



Exempt Markets: Rebuilding Credibility and Perception

“It’s a fallacy that people who have great wealth are sophisticated investors.”

BY PARKER GRANT

Exempt markets (EM) are one of Canada’s most misunderstood, sometimes controversial but increasingly popular sources of capital.

The textbook definition cites EM as a segment of the capital markets for which certain exemptions are provided under provincial securities legislation. Exempt market dealers (EMDs) are registered dealers, trading in exempt securities, to qualified exempt market clients.

They deal in certain market sectors (oil and gas, real estate, minerals, technology, etc.) and their clients can be companies, institutional investors or qualified, high net worth individuals.

While EMD registration is a must in all provinces, actual specific rules, regulations and enforcement varies, sometimes drastically, from province to province.

Despite some skeptical controversy, EMDs are subject to full dealer registration and compliance requirements, directly regulated by the Alberta Securities

Commission (ASC), and must also meet various dealer obligations – from insurance, audited and financial statements to capital and solvency expertise and compliance.

Contrary to popular myth, the EM concept is nothing new.

“In its rawest form, the exempt market is back-to-basics investing,” says the dynamic and revved Craig Skauge, president and chair of the Alberta-based National Exempt Market Association (NEMA).

“It’s about investing in a product because one believes in the underlying idea and people behind the idea, not because they anticipate that a tweet from a TV personality or announcement from the federal government will move the market and make them a few bucks.

“While many look at this as a new way of investing, it is really one of the oldest forms there are. Some people find it hard to imagine a time before the stock markets existed. How did people invest before they could find and check stock



Craig Skauge, President and Founder, National Exempt Market Association (NEMA)



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performances in the newspaper?” he asks, with an amused smile. “Quite simply, people invested in their community, with people they knew and in brick-and-mortar ideas they could see happen.”

As the most committed and enthusiastic industry boosters (like Skauge) reluctantly concede, the exempt market

sector has some lingering credibility, image and perception issues.

Despite being a rapidly growing corner of Canada’s capital markets, some recent EM failures (with hundreds of millions of dollars of vanished investor money) eventually prompted Canada’s securities watchdogs to step up scrutiny of the industry’s business practices.


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“There is a dangerous fallacy when it comes to investors. It’s a false and risky assumption that people who have great wealth are sophisticated investors.”

~ Marian Passmore

“Canadian regulators have been dealing with a number of exempt market issues at play,” explains Marian Passmore, associate director at the Canadian Foundation for Advancement of Investor Rights (FAIR), the independent, national non-profit agency for securities regulation and enhancing the rights of Canadian shareholders and individual investors.

“Given the widespread non-compliance with the rules, a multifaceted approach including reforming the regulatory framework for exempt market dealers and portfolio managers has to be in place to protect investors.

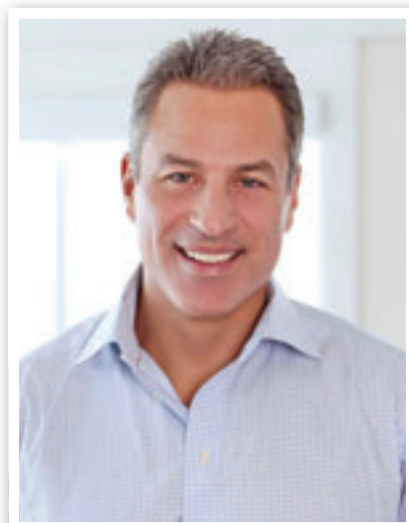
“There is a dangerous fallacy when it comes to investors,” she warns. “It’s a false and risky assumption that people who have great wealth are sophisticated investors. It’s been proven over and over that it’s simply not the case!”

In late 2009, the Canadian Securities Administrators (CSA) – the umbrella group for provincial securities regulators – proclaimed National Instrument 31-103 into force as an attempt to better regulate the various exempt markets across the country and create some measure of accountability for the people who operated within it.

But for many Albertans who were already invested in the exempt market, 31-103 proved to be too little, too late. By the time it was passed into

law, it was clear that they would never see the money that they invested with real estate firms like Bridgecreek, Concrete Equities and the Harvest Group of Companies, among others, either because of deliberate fraud or massive incompetence on the part of the people running them.

