

PREPARING CEDC OFFERING DOCUMENTS: COMMON ISSUES AND DEFICIENCIES

Introduction and Purpose

The purpose of this guidance is to assist corporations and cooperatives in raising capital under the Community Economic Development Corporations (**CEDC**) application process. This is a joint application process that requires approval by the Department of Finance to determine if the project is eligible for the Small Business Investor Tax Credit (**SBITC**) and by the Financial and Consumer Services Commission (**FCNB**) to ensure that the offering complies with Local Rule 45-509 *Community Economic Development Corporations and Cooperatives (CEDC Rule)*.

This guidance will offer assistance to those corporations and cooperatives who are preparing an offering document to qualify for this program. Other information on the eligibility requirements and the process are available on our [website](#).

The offering document is intended to provide potential investors with sufficient information to make an informed investment decision. The requirements for the offering document are set out in the CEDC Rule. Generally, the disclosure must comply with the requirements set out in the CEDC Rule, be easy to read and understand. It should be concise, and drafted in clear, plain language.

Failing to comply with the requirements of the CEDC Rule may result in FCNB taking one or more of the following actions (depending on the nature and extent of the failures):

- Requiring the CEDC to file a revised or amended offering document
- Requiring the CEDC to prepare and deliver an updated offering document to existing purchasers
- Requiring the CEDC to grant rescission rights to certain investors
- Imposing a cease trade order
- Taking enforcement action

The following are common issues identified in disclosure documents.

1. *Not allowing enough time for FCNB and the Department of Finance to review prior to scheduled offering date*

A CEDC's offering document must state the date that it intends to begin raising funds and must close its offering within 90 days of the scheduled offering date. Often, CEDCs schedule their offering dates too soon after submitting their proposed offering document to FCNB and the Department of Finance. We encourage CEDCs to allow sufficient time for the review and to use a targeted date for the offering in the initial submission. However, if time is of the essence, the CEDC should contact FCNB and the Department of Finance for assistance to meet a targeted offering date.

Each offering document is subject to two reviews: one by FCNB to assess whether the CEDC complies with securities law, including all requirements under the CEDC Rule, and one by the Department of Finance to assess whether the CEDC meets the criteria for the SBITC. Before a scheduled offering can begin, each CEDC requires a Letter of Non-Objection from the Executive Director of Securities at FCNB, as well as a certificate of registration issued by the Minister of Finance under the SBITC program. If an offering is

scheduled to begin before either of these have been issued, the CEDC may have to re-submit its offering document with a later scheduled offering date. This can cause unnecessary delays.

We strongly encourage CEDCs to file with both FCNB and the Department of Finance at the same time to allow for a coordinated review.

CEDCs should expect to receive initial comments from FCNB within 20 business days of submitting a draft offering document. Often, FCNB may have comments, questions or clarifications on a draft, or may require certain changes to the draft. This will require an additional period of time for the CEDC to revise its offering document and answer any questions, as well as additional review time by FCNB. It is important to know that a Letter of Non-Objection will not be issued until all of FCNB's concerns have been satisfied. Staff of FCNB are available to meet (virtually or in-person) with CEDC applicants to clarify our comments.

If an application is materially non-compliant or does not meet the eligibility requirements in a material way, the applicant may be asked to submit a revised offering document that meets the eligibility requirements under the *Small Business Investor Tax Credit Act* or the CEDC Rule. Those key eligibility requirements under the SBITC program include:

- Being incorporated or registered to carry on business in New Brunswick;
- Having authorized capital consisting of shares without par value for corporations or at least one class of investment shares without a par value for cooperatives;
- Having net tangible assets of \$40 million or less;
- Having all, or substantially all, of assets and income of the community economic development corporation or cooperative being used to generate active business income;
- Paying, in each of the four years after the date of registration, at least 75% of its wages and salaries to individuals who are residents of New Brunswick unless the community economic development corporation or cooperative exports outside of NB more than 50% of their goods and services, then, the requirement is for 50% of its wages and salaries to individuals who are residents of New Brunswick.

CEDCs should consider the time necessary for a review period when selecting their scheduled offering dates.

2. *Incomplete or ineligible applications*

We expect that applications will disclose all key terms and conditions of the offering and the securities being offered and be in final or near final form. The application should include all supporting documentation, including financial statements, investment plan, promotional materials, constating documents (articles of incorporation, continuation, amalgamation, by-laws etc.), details on the share structure, by-laws of the corporation or cooperative and required [criminal records checks](#) of the directors, officers, promoters and significant shareholders.

Failure to include all required documents will cause delays in the review process. Many of the documents are interconnected and must be reviewed together to ensure consistency and accuracy, particularly the financial statements.

3. *Missing or incomplete financial statements*

Many CEDCs submit an application that does not include financial statements or includes incomplete financial statements. The financial statements are an integral part of the offering and are key supporting documents for the offering. The disclosure in the offering must be reviewed with the supporting financial statements. A complete set of financial statements must include all of the following key elements:

- Statement of financial position;
- Statement of comprehensive income;
- Statement of changes in equity;
- Statement of cash flows;
- Appropriate comparative periods for the above noted statements;
- Notes to the financial statements;
- Interim financial statements.

