

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Committee on Banking and Insurance

BILL: SB 914

INTRODUCER: Senator Richter

SUBJECT: Offer or Sale of Securities

DATE: March 30, 2015

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Johnson	Knudson	BI	Pre-meeting
2.			AGG	
3.			AP	

I. Summary:

SB 914 authorizes intrastate crowdfunding as a mechanism for small businesses to raise up to \$1 million annually in crowdfunding securities. Issuers and intermediaries engaging in intrastate crowdfunding would be subject to specified requirements, as described below, under the Florida Securities and Investor Protection Act, which is administered by the Office of Financial Regulation (OFR). In recent years, crowdfunding websites have proliferated to raise money for charities, artistic endeavors and businesses. People may contribute money in the form of donations or in return for the product or other reward. These sites did not offer equity crowdfunding, such as an ownership interest or share of profits in a business, due to federal and state security laws. However, a growing interest in equity crowdfunding as a mechanism for capital formation has resulted in many states enacting laws exempting intrastate crowdfunding from securities registration.

The bill creates an intrastate exemption for securities meeting certain state and federal requirements. The issuer, intermediary, investor, and transaction must be located in Florida in accordance with the federal intrastate exemption. Like the federal Jumpstart Our Business Startups Act¹ (JOBS Act), as described below, the bill exempts an issuer and the offering for a 12-month period for an offering of up to \$1 million of securities, requires registration for the intermediary, and mirrors the federal law's investment limitations for investors. The bill requires issuer notice filings and intermediary registration with OFR, disclosures to investors, an escrow agreement for investor funds, a right of rescission, and financial reporting to investors and to the OFR. The bill also gives authority to the Financial Services Commission to adopt rules relating to notice-filing and registration forms, books and records, and investor protections.

The JOBS Act creates an interstate exemption from the registration requirements of the Securities Act of 1933 for the issuance, offer, and sale of crowdfunding securities subject to

¹ Public Law 112-106.

certain conditions. Issuers can raise up to \$1 million per year. Issuers have to engage an intermediary that is registered with the Securities and Exchange Commission (SEC). The JOBS Act requires the SEC to adopt rules implementing the new exemption that allows crowdfunding. Since no rules have been adopted, interstate crowdfunding is not permitted. In response to this delay, many states have enacted intrastate crowdfunding exemptions, which combine elements of the federal JOBS Act with Section 3(a)(11) of the Securities Act of 1933. Under this exemption, the issuer is exempt from federal registration if the issuer, all purchasers, and the transactions are contained within the same state.

According to the OFR, costs to implement the bill would be \$245,823. The impact on state revenues is indeterminate at this time.

II. Present Situation:

Federal Regulation of Securities

Securities Act of 1933

The federal Securities Act of 1933 (Securities Act), requires every offer or sale of securities using the means and instrumentalities of interstate commerce to be registered with the U.S. Securities & Exchange Commission (SEC), unless an exemption, (such as the intrastate exemption, is available). The Securities Act's emphasis on disclosure of important financial information through the registration of securities enables investors to make informed judgments about whether to purchase a company's securities. While the SEC requires that the information provided be accurate, it does not guarantee it. Investors who purchase securities and suffer losses have important recovery rights if they can prove that there was incomplete or inaccurate disclosure of important information.

Securities Exchange Act of 1934

With the enactment of the Securities Exchange Act of 1934 (act), Congress created the Securities and Exchange Commission. The act provides the SEC with broad authority over all aspects of the securities industry. This includes the power to register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's securities self regulatory organizations (SROs). The various securities exchanges, such as the New York Stock Exchange, the NASDAQ Stock Market, and the Chicago Board of Options are SROs. The Financial Industry Regulatory Authority (FINRA) is also an SRO.

The act also identifies and prohibits certain types of conduct in the markets and provides the SEC with disciplinary powers over regulated entities and persons associated with them. The act also authorizes the SEC to require periodic reporting of information by companies with publicly traded securities.

Generally, any person acting as a "broker" or "dealer" as defined by Section 3(4), and 3(a)(5) of the Securities Exchange Act of 1934, respectively, must be registered with the SEC and join a self-regulatory organization—the Financial Industry Regulatory Authority (FINRA), a national securities exchange, or both. Broker-dealers must also comply with state laws relating to registration requirements.

Intrastate Exemption

Section 3(a)(11) of the Securities Act of 1933 provides: “Any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and business within or, if a corporation, incorporated by and doing business within, such State or Territory.”² Prior to the enactment of the JOBS Act, states such as Kansas and Georgia had already enacted their own securities offering exemption pursuant to the federal intrastate exemption under Section 3(a)(11) of the Securities Act of 1933 and SEC Rule 147,³ in an effort to stimulate state-based offerings.

