



Senate Fiscal Agency
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BILL ANALYSIS

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Senate Bill 200 (Substitute S-3 as passed by the Senate)
Sponsor: Senator Darwin L. Boohar
Committee: Banking and Financial Institutions

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RATIONALE

In recent years, Michigan has enacted a variety of measures to allow businesses in the State to issue and offer intrastate securities for sale to Michigan residents. These measures include the establishment of the "Michigan Invests Locally Exemption" to the Uniform Securities Act, which exempts the sale of an intrastate security from the Act's registration requirements if it meets certain criteria. This enables businesses to engage in "crowdfunding" (raising money from a large number of people who invest small amounts of money) without having to register under the State's securities law. Legislation then created a regulatory framework for an intrastate market, in order to connect buyers and sellers of securities issued by in-State companies. This measure governs "Michigan investment markets", which are broker-dealers whose only business is intrastate transactions, which qualifies them for an exemption from Federal registration. To stimulate growth and interest in intrastate securities, it now has been suggested that Michigan investment markets and certain investors in qualifying intrastate securities should be permitted to receive economic assistance from the Michigan Strategic Fund.

CONTENT

The bill would add Section 88s to the Michigan Strategic Fund Act to do the following:

- **Require the Michigan Strategic Fund to create and operate the Michigan Investment Program, to provide economic assistance to Michigan investment markets and qualified persons with a controlling interest in a Michigan advancement portfolio.**
- **Require the Michigan Investment Program to provide for a detailed application, approval, and compliance process.**
- **Specify the provisions to be included in a written agreement for a grant, loan, or other economic assistance.**
- **Set a cap of \$1.0 million on the amount a Michigan investment market or qualified person could receive under the Michigan Investment Program in a fiscal year, and a cap of \$2.0 million on the total amount of assistance the Program could provide in a fiscal year.**
- **Provide that the Fund could not enter into an agreement unless the investment market or qualified person met certain conditions.**
- **Require the Fund to post on its website information related to the Michigan Investment Program, and issue an annual report to the Legislature.**

The bill states, "The legislature finds and declares that funding authorized under this section to encourage diversification of the economy, to encourage capital investment in this state, and to promote the development of Michigan investment markets and Michigan advancement portfolios in this state is a public purpose and of paramount concern in the interest of the health, safety, and general welfare of the citizens of this state."

Definitions

The bill would define "Michigan advancement portfolio" as a collection of investments that, as a whole, meets all of the following criteria: a) the collection includes securities only in businesses that are doing business in this State, b) at least 10% of the portfolio's overall investment for a calendar year is in businesses that qualify as small businesses according to the United States Small Business Administration small business size standards for the applicable industry at the time of the investment, and c) the collection begins with at least \$200,000 in investments.

"Michigan investment market" would mean that term as defined in Section 451 of the Uniform Securities Act (2002): a person that is a broker-dealer, is exempt from Federal registration under Section 15(a)(1) of the Securities Exchange Act of 1934, and provides a market or exchange, including an online market or exchange operated through a web portal, at which transactions in securities that are sold or offered for sale in this State under an intrastate offering exemption take place. (The Securities Exchange Act is Federal law pertaining to the offer, sale, or purchase of securities on the secondary market (rather than a transaction that directly involves the issuing company). Section 15(a)(1) requires the registration and regulation of securities brokers or dealers, but exempts a broker or dealer whose business is only intrastate transactions.)

"Qualified person" would mean a person that is doing business in this State or is a resident of this State and is either an institutional investor or an accredited investor as defined by Rule 501 of Securities Exchange Commission (SEC) Regulation D. (Regulation D contains several rules that provide exemptions from the requirement to register securities with the SEC.) The Fund could rely on confirmation that the purchaser was an accredited investor from a licensed broker-dealer or another third party in making a determination that the individual was an accredited investor.

"Institutional investor" would mean that term as defined in Section 102a of the Uniform Securities Act. (That definition includes, among other entities, a depository institution or international banking institution, an insurance company, an investment company, a registered broker-dealer, and certain employee pension or benefit plans.)

Each of the following would be prima facie evidence that an individual was a resident of this State: a) a valid operator's license, chauffeur's license, or official personal identification card issued by this State, b) a current Michigan voter registration, c) a signed affidavit, as described in Section 7cc(2) of the General Property Tax Act, that indicated that the individual owned and occupied property in this State as his or her principal residence, and d) any other record or documents issued by this State that established that the individual's principal residence was in this State.