If there are any notes to the financial statements, these notes must be appropriately addressed in the offering document. Interim financial reports are required if the CEDC has not completed a financial year and for CEDCs who have completed one or more financial years, the most recently completed interim financial report should be included. Details on the required financial statements are set out the CEDC Rule at section 10 [Financial statements included in the offering document].

4. *Fees not included with initial application*

As per section 2.6.1 of Local Rule 11-501 *Fees*, the requisite filing fee for a CEDC application is \$350 made payable to Financial and Consumer Services Commission – New Brunswick. Payment can also be made electronically by contacting FCNB for the Direct Deposit Authorization Form. Payment should accompany the initial filing of the application. Details on fees are set out in [Local Rule 11-501 Fees](#).

5. *Failing to include sufficient information*

The over-arching purpose of the offering document is to enable prospective investors to make an informed investment decision regarding the CEDC. To make informed decisions, prospective investors must be given enough information to understand the nature of the CEDC's business, its current circumstances, its strategies and plans for future development, and the state of the marketplace in which it operates.

There are several common ways in which CEDCs fail to provide enough information in their offering documents. Each of these is discussed below.

a) *Inadequately disclosing the CEDC's business*

Some CEDCs provide very little information about the nature of their business and its development, as required under items 2.1, 2.2 and 2.3 of Form 45-509F1. Disclosure of the CEDC's business should be more than a few generic sentences about the business. It should include a description of the goods or services offered, the business's strategy for generating revenue and profit, the steps that the business plans to take to reach its goals, and their plans for meeting operating expenses.

For CEDCs that have a more complex structure, such as where there are multiple related entities (e.g., subsidiaries, partnerships or joint ventures), the CEDC should disclose the corporate structure, along with

the key activities of each entity within the structure. A CEDC may need to provide an organizational chart to help prospective investors understand the business.

For CEDCs that are investment funds, disclosure of the business should include the fund's investment policies, including how potential investments are evaluated and the decision process for purchasing or selling investments. The fund's intended investment portfolio should also be summarized, with information about the securities held, the number of units or shares, the average cost and fair value, as well as the types of securities that the fund is authorized to hold.

Some CEDCs incorporated under the New Brunswick *Cooperatives Act*. In addition to disclosing the nature of their businesses, these CEDCs should also disclose key principles of cooperatives and include information in the offering document to explain how cooperatives operate generally.

b) Failing to provide balanced disclosure

Some CEDCs have presented an unrealistic or excessively promotional picture of their business to prospective investors.

For example, a newly formed investment fund, with no track record and no assets or capital, may propose raising \$3,000,000 under its "maximum offering" that it will use to build an investment portfolio.

While this may be the CEDC's long-term goal, we believe that it is unrealistic, and potentially misleading. Disclosing, under "Risk Factors", that there is no assurance the issuer will actually be able to raise the maximum offering does not justify, in our view, the promotional nature of such disclosure.

CEDCs should ensure that disclosure in their offering documents is balanced and realistic relative to their current stage of development.

c) Inadequately disclosing available funds and use of available funds

A CEDC must accurately represent to prospective investors all funds that are available to it, including from the proposed CEDC raise, other raises or issues of securities, and from sources such as bank loans or grants. This information must be accurately set out in item 1.1 of Form 45-509F1.

Under line E of item 1.1, CEDCs must state the "additional sources of funding required". The intent of line E is to enable a CEDC to show other sources of funding currently available to it (such as financing being arranged through a bank) that the CEDC plans to combine with the funds raised from the offering to achieve its goals. Line E is not intended to refer to future raises of capital.

Under item 1.2 of Form 45-509F1, the CEDC must also disclose all intended uses of funds available to it (both from the planned raise and from other sources). This disclosure should be detailed and complete and must be more than a single generic description.

A common deficiency in offering documents is that CEDCs often fail to identify payments that must be made to related parties in the table at item 1.2. For example, payments from the CEDC to management companies controlled by insiders of the CEDC must be disclosed in the order of priority at which these payments must be made.

d) Inadequate disclosure of short-term and long-term business objectives

Items 2.4 and 2.5 of Form 45-509F1 require the CEDC to disclose the short-term and long-term business objectives of the CEDC, respectively. The CEDC should disclose each significant event that must occur to accomplish the development project, the specific time period in which each event is expected to occur, and the costs related to each event. CEDCs should consider providing this information in a table if it would make the section easier to read.

Disclosure of short-term and long-term objectives may include information about the resources required to complete the development of a product (for example, in the case of a research and development project), or their plans and strategies to overcome the challenges to their business, such as the competition they face, or the political, technological, economic and other factors that they are currently aware of that may impact their business.

6. Internal inconsistencies within the disclosure document

Many of the documents and disclosure requirements within a document are interconnected and must be reviewed holistically to ensure consistency and accuracy. For example, the securities being offered and the minimum capital raise must be consistent throughout the disclosure document and the financial statements. There must be internal consistency in the offering document, particularly between the offering, the use of available funds, short- and long-term objectives and the financial statements. Also, the securities being offered must be consistent with the share capital authorized under the CEDC's constating documents.

