

These partners are recommending that the Ontario government utilize existing infrastructure to create an enabling environment in which social enterprise can thrive. The recommendations are to:

1. Clarify and scale-up the role of Community Bonds – RRSP/TFSA eligible debt instruments designed to enable nonprofit financing
2. Expand Infrastructure Ontario’s eligibility criteria to enable nonprofits to access $3.8 billion in financing through an existing infrastructure
3. Create a Social Enterprise / CED Tax Credit

This briefing focuses on the implementation of Community Bonds in Ontario.

COMMUNITY BOND

In simple terms, Community Bonds are securities issued by a nonprofit to an individual or an organization in return for an investment in the nonprofit. It is a binding promise by the nonprofit to pay the investor a specified rate of interest over the life of the bond and to return the investor’s capital at the end of the term. It could be secured or unsecured depending on the purpose of issuing the bonds.

Put another way, Community Bonds are loans that provide a fair return on investment and enable nonprofits to leverage their greatest asset – their clients, members, donors and constituents – to create assets that will serve the community in perpetuity.

A Community Bond is:

- A debt instrument – It is essentially a loan (nonprofits and communities can’t issue equity)
- RRSP/TFSA Eligible – Community Bonds can be RRSP/TFSA eligible and are held inside their RRSP/TFSA portfolio
Accessible – Minimum investments need to be affordable for citizens to be able to invest

Community Bonds are about leveraging the one asset that nonprofits do have – their relationships with their communities.

Just imagine how small towns could create their own performing arts spaces, financed by their audience; how hockey rinks could be financed by the hockey moms, or how existing property owners could re-finance their assets with community bonds to do vital green retrofits.

Community Bonds are open to all investors: individuals, foundations, companies, business people or retirees. They are a true ethical investment, one which citizens could often walk into, point at and say that they ‘own’ a piece of this. Community bonds democratize social finance making investment possible to everyone: they are the ultimate “buy local” strategy.

Community Bonds are also a vital tool for citizens to re-engage with their communities, as they have the potential to: shift a system; transform a marketplace; change behaviour; and create social value. At the same time, the use of community bonds rebuilds the relationship between the citizen and the commons, provides an amazing tool for the citizen and nonprofit sector to accomplish public benefit missions, and enables communities to create their own solutions.

Community Bonds are a ‘bottom up’ solution that will be driven by the nonprofits and civic entrepreneurs, but they require legislative clarity and oversight to give confidence to both the investors and investees.

**Recommendation:**

The Community Bonds we recommend would be very much like corporate bonds. Like corporate bonds, the process of selling Community Bonds to the public needs to be regulated. Investors must be in a position to assess the level of risk that they are willing to assume, as with any investment. We recommend that this be done by an Offering Statement Process and that provisions similar to those in the Co-operative Corporations Act be included in Bill 65.
BACKGROUND

In initiating the Partnership Project, the government has given a clear indication that it wants to create the mechanisms (legislative and other) to support the nonprofit sector in developing new methods and tools to strengthen itself.

Many in the sector are anxious to have new tools to finance the purchasing of buildings and other capital assets, and to develop social enterprises. Recent research suggests that almost 50% of nonprofits are already practicing social enterprise, and 30% of those not yet practicing are exploring the creation of a social enterprise to support their missions.3

The net impact of new financing tools would be stronger organizations with more resources that are better able to fulfill their mission. OSER is advocating the Community Bond as an ideal low cost vehicle to provide more financing to the sector, while at the same time ensuring a level of protection for investors. It would also provide nonprofit supporters (both individuals and organizations) with an opportunity to make significant long term investments in nonprofits and in their own communities.

Building Capacity: While this financing tool will not suit every nonprofit, once it is established and the proper support provided, the “early adopters” will start to use it and demonstrate its viability to a broad range of organizations in this sector. Nonprofits will start to seek board members with financing expertise to help develop strategies to use bond financing.

We know that there are organizations and individuals with capital eagerly awaiting investment opportunities in this sector. A 2009 study of nine philanthropic foundations found they had allocated $32 million to community and mission based investments, representing four per cent of their total endowments4. Another study of Community Investments in Canada estimated that in 2008 there was a minimum of $1.4 billion in community investment assets managed by 487 organizations5. Community Bonds will be one important mechanism that will facilitate the flow of these resources into the nonprofit sector. To assist individual investors, we recommend that Community Bonds be RRSP/TFSA eligible.

