CCUA Canadian Credit Union Association | ACCF Association canadienne des coopératives financières

151 Yonge St. / rue Yonge
Suite 1000 / bureau 1000
Toronto, ON M5C 2W7
Tel: / Tél. : 416.232.1262
Fax: / Téléc : 416.232.9196

ccua.com

August 9, 2018

To whom it may concern,

We are writing to comment on the Capital Market Regulatory Authority's (CMRA) consultation around draft prospectus and registration exemptions published on May 8, 2018, particularly as it applies to prospectus and registration exemptions for credit unions.

We are making this representation on behalf of the 257 credit unions outside of Quebec that are members of our trade association, the Canadian Credit Union Association (CCUA). Collectively, CCUA members hold more than $220 billion in assets and provide services to 5.6 million Canadians.

As the companion document notes, the provinces currently have registration and prospectus exemptions for trades in certain securities issued by credit unions subject to local credit union legislation. We appreciate and support the desire to carry these exemptions forward because they are based on sound principles and policy arguments, namely recognition that co-operatives like credit unions face challenges raising capital and that the incentive structure within a credit union system differs significantly from that of a joint-stock publicly-traded bank (for example).

We would like to propose, however, that dealer registration and prospectus exemptions be extended to federal credit unions. As you may know, the federal government passed legislation enabling the creation of co-operatively structured *federally incorporated* credit unions in 2010. The legislation became operative in 2012 with the introduction of accompanying regulations. Since then, one credit union – Uni Financial Cooperation – has successfully continued into federal jurisdiction and three more have applications or are about to begin formal applications to continue as federal entities.

We are therefore asking that the registration and prospectus exemptions currently available to provincially-incorporated credit unions be extended to federal credit unions. In the accompanying Annex, we elaborate on the policy rationale for these exemptions and carrying them forward to federal credit unions.

We would be pleased to discuss this matter at your convenience.

Best regards,

Marc-André Pigeon
Assistant Vice President,
Canadian Credit Union Association

Canadian Credit Union Association
Association canadienne des coopératives financières

151 Yonge St. / rue Yonge
Suite 1000 / bureau 1000
Toronto, ON M5C 2W7
Tel: / Tél. : 416.232.1262
Fax: / Téléc : 416.232.9196

ccua.com

ANNEX: Policy Rationale

Policymakers have long understood the importance of treating co-operatives and credit unions differently than other types of corporate entities. As the CMRA's consultation notes, co-operatives and credit unions are already exempt from registration and prospectus requirements.

These exemptions are premised on an understanding of co-operatives as entities that were created by groups of citizens primarily interested in obtaining services at a reasonable cost. By contrast, the ownership of a joint-stock company is primarily interested in a financial return, whether in the form of a dividend or share-price appreciation. This important structural difference has some consequences that are of relevance from a securities law perspective:

1. It can be challenging for co-operatives to generate initial start-up or growth capital because there is no real possibility of a capital gain on the shares (which trade at par if they trade at all) and hence no pure financial incentive to invest. As a result, policymakers have understood that layering on compliance costs in the form of onerous dealer registration and prospectus requirements could deter the formation and growth of co-operatives, especially since in many cases the start-up capital required is relatively small compared with the potential regulatory burden of registration/prospectus requirements;

2. Because of their unique own-use-control structure, start-up and established co-operatives are often challenged in their ability to raise capital from traditional lenders and therefore rely on raising capital from members. Many lenders are unfamiliar with – and hence uncertain about – the dispersed nature of ownership, the democratic governance structure, and co-operative legislative structures all of which lead to the question : "Who do I go after if a loan goes wrong?".

3. There are few legal or accounting professionals that have practices dedicated to supporting co-operatives, which can pose challenges for citizens interested in coming together to start a co-operative.

4. The co-operative structure minimizes the risk of securities fraud – members are primarily interested in obtaining services, not maximizing returns and so much of the incentive for fraud fades away. The research of online sources including Quicklaw, Westlaw, CanLII, and HeinOnline did not reveal any reported Canadian cases involving securities fraud by cooperatives. Further, there are no Canadian articles or journals noting securities fraud in cooperatives as a concern.