Issuers may also rely on the SEC’s Rule 147, known as the “safe harbor” rule, which provides specific guidance on section 3 (a)(11) offerings. For example, Rule 147 specifies that at least 80 percent of the gross revenues and its subsidiaries (on a consolidated basis) be derived from the subject state in order to be deemed “doing business within a state or territory.” Rule 147 states that the legislative history of section 3(a)(11) suggests that “the exemption was intended to apply only to issues genuinely local in character, which in reality represent local financing to local industries, carried out through local investment.”

Unlike the Title III crowdfunding exemption of the JOBS Act, section 3(a)(11) does not limit the size of the offering, and unlike several other exemptions, section 3(a)(11) does not limit the number of investors or require that they be accredited. However, it is noted that section 3(a)(11) is strictly and narrowly construed, and if any of the securities are offered or sold to even one out-of-state person, the exemption may be lost and the company could be in violation of the Securities Act of 1933.⁴ Broker-dealers that conduct their business on a purely intrastate basis are not required to register at the federal level.⁵ Applicable SEC guidance provides that the intrastate exemption is narrowly construed and offerings advertised through the internet are deemed interstate, not intrastate, in nature:

The exception provided for intrastate broker-dealer activity is very narrow. To qualify, all aspects of all transactions must be done within the borders of one state. This means that, without SEC registration, a broker-dealer cannot participate in any transaction executed on a national securities exchange or NASDAQ. Also, information posted on the Internet that is accessible by persons in another state would be considered an interstate offer of securities or investment services that would require Federal broker-dealer registration.⁶

² 15 USC s. 77c(a)(11). SEC Rule 147 (17 CFR s. 230.147) provides a “safe harbor” that guarantees compliance with Section 3(a)(11) if the conditions set forth in the rule are met.

³ 17 CFR s. 230.147.

⁴ U.S. SECURITIES & EXCHANGE COMMISSION, *Small Business and the SEC*, <http://www.sec.gov/info/smallbus/qasbsec.htm#intrastate> (last visited March 30, 2015).

⁵ Section 15(a)(1) of the Securities Exchange Act provides an exemption from broker-dealer registration for a broker-dealer whose business is “exclusively intrastate and who does not make use of any facility of a national securities exchange.” 15 U.S.C. 78o(a)(1).

⁶ SEC Guide to Broker-Dealer Registration, available at <http://www.sec.gov/divisions/marketreg/bdguide.htm> (last visited March 29, 2015).

On April 10, 2014, the SEC issued interpretive guidance regarding section 3(a)(11) of the Securities Act of 1933 and the Internet.⁷ The SEC indicated that use of a third-party Internet portal to promote an offering to residents of a single state would not violate the intrastate exemption, if the portal implemented “adequate measures,” such as disclaimers, restrictive legends, and limited access to information about specific investment opportunities to persons who confirm they are residents of the relevant states by way of zip codes or address verification. Although the SEC’s interpretive ruling is not conclusive, issuers generally would not be able to use popular social media platforms (such as Facebook, Twitter, or LinkedIn) to promote an intrastate crowdfunding offering, because these sites can be indiscriminately accessed by non-Florida residents. In addition, the issuer would likely need to ensure that an investor does not continue to use the portal after moving out of state.⁸

It is also important to note that section 3(a)(11) only provides an exemption from federal registration, but does not provide immunity from the antifraud or civil liability provisions of the federal securities laws, including investor rescission. States may still require registration for purely intrastate offerings involving a general solicitation of investors.

JOBS Act and Crowdfunding

Title III of the JOBS Act (“Title III”) provides an interstate exemption from the registration requirements for crowdfunding transactions. Unlike other securities exemptions, Title III permits the issuer (fundraiser) to advertise and solicit sales of securities from the public and to sell the securities to non-accredited investors without first registering with the SEC or other regulatory authority. Title III also allows intermediaries - either registered broker-dealers or a new Internet-based platform entity (funding portals) – to facilitate the online offer or sale of securities, subject to certain requirements, including registering with “with any applicable self-regulatory organization” as defined in the 1934 Securities Exchange Act. The SEC’s proposed rule provides that this self-regulatory organization is FINRA, which is the only registered national securities association.⁹ If the Title III conditions are met, funding portals are exempt from having to also register with the SEC.

