CORPORATE GOVERNANCE 2.0

Consider Governing Corporation and Independent Financial Monitor

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The purpose of corporate governance, in layman's terms, is to make sure that business owners respect shareholders, operate in a mindful way, and follow the business plan that they originally outlined to investors to obtain their capital.

Corporate Governance 1.0: Additional directors, preferably independent.

In 2013, The National Exempt Market Association encouraged industry leaders in the Canadian Exempt Market to come together and discuss ideas on how to improve the integrity of the private capital markets. The suggestion that was presented, and later on implemented through cooperation of dealing representatives and dealer principals, was to make additional directors, preferably independent directors and dual authorization for fund transfers a requirement for exempt market offerings. This industry collaboration on insisting on high-level corporate governance has led to stronger offerings and growing confidence of the Canadian exempt market industry today.

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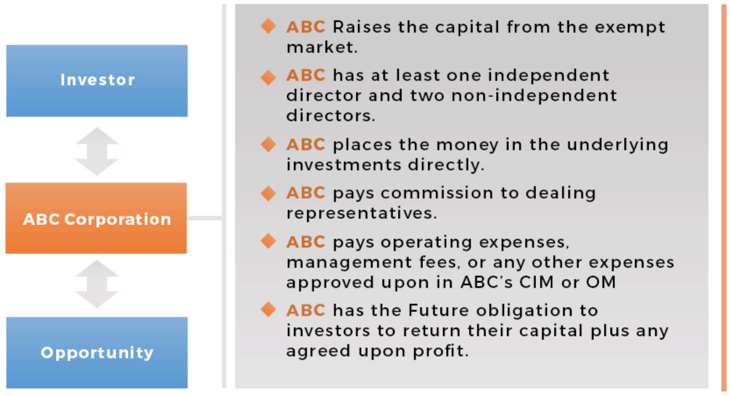
Corporate Governance 2.0: Governing Corp & Independent Financial Monitor

As industry leaders and participants always look for ways to further strengthen the corporate governance of exempt market offerings, I would like to put forward an idea to be considered by industry participants: for offerings to establish a separate Governing Corporation with an independent financial monitor.

I thought the best way to explain this idea would be to give an example of a structure and then provide explanations through answering questions I would expect from industry participants. The purpose of this article is to encourage dialogue between NEMA members to brainstorm on potential new best practices.

Illustrative Structure: ABC Corporation

Issuer 'ABC Corporation' raises capital and offers investors single digit returns. The issuer then places the capital in some type of opportunity which is expected to provide returns in the double digits. Below is a graph that shows the transitional transaction flow between investor, ABC Corporation, and the opportunity (underlying investments). On the right side, there is a list of ABC Corporation's key objectives, corporate governance, and duties and responsibilities.



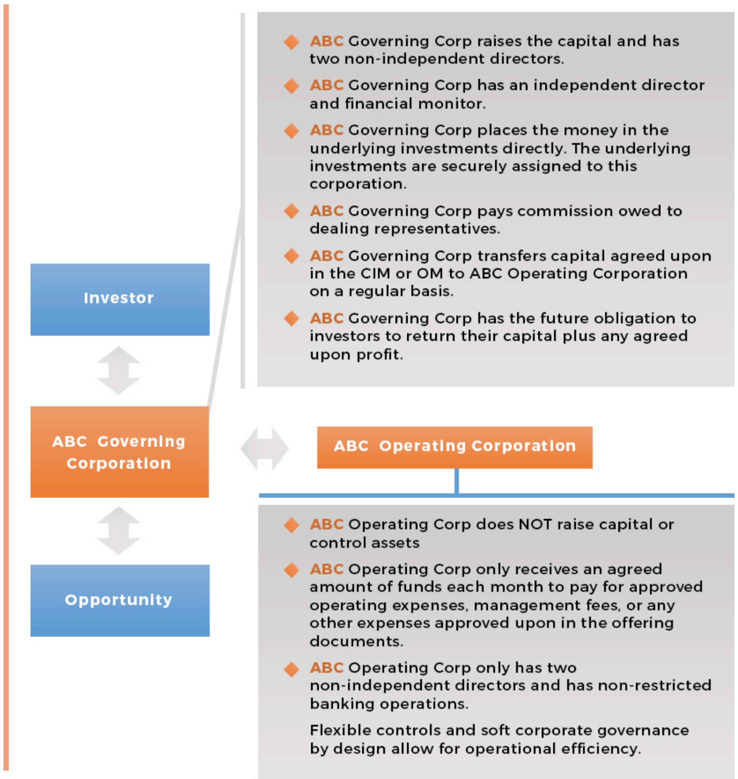
Over years of doing business, it has become apparent to me that the traditional structure corporate governance is not sufficient to ensure that all issuers invest and spend according to their OM or CIM disclosure and the funds required for asset redemptions would stay for investor's benefit instead of going into non-disclosed/non-agreed related lending.