Current Regulatory Environment: Generally there is no requirement under Ontario Securities Law for nonprofit corporations to file a prospectus – a legal document describing the securities on offer – when issuing debt (bonds). Ontario Securities Regulations (National Instrument 45-106 s. 3.38) contain an exemption for securities issued by nonprofits, which recognizes that when investing in nonprofits, the public does not need the protections inherent in the prospectus process. This exemption, however, has created a procedural vacuum. Nonprofits are looking for a standardized, regulated process which would allow them to file their offering statement and issue bonds in a cost effective way.
RECOMMENDATIONS

Legislative:

- A “Community Bonds Working Group” should be formed with participation from FSCO, the Ministry of Citizenship and Immigration, or a Nonprofit Sector Secretariat. The Secretariat would include nonprofit sector members and consultants from the legal community to draft Community Bond regulations and supporting documentation, including offering statement template, subscriber form and trust agreement.
- Bill 65 and Regulations should be amended to include provisions for Community Bonds for Public Benefit Corporations. The Ontario Securities Act and Regulations should be amended to specifically exempt nonprofits covered under Bill 65.

RRSP/TFSA Eligibility: Ministry of Citizenship and Immigration or Nonprofit Sector Secretariat should make a formal request to Canada Revenue Agency to declare that Community Bonds issued by Public Benefit Corporations are RRSP/TFSA eligible.

Resources to the Nonprofit Sector to support this initiative: Resources need to be focused in three areas to fully realize the potential of Community Bonds:

- **Education and promotion** – a province-wide education and promotional program should be developed and delivered to help establish Community Bonds. This can be achieved through community visits, conference speaking engagements and other face-to-face opportunities to explain this financing tool. This can be supplemented by “webinars” and other electronic delivery of materials.

- **Reference Materials** – although developing the offering template will be the responsibility of the “Community Bonds Working Group,” additional materials such as a step-by-step guide, case studies and frequently asked questions are needed to assist in drafting offering statements.

- **Technical Support** – is crucial to the program’s success, especially in the early days. Nonprofits will need access to knowledgeable staff to answer their questions at every step in the process, including review of draft offering statements for submission. Having such technical advice available would not only encourage nonprofits to consider Community Bonds, it would improve the quality of the filings, thereby ensuring more productive use of FSCO resources when reviewing offering statements.
RECOMMENDED OFFERING STATEMENT PROCESS

KEY PLAYERS

1. Financial Services Commission of Ontario (FSCO) – should act as the regulator in much the same way it does for Co-operatives. It would:
   - Develop guidelines (including timing) to assist the offering statement process
   - Provide standard offering templates to nonprofits
   - Provide input throughout the filing process
   - Issue a receipt if the offering statement meets regulatory requirements

2. The Ontario Nonprofit Network working on behalf of and in collaboration with leaders in the nonprofit sector – should establish appropriate structures to provide education and support to the nonprofit sector. During the capacity building phase, and once the program is established, it is crucial that mechanisms are in place to ensure that ongoing education and support are readily accessible to the nonprofit community, including:
   - Information Sessions – In the early stages this process will require province-wide information sessions to get nonprofits thinking about how Community Bonds could work for them.
   - Resources – Written guidelines, case studies of successful Community Bond offerings and other reference materials.
   - Support – Ongoing input to nonprofits throughout their offering statement drafting process.

OFFERING STATEMENT DRAFTING AND FILING STEPS

The key to making Community Bonds a cost effective tool for the nonprofit community will be clarity in – and support through – the offering statement drafting and filing process. See Appendix A for additional details.

1. Offering statement preparation:
   - Nonprofits will have access to reference materials such as case studies and guidelines in addition to technical support from ONN, to assist in drafting the offering statement.
   - Nonprofits may engage consultants to complete the business plan and related offering statement documents. The process will be straightforward enough that consultants’ efforts can be focused on business plan development.

2. The draft offering statement is then sent to ONN for initial vetting. Staff at ONN will review the document and let the applicant know what, if any, additional documents or information is required before the document is filed.
3. **Draft offering statement is filed**, by nonprofit, with FSCO for issuance of receipt using the following steps:
   a) FSCO will issue a comment letter that addresses the components of the standard offering statement template item by item, detailing additional pieces of documentation and explanation required.
   b) The applicant will address those issues and update their draft offering statement accordingly.
   c) Once FSCO feels that all the issues have been addressed, it will ask the applicant to submit a “black line copy” tracking all changes to the document since the first submission.
   d) Once FSCO has reviewed the black line document it will request a final “clean” and signed copy.