Certain companies are not eligible to use the Title III exemption, such as non-U.S. companies, companies that already are SEC reporting companies, certain investment companies, and others as determined by SEC rule. Title III also includes a disqualification provision under which the exemption is unavailable if the issuer or related persons were subject to certain disqualifying events, such as being subject to a state financial regulatory final order barring the individual from the financial industry or a criminal conviction involving the purchase or sale of securities or false filings with the SEC.

⁷ See Questions 141.03-141.05 (issued April 10, 2014), available at <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm> (last visited March 30, 2015).

⁸ Elizabeth J. Chandler, *SEC Staff Releases Compliance and Disclosure Interpretations Related to Intrastate Crowdfunding*, THE NATIONAL LAW REVIEW (Apr. 14, 2014), <http://www.natlawreview.com/article/sec-securities-and-exchange-commission-staff-releases-compliance-and-disclosure-inte> (last visited March 30, 2015).

⁹ SEC Proposed Regulation Crowdfunding Section 227.400.

In addition to the requirements discussed above, to qualify for the exemption, crowdfunding transactions by an issuer (including all entities controlled by or under common control with the issuer) must meet the following:

- The amount raised must not exceed \$1 million in a 12-month period.
- Individual investments in a 12-month period are limited to: the greater of \$2,000 or 5 percent of annual income or net worth, if annual income or net worth of the investor is less than \$100,000; and 10 percent of annual income or net worth (not to exceed an amount sold of \$100,000), if annual income or net worth of the investor is \$100,000 or more.
- An offering made in reliance on the exemption must be conducted through an intermediary that is either a registered broker or a registered “funding portal.” Transactions must be conducted through an intermediary that either is registered as a broker or is registered as a new type of entity called a “funding portal,” which would be subject to an exemption from broker registration.
- Issuers and intermediaries that facilitate transactions between issuers and investors in reliance on the crowdfunding exemption must provide certain disclosures to investors and potential investors and provide notices and other information to the SEC.

The JOBS Act requires the SEC to adopt rules to implement interstate crowdfunding. On October 23, 2013, the SEC proposed rules that would implement Title III. The SEC has advised that no Title III (interstate) crowdfunding is permitted until the SEC’s rules are finalized; specifically, one cannot operate a crowdfunding intermediary or funding portal unless registered in accordance with the final rules.¹⁰

State Regulation of Securities

In addition to federal securities laws, “Blue Sky Laws” are state laws that protect the investing public through registration requirements for both broker-dealers and securities offerings, merit review of offerings, and various investor remedies for fraudulent sales practices and activities.¹¹ In Florida, the Securities and Investor Protection Act, ch. 517, F.S. (act), regulates securities issued, offered, and sold in the state of Florida. The Florida Office of Financial Regulation (OFR) regulates and registers the offer and sale of securities in, to, or from Florida by firms, branch offices, and individuals affiliated with these firms in accordance with the act and Chapter 69W, Florida Administrative Code.¹²

The act prohibits dealers, associated persons, and issuers from offering or selling securities in this state unless registered with the OFR or specifically exempted.¹³ Additionally, all securities in Florida must be registered with the OFR unless they meet one of the exemptions in

¹⁰ U.S. SECURITIES & EXCHANGE COMMISSION, Information Regarding the Use of Crowdfunding Exemption in the JOBS Act, at <http://www.sec.gov/spotlight/jobsact/crowdfundingexemption.htm>. See also JOBS Act Frequently Asked Questions About Crowdfunding Intermediaries, at <http://www.sec.gov/divisions/marketreg/tmjobsact-crowdfundingintermediariesfaq.htm> (last visited March 30, 2015).

¹¹ U.S. Securities and Exchange Commission, *Blue Sky Laws*, <http://www.sec.gov/answers/bluesky.htm> (last visited March 30, 2015).

¹² Pursuant to s. 20.121(3)(a), F.S., the Financial Services Commission (the Governor and Cabinet) serves as the OFR’s agency head for purposes of rulemaking and appoints the OFR’s Commissioner, who serves as the agency head for purposes of final agency action for all areas within the OFR’s regulatory authority.

¹³ Section. 517.12, F.S.

ss. 517.051 or 517.061, F.S., or are federally covered (i.e., under the exclusive jurisdiction of the SEC).¹⁴ Failure to meet the precise requirements of these exemptions, can subject the issuer to civil, criminal, and administrative liability for the sale of unregistered securities, which is a third-degree felony in Florida.¹⁵ Civil remedies under the act include rescission and damages.¹⁶ In addition, issuers must comply with disclosure requirements in state and federal laws that provide potential investors with full and fair disclosures regarding the security.