For purposes of Section 88s, a business would be considered to be doing business in this State if all of the following were met: a) if the business had gross revenue of more than \$5,000 from the sale of products or services or other conduct of its business for its most recent 12-month fiscal period, it derived at least 80% of its gross revenue, and that of its subsidiaries on a consolidated basis, from the operation of a business or of real property located in or from the rendering of services in this State during one of the following periods: i) in its most recent fiscal year, if the first offer of any part of the issue were made during the first six months of the issuer's current fiscal year, or ii) in the first six months of its current fiscal year, or during the 12-month fiscal period ending with that six-month period, if the first offer of any part of the business's intrastate offering were made during the last six months of the business's current fiscal year; b) at the end of its most recent semiannual fiscal period before the first offer of any part of the issue, the business had at least 80% of its assets and those of its subsidiaries in this State; c) the business intended to use and used at least 80% of the net proceeds to the business from the sale or resale of intrastate securities in connection with the operation of a business or of real property in, the purchase of real property located in, or the rendering of services in this State; and d) the principal office of the business was located in this State.

Michigan Investment Program

The Michigan Investment Program would have to provide for the following: a) grants, loans, and other economic assistance in developing Michigan investment markets and Michigan advancement portfolios, and b) a detailed application, approval, and compliance process published and available on the Michigan Strategic Fund's website. This process would have to contain at least the following: a) a Michigan investment market or qualified person with a controlling interest in a Michigan advancement portfolio could apply for a grant, loan, or other economic assistance in a form and manner determined by the Fund, and b) after receiving an application, the Fund could enter into a written agreement with the Michigan investment market or qualified person.

With assistance from the Michigan Economic Development Corporation (MEDC) and the Office of the Chief Compliance Officer, the Fund would have to establish policies and procedures to conduct background checks on each Michigan investment market and qualified person applying for a grant, loan, or other economic assistance under Section 88s.

In any fiscal year, a Michigan investment market or qualified person could not receive more than \$1.0 million from the Michigan Investment Program. In any fiscal year, the Michigan Investment Program could not provide grants, loans, or other economic assistance that, in the aggregate, exceeded \$2.0 million.

"Other economic assistance" would mean "any other form of assistance allowed under this act that is not a grant or loan". Other economic assistance could include providing security for a qualified person's investments within its Michigan advancement portfolio. That security could be equal to or less than 35% of the original value of the qualified person's advancement portfolio; however, that security would be payable only in proportion to realized losses in investments within that portfolio on an individual basis. The securitization would be subject to all of the following:

- Michigan advancement portfolios with initial investments totaling \$200,000 to \$350,000 would be eligible for security up to 20%.
- Initial investments totaling \$350,000.01 to \$500,000, up to 25%.
- Initial investments totaling \$500,000.01 to \$1.0 million, up to 30%.
- Initial investments totaling more than \$1.0 million, up to 35%.

Written Agreement

The written agreement between the Fund and a Michigan investment market or qualified person would have to provide for the following: a) in a clear and concise manner, all of the conditions imposed, including specific time frames, on the Michigan investment market or the qualified person to receive a grant, loan, or other economic assistance, b) a provision for the repayment of any grants, loans, or other economic assistance if the Michigan investment market or qualified person failed to comply with the agreement, and c) an audit provision that required the Fund to verify that established milestones for the Michigan investment market or qualified person were met.

The Fund could not enter into a written agreement with a Michigan investment market or qualified person unless the investment market or qualified person provided a business plan or demonstrated the need for the grant, loan, or other economic assistance, and agreed to provide the data described in the agreement necessary for the Fund to report to the Legislature under the Act.

Website Posting & Reports

The Fund would have to post on its website, or on the MEDC's website, the name and location of each Michigan investment market and qualified person that received a grant, loan, or other economic assistance awarded under Section 88s and the amount of the grant, loan, or assistance. At least every three months, the Fund would have to post on its website the name and location of each Michigan investment market and each qualified person that received approval of a loan, grant, or other assistance in the immediately preceding three-month period.

The Fund would have to report annually to each house of the Legislature on the activities of the Fund that occurred under Section 88s in the previous fiscal year. The report would have to be made available in an electronic format, and would have to include all of the following: a) the total number of new agreements, b) the amount of the grant, loan, or other economic assistance awarded separately for each Michigan investment market and each qualified person, and c) the actual amount of the grant, loan, or other economic assistance for each Michigan investment market and each qualified person verified by the Fund.

Proposed MCL 125.2088s

BACKGROUND

Under the Securities Act of 1933, a company that sells or offers to sell its securities must register them with the U.S. Securities and Exchange Commission unless the company qualifies for an exemption from the registration requirements. The source of one exemption is Title III of the JOBS (Jumpstart Our Business Startups) Act. Enacted in 2012, this Act allows a private company to sell to investors securities in any state in the United States in small amounts to a large number of unaccredited investors without registering the securities with the SEC or state regulators. (An accredited investor is a financially sophisticated investor determined to require reduced need for protection under Federal securities laws and regulations.¹) The sale of small amounts of unregistered securities to unaccredited investors is referred to as "crowdfunding". These activities became legal under JOBS Act crowdfunding rules, which took effect on May 16, 2016.

