

Legislative Analysis



EXEMPT CERTAIN SECURITIES FROM REGISTRATION UNDER UNIFORM SECURITIES ACT

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House Bill 4996

Sponsor: Rep. Nancy Jenkins

Committee: Commerce

Complete to 10-16-13

A SUMMARY OF HOUSE BILL 4996 AS INTRODUCED 9-18-13

Under the Uniform Securities Act (2002), a person cannot offer or sell a security in this state unless one or more of the following are met: (a) The security is a federal covered security; (b) the security, transaction, or offer is exempted from registration under Sections 201 to 203; or (c) the security is registered under the act.

House Bill 4996 would amend Section 202 of the act to provide an additional exemption from registration for securities that meet certain specified criteria. The criteria are listed in a new Section 202a that forms the bulk of the bill.

The Uniform Securities Act (2002) is based on a model act from the Uniform Law Commission of the National Conference of Commissioners on Uniform State Laws (NCCUSL) and is designed to coordinate federal and state securities legislation. The purpose of such regulation is to prevent fraudulent sales of securities to investors.

By "securities," the act means notes; stocks; treasury stocks; security futures; bonds; debentures; evidences of indebtedness; certificates of interest or participation in profit sharing agreements; collateral trust agreements; interests in oil, gas, or mineral rights; puts, calls, straddles, and options on securities; certificates of deposits, or groups and indexes of securities; investments in viatical or life settlement agreements; and similar instruments. The administrator of the act is the Department of Licensing and Regulatory Affairs (LARA).

House Bill 4996 would exempt from registration an offer or sale of a security that meets all of the following requirements:

**** The issuer of the security is an entity that is incorporated or organized under Michigan law and is authorized to do business in Michigan.**

**** The transaction meets the requirements of the federal exemption for intrastate offerings (under the Securities Act of 1933).**

**** The sum of all cash and other consideration to be received for all sales of the security in reliance on this exemption does not exceed the following amounts:**

-- One million dollars, less the aggregate amount received for all sales of the security by the issuer within the 12 months before the first offer or sale made in reliance on the exemption, if the issuer has not undergone, and made available to each prospective investor and the administrator the documentation from, a financial audit with respect to its most recently completed fiscal year; or

-- Two million dollars if it has undergone and made available documentation from a financial audit with respect to its most recently completed fiscal year.

** The issuer has not accepted more than \$10,000 from any single purchaser unless the purchaser is an accredited investor (under Securities and Exchange Commission rules).

** At least 10 days before the beginning of an offering of securities in reliance on the exemption or the use of any publicly available website in connection with an offering of securities in reliance on the exemption, the issuer files a notice with the administrator in writing or in electronic form containing:

-- a notice of claim of exemption from registration, specifying that the issuer will be conducting an offering in reliance on the exemption, accompanied by the specified filing fee.

-- a copy of the disclosure statement to be provided to prospective investors in connection with the offering. (The bill details what must be contained in this disclosure statement.)

-- an escrow agreement with a bank or other depository institution in the state, in which investor funds will be deposited, that provides that all offering proceeds will be released to the issuer only when the aggregate capital raised from all investors is equal to or greater than the minimum target offering amount specified in the business plan as necessary to implement the business plan, and that all investors may cancel their commitments to invest if that target offering amount is not raised by the time stated in the disclosure document.

** The issuer is not an investment company under federal law.

** The issuer informs each prospective purchaser that the securities are not registered under federal or state securities law and that the securities are subject to limitations on resale and displays specified language on the cover page of the disclosure document.

** The issuer requires each purchaser to certify things in writing, including: "I am investing in a high-risk, speculative business venture. I may lose all of my investment, and I can afford the loss of my investment."

** If the offer and sale of the securities is made through an Internet website, all of the following requirements are met: the issuer provides to the website and LARA evidence that the issuer is organized under the laws of Michigan and that it is authorized to do

business in the state; the issuer obtains from each purchaser of a security evidence that the purchaser is a resident of the state and, if applicable, an accredited investor; the website operator registers with LARA and describes its role; and the issuer and the website keep and maintain records of the offers and sales of securities through the website and provide ready access to the records to LARA on request.

** All payments for the purchase of securities are directed to and held by the bank or depository institution, which must notify the administrator of the receipt of payments for securities and the identity and residence of the investors. Investor information is not a public record and is not available for public inspection.

** Offers or sales of a security are not made through an Internet website unless the website is registered with LARA. The website is not subject to the broker-dealer, investment adviser, or investment adviser representative registration requirements if the website meets certain conditions specified in the bill.

** The issuer does not pay, directly or indirectly, any commission or remuneration to an executive officer, director, managing member, or other individual with similar status or who performs similar functions in the name of and on behalf of the issuer for offering or selling the securities unless registered as a broker-dealer, investment adviser, or investment adviser representative. Such persons are exempt from registration requirements if they do not receive, directly or indirectly, any commission or remuneration for offering or selling securities of the issuer that are exempt from registration under the bill.

** The issuer provides a copy of the disclosure document provided to LARA to each prospective investor at the time the offer of securities is made.

If the offer and sale of a security of an issuer is exempt, the issuer must provide a quarterly report to the issuer's investors until none of the securities issued are outstanding. The report must be provided free of charge to investors, and each report must be filed with the administrator and the issuer must provide a copy to any investor on request.

The report must include: the compensation received by each director and executive officer of the issuer, including cash compensation earned since the previous report and on an annual basis, and any bonuses, stock options, other rights to receive securities of the issuer or an affiliate, or other compensation received; and an analysis by management of the issuer of the business operations and financial condition of the issuer.

The exemption would not apply if the issuer or a person affiliated with the issuer or offering is subject to any disqualification established by the administrator by rule or contained in Rule 262 promulgated under the federal Securities Act of 1933. However, this would not apply if, on a showing of good cause and without prejudice to any other action by LARA, the department determines it is not necessary to deny an exemption; or if the issuer establishes that it made factual inquiry into whether any disqualification

existed but did not know, and in the exercise of reasonable care could not have known, that a disqualification existed. The nature and scope of the requisite inquiry will vary based on the circumstances of the issuer and other offering participants.

The administrator could adopt rules to implement provisions of the bill and to protect investors that purchase securities that are exempt from registration under the bill.

LARA would charge a nonrefundable filing fee of \$150 for filing an exemption notice. Fees paid to LARA would be used to pay the costs incurred and administering the Uniform Securities Act.

BACKGROUND INFORMATION:

The NCCUSL lists the following as key components of the model act: (1) the registration of securities by means of three methods (notice, coordination, and qualification) to clarify and simplify the process for both regulators and industry; (2) the regulation of broker-dealers, investment advisors, and their agents and representatives through registration in the states where they do business; (3) expanded enforcement powers, including civil and criminal actions against perpetrators of fraud, including court and administrative action; (4) investigatory and subpoena powers for state securities administrators; (5) criminal penalties, which are set by the state; (6) investor education; and (7) electronic filing facilitation.

FISCAL IMPACT:

House Bill 4996 would have an indeterminate, but likely nominal, fiscal impact on the Corporations, Securities, and Commercial Licensing Bureau (CSCLB) within the Department of Licensing and Regulatory Affairs (LARA); because there are few enforcement responsibilities under HB 4996, the CSCLB anticipates that the \$150 filing fee for exemption notices would be sufficient to cover CSCLB administrative costs.

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.