Currently, no Florida exemption permits the advertising or solicitation for the offer or sale of unregistered securities to the public, or for securities sold to the public to be sold by an unregistered dealer.

III. Effect of Proposed Changes:

The bill creates an intrastate exemption for crowdfunding transactions from the registration requirements under s. 517.061, F.S., for the offer and sale of certain securities. The bill contains provisions from the JOBS Act and is limited to intrastate offerings under 15 U.S.C. s. 77c(a)(11). In contrast to other securities transactions under the OFR's jurisdiction that are exempt from registration, the securities in these crowdfunding transactions may be generally advertised and sold typically over the Internet and are not required to be sold through a registered broker-dealer when offered to the general public, but may be sold through an intermediary. The bill provides for the offer and sale of up to \$1 million of unregistered securities per offering, and sets forth terms and conditions for issuers and intermediaries offering and selling such securities.

Section 1 defines an intermediary to mean a natural person residing in this state, or a corporation, trust, partnership, association, or any other legal entity registered with the Secretary of State to do business in this state, that represents an issuer in a transaction involving the offer or sale of securities under s. 517.061, F.S.

Section 2 provides that an issuer and each intermediary that represents an issuer is exempt from the registration requirements of s. 517.07, F.S., if the offer or sale of the security meets certain requirements:

Issuer Requirements:

- Be a for-profit business entity formed under the laws of this state and be registered with the Secretary of State.
- Be represented by an intermediary.
- Submit a nonrefundable filing fee of \$200 and file a notice with the OFR in a form prescribed by commission rule, that:
 - Indicates that the issuer is conducting an offering in reliance upon this exemption.
 - Contains the contact information of the issuer, all persons who will be involved in the offer or sale of securities on behalf of the issuer, and the federally insured financial institution authorized to do business in this state in which investor funds will be deposited.

¹⁴ Section 517.07, F.S. If a security is registered with the SEC, s. 517.082, F.S., requires the broker or issuer to notify OFR that the security is registered with the SEC.

¹⁵ Section 517.302(1), F.S.

¹⁶ Section 517.211(3-5), F.S.

- Include documentation verifying that the issuer is organized under the laws of Florida and authorized to do business in Florida.
- Not be, either before or as a result of the offering, an investment company as defined in s. 3 of the Investment Company Act of 1940, 15 U.S.C. s. 80a-3, or subject to the reporting requirements of s. 13 or s. 15(d) of the Securities Exchange Act of 1934, 15 U.S.C. s. 78m or s. 78o(d).
- Execute an escrow agreement with a federally insured financial institution authorized to do business in this state for the deposit of investor funds.
- Not be subject to a disqualification established by the commission or office or a disqualification described in United States Securities and Exchange Commission Rule 262, 17 C.F.R. s. 230.262, under the Securities Act of 1933.

Intermediary Requirements:

- Comply with any notice or filing requirements for exemption from registration as a broker-dealer established by rule or order of the Financial Services Commission or the OIR under this chapter, which shall include annual registration and submission of a nonrefundable \$200 registration fee.
- Facilitate the offer and sale of securities.
- Provide basic information on its platform regarding the high risk of investment in and limitation on the resale of exempt securities and the potential for loss of an entire investment. The basic information shall include:
 - A description of the escrow agreement that the issuer has executed and the conditions for the release of such funds to the issuer in accordance with the agreement.
 - A description of whether financial information provided by the issuer has been audited by an independent certified public accountant.
- Maintain records of the offers and sales of securities made through its platform, as prescribed by commission rule, and provide access to such records upon request by the OIR.
- Obtain evidence from each investor showing that the investor is a resident of Florida. An investor that provides a legible copy of a Florida driver license has provided evidence of state residency.
- Obtain an affidavit from each investor stating that the investment being made by the investor is consistent with the income requirements.
- Deposit and release investor funds in escrow pursuant to the escrow agreement executed by the issuer.
- Provide a monthly update for each offering, which is accessible on the intermediary's platform, and includes the date and amount of each sale of securities in the previous calendar month.
- Not be subject to a disqualification established by the commission or office or a disqualification described in SEC Rule 262, 17 C.F.R. s. 230.262, under the Securities Act of 1933.

Intermediary Prohibitions:

- Offer investment advice or recommendations. A refusal by an intermediary to post an offering that it deems not credible or representing a potential for fraud shall not be construed as an offer of investment advice or recommendation.
- Solicit purchases, sales, or offers to buy securities offered or displayed on its platform.