4. **Superintendent’s Receipt is issued**

5. **Offering goes to the public** using the following steps:
   a) Nonprofit solicits subscriptions from its supporter community (individuals and organizations) and the general public through its established networks, community meetings and other forums and media as appropriate.
   b) Offering statement and the subscriber form are made available to potential investors - See Appendix A for details.
   c) Investor completes subscriber form and purchases bonds.
   d) Payments are made to the trustee “in trust” (See Appendix A for more details on the role of the trustee).
   e) Nonprofit markets the bonds, working with financial institutions that will charge a reasonable commission and perform the appropriate administrative functions to facilitate purchasers, including bonds, in their RRSP and TFSA accounts.

6. **Bond transaction closes** and nonprofit issues final documentation to bond holders.

7. **During the term of the bond** the following will occur:
   a) **Nonprofit organization** will:
      i) Make interest payments and repay principal at the end of the term
      ii) Provide annual financial statements to FSCO
   b) **Trustee** will:
      i) Fulfill obligations as detailed in the trust agreement
OFFERING STATEMENT TEMPLATE

The offering statement is how the nonprofit communicates its investment proposal to the public. It is important, therefore, that this document be structured in a way that allows the nonprofit to communicate its business case easily, in a “full, true and plain” way, so that the investor fully understands the benefits and risks involved in making a bond purchase. Please see Appendix B for a fuller list of what is included in the offering statement. Primary components of the offering statement are:

1. **Receipt** – Although the superintendent may issue a receipt, if in his or her view, the statement meets regulatory standards the offering statement will also clearly state that the superintendent has not assessed “the merits of the matters addressed in this offering statement”.

2. **Declaration** – The management’s assertion that this is a “full true and plain” disclosure of all material facts and is in compliance with the act.

3. **Cautions/certificates** – What the investor should consider before investing and certificates from experts whose opinions are included in the offering statement.

4. **The Issuer** – Corporate details on the nonprofit offering bonds for sale and trustee selected to administering the transaction.

5. **Details on the bonds being offered** – Will give the investor information on the nature of the bond offering.

6. **Bond subscriber form** – A detailed description of the steps and documents required to complete the purchase transaction.

7. **Business Plan**

8. **Officers and Directors**

9. **Nonprofit’s current information**
APPENDIX A

Additional Details on the Offering Statement Drafting and Filing Steps

General Conditions for Issuing a Receipt

The Superintendant may in his or her discretion issue a receipt for any statement filed under this regulation unless it appears to the Superintendant that:

a) The statement of any document required to be filed therewith:
   i. Fails to comply in any substantial respect with any of the requirements of the Act
   ii. Contains any statement, promise, estimate or forecast that is misleading, false or deceptive, or
   iii. Conceals or omits to state any material facts necessary in order to make any statement contained therein not misleading in the light of the circumstances in which it is was made or

b) The proceeds from the sale of bonds to which the statement relates that are to be paid into the treasury of the corporation, together with other resources of the corporation, are insufficient to accomplish the purpose of the issue stated in the statement.

Exemptions

The offering statement would be mandatory except where the size of the transaction or number of bondholders limit the benefits that the offering statement provides:

i. Less than 35 bondholders
ii. Bondholders purchase less than $10,000 in bonds
iii. Total amount raised less than $200,000

Exempt nonprofit organizations issuing Community Bonds outside the offering statement filing process would still be able to access the resources, best practices etc. from the ONN.

Any corporation not required to file an offering statement would still be entitled to do so.

Role of the Trustee

In order to better protect the bondholders’ interest during and after the transaction, a trustee will be designated by the nonprofit as part of the offering process. Trustees will only charge a reasonable fee based on time spent and for their out-of-pocket expenses in performing this function. The trustee will:

• Be a practicing lawyer and member in good standing of the Ontario Bar Association
• Accept all payments for bonds
• Return to the bond holders funds paid in the event that the bond transaction does not close
• Act on behalf of the bondholders in all legal matters relating to security for the bond
• Carry out over the life of the bond all activities necessary to ensure that the rights of the bonds are protected.

Material Changes

If during the offering process there is a material change to the facts as set out in the offering statement the nonprofit will have 30 days to file a statement of that change. The Superintendant may request that the offering statement be revised to reflect the impact of the changes. The process to file a further offering statement will be the same as that of the initial filing.