What is lacking in the above scenario?

The independent director receives information with a substantial delay. Even if non-audited monthly financials are internally prepared, they would only inform the independent director after it is too late that something harmful has happened. Our firm decided to do things untraditionally. We have financial interests in four companies, of which I am a director and a monitor, for the purpose of protecting our firm's shareholders' investment.

As a director, I am not satisfied with simple financial reports after the actions have been taken. Instead, I monitor these firms proactively to protect our shareholders' position in these firms. We trust all our business partners, but we feel that this is necessary gold standard corporate governance for our firm's principals. This practice has proven effective in our business and therefore we believe retail investors should also have a monitor or someone to review current information and not delayed financial information to safeguard transactions.

The graph proposed below demonstrates a new corporation structure which consists of an independent governing corporation and an operating corporation. Both corporations take on independent roles, objectives, and corporate governance in facilitating the transactions between investors and the underlying investment.



The main idea behind the splitting of ABC Corporation is based on functionality, protection, and efficiency. The ABC Governing Corp receives assets and cash. An independent financial monitor who watches over all funds and their approval is required to transfer any funds. The ABC Governing Corp also receives all redemptions from the assets when they are returned. This structure essentially assures that management can't misuse any assets without the knowledge of the independent monitor which reports to the independent director. The ABC Operating Corp is necessary. It allows management to work with their agreed operating capital and also pay their management fees without having to go for approval on small sums of money or activity.

Independent Financial Monitor Q&A

1. What is an Independent Financial Monitor?

An independent financial monitor works under the Governing Corporation that controls the banking and transfers of assets including cash. No funds can be transferred out of the Governing Corporation unless the monitor has approved the transfer. All assets that are obtained, in this case, notes from lending to other companies, would be secured to this Governing Corp.

2. What specifically would the independent monitor do on a regular basis?

The independent monitor would review the request for transfer from operating management. The person needs to make sure that the requests follow the outline of use of funds disclosed to investors. Then once a month, or any other chosen period, the monitor would authorize the fund transfer from the Governing Corp to the Operating Corp.

3. Is it possible to lock down banking so the monitor's approval is required?

Yes, it is available at most of the leading six Canadian banks.

4. Who would make a good candidate for an independent monitor?

Being independent with strong business intuition/common sense, specialized knowledge, years of related experience, and a high level of ethical standard are some of the key qualities that I would be looking for when selecting a candidate for an independent monitor. It is my view that the role is not reserved only for accountants or other accredited professionals as an astute business person often is more confident and comfortable when dealing with a disagreement with management.

5. How much would it cost to fulfill this role or setting up two corporations?

I would suggest the fee to be similar to that of an independent director. I am a director of an offering that has installed an independent monitor and we have offered a qualified individual $6000 per year. The costs to set up an additional corporation is minimal.

6. How is this different from a custodian?

Typically custodian do not restrict fund transfers by management. This is a necessary key difference that is needed for strong corporate governance.

These are my thoughts on how we can improve our current corporate governance practice. Comments and feedback are welcome. Of course, what I would really like is to see organizations like NEMA facilitate another round-table discussion including industry leaders and concerned participants regarding further strengthening the integrity of our industry. We came together in 2013, we can certainly come together again today to make positive changes that benefit us all.

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