7. Inadequate disclosure of risks

Because of the risk associated with an investment in a CEDC, offering documents must contain full, clear and accurate disclosure of the risk factors that the CEDC considers to be the most substantial risks to an investor. Risk factors are those factors material to the CEDC that a reasonable investor would consider important in deciding whether to buy the CEDC's securities. It is the responsibility of the CEDC to ensure that this section is accurate and complete. The risks should be presented in a realistic manner and not present an overly promotional picture of the CEDC. The risks should specifically address the following:

- Investment risk – the risks specific to the securities being offered. Some examples may include:
 - the lack of a market or an illiquid market for the securities might result in an inability to re-sell the securities that a prospective purchaser obtains from a CEDC;
 - the fact that the securities have not been valued by an independent third party such as a Chartered Business Valuator;
 - limited opportunity to exit the CEDC.
- Issuer risk – the risks specific to the CEDC. Some examples may include:
 - insufficient funds to accomplish the business objectives and no history;
 - a limited history of revenue or profits;
 - lack of direct investment experience by the CEDC, its board and promoters.
- Industry risk – the risks faced by the issuer because of the industry in which it operates. Some examples may include:
 - environmental and industry regulation and competition;
 - economic downturns in the local community.

- If an investment fund, some risks may include:
 - uncertainty as to when the fund will see a return on its investments;
 - the fund’s investment plan may not adequately describe the types of projects that it can invest in;
 - the fund *may* be permitted to invest in companies and/or initiatives led by employees, officers or directors of the CEDC;
 - the fund may not have an investment plan.

A CEDC should provide disclosure of the risks in clear language that is accessible for prospective purchasers. Offering documents that do not provide adequate or appropriate disclosure of the risks of the investment will be required to submit a revised draft of the offering document.

8. *Omitting key terms of material agreements*

Item 2.8 of Form 45-509F1 requires the CEDC to list all material agreements to which it is a party, including their key terms. This section is intended to enable the CEDC to list: 1) all material agreements with third parties, such as leases, services agreements, key supply agreements, etc.; and 2) all agreements with related parties or insiders to the CEDC.

It is not sufficient that material agreements or their key terms are mentioned elsewhere in the offering document or mentioned in notes to the financial statements; they must be listed in this item of the offering document.

Key terms of material agreements generally include the goods, services or other value being provided or obtained and the form or amount of compensation being paid in exchange.

9. *Inadequately disclosing management experience, compensation and holdings*

Under item 3.1 of Form 45-509F1, the CEDC must state the compensation received in the most recent two years by each director, officer, promoter, or principal holder of the CEDC. This disclosure must include all compensation received from the CEDC, whether directly or indirectly, and regardless of form (cash, shares, options, etc.). Indirect compensation includes compensation paid by the CEDC to a related party of the director, officer, promoter, or principal holder, such as a professional corporation or a holding company. Where compensation is set out elsewhere in the offering document, such as under key terms of material agreements, it must also be listed under item 3.1.

Under item 3.2 of Form 45-509F1, the CEDC must state the principal occupations of each director, executive officer and promoter for the last five years, including date ranges for all positions held during that time period. This disclosure should be accurate, relevant, and clearly described. It should not be generic or promotional in nature. For example, stating “*has over 15 years of real estate experience*” is generic and could be misleading without further explanation. Disclosure of management experience should state the precise titles, roles or jobs held by directors, executive officers and promoters, and at which organizations. This should include both their principal occupations, as well as any other relevant experience in a business similar to that of the CEDC.

10. Income tax considerations

As taxation laws are complex and rapidly changing, a CEDC may wish to obtain professional tax advice in preparing this disclosure. If a professional advisor assisted the CEDC in preparing the disclosure, the name and address of the professional advisor must be included in the offering document.

If a CEDC has not obtained professional tax advice for the preparation of this disclosure, then the CEDC should only provide disclosure of a general nature. CEDCs should always recommend that investors obtain independent tax advice specific to their situation.

CEDCs that are intending to be RRSP eligible should ensure that they have obtained tax advice and clearance from the Canada Revenue Agency. Without confirmation from the Canada Revenue Agency regarding RRSP eligibility, the CEDC should limit disclosure regarding RRSP eligibility to stating that the investment may be RRSP eligible and that potential investors are encouraged to consult with their own professional advisors regarding tax consequences applicable to them.

11. Failing to qualify forward-looking information

CEDCs sometimes provide information in their offering documents regarding forecasted future performance of the business, such as financial projections or *pro forma* financial statements. CEDCs that provide this information to prospective investors must clearly explain that all forward-looking information is only an estimate of future performance.

If CEDCs intend to conduct additional raises of capital in the future, and those raises are incorporated into forward-looking financial projections, the CEDC must clearly set out to potential investors that the projections are reliant on future raises, which are subject to compliance with all regulatory requirements.