A material change will be defined as a change in the operations, assets or liabilities of the nonprofit that would reasonably be expected to have a significant adverse impact on the financial position of the nonprofit or that might prevent the nonprofit from achieving the purpose of an offering.
APPENDIX B

Additional Details on the Offering Statement Template

1. **Receipt**
The receipt will contain a notice to the reader that, although a receipt has been issued, the Superintendent did not assess the following as part of the filing process:
   - the managerial expertise, reputation and commitment of the nonprofit
   - whether the offering will raise sufficient funds to meet objectives
   - whether any financial forecast or projection contained in this offering document has a reasonable basis.

2. **Cautions and Certificates**

   **Cautions**
The investor will also be reminded that:
   - Investing involves risk, and investors should understand that they could lose a portion of their investment.
   - They should read the entire offering document, particularly the risk factors.
   - They should review the information concerning the nonprofit’s management, board of directors and professional consultants. Experience and ability to manage are often the most important keys to success.
   - The offering document is a legal document and the investor should consult with their lawyer before purchasing a bond.
   - There is no organized market through which the bonds may be sold. It may be difficult or even impossible for the investor to sell the bond.

   **Certificates**
   - Certificates from the authors of any opinions (audit report, AACI appraisal) authorizing their use in the offering statement.

3. **The Issuer**
   - Full Legal Name
   - Corporate Address
   - Incorporated Status, Date and Business Number
   - Charitable Registration # (if applicable)
   - Purpose (from incorporation documents)
   - Brief history of the nonprofit
   - Telephone, fax, email, website
   - Contact Person in the organization re: the offering
   - Trustee – name, profession, relationship to the nonprofit, contact information
4. **Details on the bonds being offered**

- Number of bonds being issued
- Face value
- Total to be raised (maximum and minimum)
- Close date
- Interest rate
- Term
- Maximum allowable investment by one individual
- Procedures (if any) for early redemption or transfer
- Security for bonds if available:
  a) Secured by real estate
     - Mortgage details
     - AACI appraisal of the property to be mortgaged
  b) Secured by other property
     - Details on how the trustee will be securing the asset (i.e. PPSA registration)
  c) Other security – I.e. guarantee by third party
- Trust agreement – Detailing the rights of the trustee and bondholder

5. **Bond Subscriber Form and Investing Instructions**

Subscriber form will include an acknowledgement that the investor has:
- Read the offering statements including all conditions and cautions
- Received all information
- Sought appropriate advice before making this investment
- Is legally able to make this investment

Investing process details:
- Trust arrangements prior to and post closing
- Cooling off period (i.e. 48 hours)
- Final documents to be received
- Instructions on how to complete the transaction
- Banking procedures if bondholder is planning to hold bonds in RRSP or TFSA
- Where to submit completed documents
- Conditions for the offering to close – (i.e. minimum subscription)
- Refund procedures in the event offer does not close

6. **Business Plan**

- Overview of recent history and strategic direction of the nonprofit
- Use of proceeds
- How does the offering and planned use of the funds fit into the overall strategic (social and financial) goals of the organization
- Detailed operational plan
- Sources of capital in addition to the bond offering (grants, other financing)
- Risks to financial and social objectives and mitigations in place
• Organizational strengths – key personnel, relevant experience

7. **Officers/Directors**

• Office
• Occupation
• Current Address
• Length of Service
• Required Retirement Date (if applicable)
• Curriculum Vitae

8. **Nonprofit’s Current status**

• Most recent financial statements – including the auditor’s name
• Any legal proceedings against the nonprofit
• Any current debt defaults
• Any other material variations (favourable and unfavourable) to the nonprofit’s operations in the past three years
• Any other material facts

This brief has been written by:

Beth Coates, Financial Manager, Canadian Alternative Investment Co-operative

With the support of:
Brian Iler, Partner, Iler Campbell LLP
Tonya Surman, Executive Director, Centre for Social Innovation
Paul Chamberlain, Program Director, CCEDNet
Lynn Eakin, Network Director, (Interim), Ontario Nonprofit Network
Jen Heneberry, Co-op Development Manager, Ontario Co-operative Association
George Alkalay, Owner, Northfield Ventures Ltd.
Christopher Payne, Corporate Strategist, Department of Economic and Rural Development, Nova Scotia

---

1 The framework and recommendations included in this brief are have drawn components from the Province of Nova Scotia’s Community Economic Development Investment Fund program and the Provisions in the Ontario Cooperative’s Act and related regulations.

---

Nova Scotia Community Economic Development Fund

Ontario Cooperative’s Act

Ontario Cooperative’s Act – Regulations