Beyond these co-op structure considerations, there is a case to be made for exemptions by type of security typically issued by credit unions. We consider each in turn.

Canadian Credit Union Association
Association canadienne des coopératives financières

151 Yonge St. / rue Yonge
Suite 1000 / bureau 1000
Toronto, ON M5C 2W7
Tel: / Tél. : 416.232.1262
Fax: / Téléc : 416.232.9196

ccua.com

Member shares
Someone interested in using the services of a credit union must typically purchase a membership share (sometimes referred to as "common shares" in some provincial credit union statutes). While historically these shares might have cost several hundreds of dollars, most credit unions today charge anywhere from $5 to $10 with some selling a share for as little as $1.

It is difficult to imagine why the issuance of these low-dollar, low risk shares would necessitate a credit union to register as a dealer or provide a prospectus document with each new member. While membership shares are loss-absorbing in the event of a wind-up, the member's exposure is limited to the nominal purchase price.

Patronage/Surplus Shares
Credit unions sometimes return a portion of their profits to members ("patronage") in the form of membership shares. This is an instance of co-operative principle No. 3, which stresses the importance of member economic participation. Again, any requirement to issue a prospectus when issuing a membership share as part of a patronage program would render the patronage program cost-prohibitive and undermine the credit union's co-operative structure; it would also be counter-productive because "patronage" payments are a way of rewarding members for their loyalty and use of the credit union's services, a "discount" if you will on the cost of providing those services. Further, we believe these issuances should be covered by the stock dividend exemption in section 2.31 of NI 45-106 which provides that the "prospectus requirement does not apply to a distribution by an issuer of a security of its own issue to a security holder of the issuer as a dividend or distribution out of earnings, surplus, capital or other sources".

Investment Shares
Because of the challenges with raising capital, even at mature co-operatives like credit unions, policymakers have understood the importance of avoiding costly registration and prospectus filing requirements for credit unions that issue investment shares. In many ways, these instruments resemble bank preferred shares and rank accordingly in the creditor hierarchy (e.g., relative to member shares for example). These shares are sold exclusively to members and come with detailed disclosure statements that explain the risks (and opportunities) of investing in these instruments. The content of these disclosure statement is prescribed. To date, no credit union member has ever lost money on these investments which have proven important for helping credit unions grow and stay competitive with their bank counterparts. They also provide members' with an important, low-cost, good return investment option that tangibly demonstrates their commitment to their credit union and to local banking. There are few such options available in the marketplace and thus these investment shares fill an important market gap.

Canadian Credit Union Association
Association canadienne des coopératives financières

151 Yonge St. / rue Yonge
Suite 1000 / bureau 1000
Toronto, ON M5C 2W7
Tel: / Tél. : 416.232.1262
Fax: / Téléc : 416.232.9196

ccua.com

Federal Considerations

As noted earlier, it is important to recognize that federal policymakers carefully drafted amendments to the *Bank Act* to ensure that federal credit unions are *co-operatively structured* just like their provincial counterparts. In fact, the federal legislation drew heavily from provincial credit union statutes. For example, federal credit unions must:

- have a legal name that includes the words "federal credit union" or "co-operative bank";
- serve "primarily" members (as opposed to non-members), a term that is often thought to mean of 90% or more;
- have a membership that consists mostly (more than 50%) of natural persons;
- have a one-member, one vote democratic structure; and
- make non-discriminatory membership available to persons who can use the federal credit union's banking services.

Further, before the Minister of Finance can issue letters patent to a federal credit union, the Minister must consider whether the continuance (or commencement) of the credit union as a federal entity is in the best interests of the Canadian co-operative financial system.

For all these reasons, we would suggest that the principle-based arguments and rationales put forward above with respect to co-operatives and provincial credit unions apply equally to federal credit unions. If anything, these arguments carry *more* weight given the challenges and costs of operating across provincial boundaries, and of working under OSFI supervision.