At the time, Calgary’s Frank Lonardelli was embroiled in controversy as the new Harvest Group CEO. He quickly discovered that the situation was much worse than it looked when he took on the ugly job of standing at the front of raucous town hall meetings



Frank Lonardelli, President and CEO of Arlington Street Investments



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with thousands of devastated and incensed investors. “It was extremely difficult, taking responsibility and explaining to halls full of private investors that their life savings were gone,” he remembers with haunting emotion.

Today he is the bold, confident and refocused president and CEO of Arlington Street Investments and admits to having learned many, many painful exempt market lessons, the hard way.

“It has to be the most nuanced space in the capital markets, with the most complicated and diverse set of products but it has representatives selling the product that have the lowest level of proficiency.

Lonardelli makes no excuses for some of the EM sector’s past failures, but looks back (with much sincere regret) that some of the key aspects of the crushing problem were lack of industry regulation and education.

He is now reasonably satisfied that his industry is on the right track with changes. “Exempt markets need a strong regulatory regime that protects investors without choking off business and anyone who works in the industry must be properly trained and must understand the business.”

According to Skauge, it was only about six years ago that EM was a welcome alternative for established capital markets.

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“When 2008 hit, credit tightened up drastically at the conventional banking level, particularly for small and medium-sized businesses. It’s almost as though those who didn’t want money could get it relatively easily, while those who needed money had to fend for themselves.

“Back to basics – and a kind of holistic approach – is where we find ourselves today in the exempt market: people raising money locally for local deals. NEMA started off with 10 members. Now we have 300 very, very good, active and involved EMD members. Maybe it is the entrepreneurial spirit of Albertans but this province has the most exempt market dealers in the country.”

Prestige Capital’s \$120-million Calgary Airport Hotel and Conference Centre is a prime example, not only of Alberta’s entrepreneurial spirit, but an exciting, current Calgary project that raised \$43 million in the exempt market.

“The goal is to help Calgary become a world-class destination for conference and business travel,” according to Curtis Potyondi, gung-ho EM booster and president of Prestige Capital. “We looked at all capital options. Even now, banks are tight with funds and we wanted to build a corporation with a strong balance sheet and wanted to syndicate our equity.

“Besides, private equity has been the cornerstone of commerce. Gradually the retail markets took that away from people. The stock market doesn’t provide important, local tangibility. Dealing with the exempt market offers more of a sense of community.”

Potyondi’s endorsement of exempt market capital combines with his excitement about the Calgary Airport Hotel and Conference Centre and his boundless Calgary pride.

“The economic spinoffs are significant,” he beams. “In fact, we are already having quite an impact. Through the construction phase we are

supporting about 300 jobs and after completion, we will be employing 175 full-time people.

“In the end we are just local investors and EM allows all the investors to participate in a business opportunity they otherwise wouldn’t have. We create the business opportunity, investors share in the ownership and they can drive by, see the building and say ‘that’s where my money went.’ ”

It is precisely the kind of credibility, image and reputation Skauge and his 300 NEMA members are working hard to establish and build on. The commitment includes the association’s EMD members actively focusing on the education, the qualifications, the accountability and the compliance of the exempt market industry, as well as the marketing and desired perception strategy as the exempt market sector learns from its missteps and moves forward.

“There is lots of work to be done,” Skauge points out. “I’d like to see barriers to entry be tightened a bit and raise the bar of our education standards. The current standard is considerably better than it used to be but could be improved.”

He acknowledges that, aside from a misunderstood image perception of exempt markets, there is also some misunderstanding about its actual target markets and competitive positioning.

“Our members are absolutely not trying to compete with the big, conventional capital markets,” he openly and adamantly asserts. “We offer a complementary product. It’s not for everyone. Maybe we can be a portion of their portfolio and there are investors who should not be in the exempt market altogether.”

In the meantime, Calgary’s exempt market dealers grow their client and investor base, train new industry professionals, satisfy skeptics, pitch for projects ... and earn a bigger piece of Alberta’s capital markets pie. **BIC**



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