- Compensate employees, agents, or other persons for the solicitation of purchases, sales, or offers to buy the securities offered or displayed on its platform.
- Hold, manage, possess, or otherwise handle investor funds or securities.

The transaction must meet the requirements of the federal exemption for intrastate offerings under s. 3(a)(11) of the Securities Act of 1933, 15 U.S.C. s. 77c(a)(11), and United States Securities and Exchange Commission Rule 147, 17 C.F.R. s. 230.147, under the Securities Act of 1933.

SB 914 provides that the sum of all cash and other consideration received for all sales of the security in reliance upon this exemption must not exceed \$1 million, less the aggregate amount received for all sales of securities by the issuer within the 12 months preceding the first offer or sale made in reliance upon this exemption. Unless the investor is an accredited investor as defined by Rule 501 of Regulation D under the Securities Act of 1933, the aggregate amount sold by an issuer to an investor in transactions exempt from registration requirements under this section during a 12-month period may not exceed:

- If the annual income and net worth of the investor are less than \$100,000, the greater of \$2,000, 5 percent of the annual income of the investor, or 5 percent of the net worth of the investor.
- If the annual income or net worth of the investor is \$100,000 or more, the greater of \$100,000, 10 percent of the annual income of the investor, or 10 percent of the net worth of the investor.

The bill requires that all funds received from investors must be used in accordance with representations made to investors by the intermediary.

All offering materials must prominently state in bold, conspicuous print:

“These securities are offered and will be sold in reliance on an exemption from the registration requirements of federal and State of Florida securities laws and consequently neither the federal government nor the State of Florida have reviewed the accuracy or completeness of any offering materials. In making an investment decision, investors must rely on their own examination of the issuer and the terms of the offering, including the merits and risks involved. These securities are subject to restrictions on transferability and resale and may not be transferred or resold except as specifically authorized by applicable federal and state securities laws. Investing in these securities involves a speculative risk, and investors should be able to bear the loss of their entire investment.”

The bill provides that exemptions from registration requirements may not be used in conjunction with any other exemption from registration requirements under this chapter, except for offers and sales to a person owning 10 percent or more of the outstanding shares of any class or classes of securities or to an officer, director, partner, or trustee or a person occupying similar status or performing similar functions. Sales to such persons do not count toward the limitation provided in the bill.

Sections 3 and 4 provide technical, conforming changes.

Section 5 provides the act will take effect July 1, 2015.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

The bill requires issuers to pay notice filing fees of \$200 and intermediaries would be subject to a \$200 registration fee.

B. Private Sector Impact:

The bill will provide start-up and small companies with another option for raising capital that would not be subject to securities registration with the OFR if certain requirements were met.

C. Government Sector Impact:

The OFR estimates¹⁷ that it will need resources to implement the provisions of the bill. The OFR estimates the total staffing costs to be \$182,672.82, as described below:

- Two Financial Specialists within the Division of Securities, Bureau of Enforcement (BE 43900570) to process complaints, examine intermediaries and risk assess for potential crowdfunding operations acting outside the scope of the requirements [2 FTEs \$60,890.94 x 2 = \$121,781.88].
- One Financial Investigator/Criminal Enforcement within the Bureau of Financial Investigations (BE 43900540) to investigate unregistered and unlawful activity [1 FTE \$60,890.94].

The bill will require updates to the OFR's licensing and examination software as well as information technology support and increased data storage to integrate notice-filings by issuers and applications by intermediaries. The bill would likely require the OFR to create electronic forms for notice-filings and applications. The fiscal impact is estimated at \$63,150 (BE 43900550 – Executive Direction and Category 210016 – REAL). The

¹⁷ Office of Financial Regulation, 2015 Legislative Bill Analysis (Jan. 21, 2015) (on file with Banking and Insurance Committee).

services covered by the estimated costs include system configuration in the licensing, fiscal, transaction, and enforcement areas; correspondence and reports development; portal development for online application process and maintenance; modification to LiveScan interface and system testing.

VI. Technical Deficiencies:

Some provisions of the JOBS Act and s. 3(a)(11) of the Securities Act of 1933 were not fully incorporated in the bill but are addressed in the delete-all amendment.

VII. Related Issues:

None.

VIII. Statutes Affected:

This bill substantially amends the following sections of the Florida Statutes: 517.021, 517.061, 517.12, and 626.9911.

IX. Additional Information:

A. Committee Substitute – Statement of Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

B. Amendments:

None.