The Securities Act of 1933 also contains an intrastate offering exemption. The exemption allows an issuer organized and carrying out significant business in a state where it is offering the security to make offers and sales of securities only to residents of that state. The security may still be subject to state laws pertaining to the issuance, offer, sale, or purchase of securities. Under Michigan's Uniform Securities Act, a person is prohibited from selling a security unless the security is: a) a Federal covered security (which generally refers to a security listed on a national stock exchange); b) exempt from registration under the Act; or c) registered under the Act.

In order to create an intrastate crowdfunding mechanism, Michigan enacted Public Act 264 of 2013, which amended the Uniform Securities Act to create the Michigan Invests Locally Exemption (MILE). The MILE exempts the offer or sale of a security in Michigan from registration as long as the issuer is incorporated or organized under Michigan law and the transaction meets the requirements for the intrastate offering exemption under the Securities Act of 1933 and various conditions relating to the maximum amount of money that can be received from investors on an individual and aggregate basis,² and satisfies other requirements. Thus, under the MILE, a small business may raise capital by offering to sell its securities to Michigan residents.

A publicly traded security derives some of its value as an investment from the ability of investors to buy and sell it in a secondary market. A secondary market is an exchange where investors purchase assets from other investors instead of the issuing company, for example, the NASDAQ or the New York Stock Exchange. Without a secondary market to find ready and willing investors, a security can become illiquid, making it difficult to sell quickly without a substantial discount. To

¹ The pertinent U.S. law is the Securities Act of 1933 and Regulation D (17 CFR § 230.501). The definition of "accredited investor" includes various financial institutions; 501(c)(3) organizations or trusts with total assets of over \$5.0 million; directors, executive officers, or general partners of the issuer of the security; an individual with a net worth of over \$1.0 million or an annual income of over \$200,000 (or joint income of over \$300,000) for the preceding two years who expects to have at least the same level of income in the current year; and any entity in which all equity owners are accredited investors. Securities sold to accredited investors are exempt from registration under the Securities Act of 1933.

² The maximum amount that an issuer may accept under the MILE per investor is \$10,000, unless the investor is an accredited investor. The aggregate maximum amount that may be received through the MILE is \$1.0 million unless audited financial statements are given to investors and the Department of Licensing and Regulatory Affairs, in which case the maximum is \$2.0 million.

facilitate the creation of secondary markets for securities offered under the MILE, Public Act 355 of 2014 added Article 4A (Michigan Investment Markets) to the Uniform Securities Act to establish a regulatory framework for Michigan investment markets.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Legislation enacted in the last few years has created new opportunities for Michigan businesses, especially start-ups and small firms, to raise capital. Early-stage companies often lack the collateral and operating history to obtain funding from traditional sources such as banks, and they might not be the type of industry in which venture capital firms typically invest. The Michigan Invests Locally Exemption provides an alternative source of financing, by enabling businesses to receive crowdfunding from Michigan investors without meeting the requirements of the State's complex securities law. It also enables people of all financial backgrounds to invest locally. Since a lack of liquidity can be a drawback to crowdfunding, Michigan investment markets can connect buyers and sellers of securities issued by Michigan businesses. Regulated at the State level, these broker-dealers help meet the needs of local companies while giving investors an opportunity to put their money into the regional economy. According to an article in *The New York Times*, Michigan was the first state in the nation to enact a law creating a regulatory framework for intrastate securities ("A Way for Local Businesses to Grow", 10-24-2014).

The bill would further these efforts by allowing investors with Michigan advancement portfolios and Michigan investment markets to receive grants and other economic assistance from the Michigan Strategic Fund. This would help stimulate the secondary market for Michigan securities, giving investors in local companies another avenue to buy and sell those securities or others. If investors had a ready market in which to buy intrastate securities, they could invest in promising local businesses, which would enable those businesses to raise capital for additional growth.

Legislative Analyst: Jeff Mann

FISCAL IMPACT

State: The bill would result in additional costs to the Michigan Strategic Fund (MSF). The MSF would need to hire staff to process, analyze, and decide on applicants in accordance with this legislation, as well as produce the reports that would be required. There also would be additional costs from the appropriation of funds that would be used to issue grants, loans, and other economic assistance. Capping the total amount of loans, grants, and economic assistance that could be issued in a given year at \$2.0 million would limit the costs to the program and administration. Costs of the program and administrative costs could be paid either through the reduction of a program currently operated by the MSF or the appropriation of additional resources to the MSF. It is not clear what would happen to money received after loans or agreements were repaid. If the funds were returned to the State, then the Legislature could appropriate the money to this program, which would reduce its long-term ongoing expenses.

Local: The bill would affect only local economic development corporations within the State that are involved with investment markets and potentially could receive economic assistance under the bill.

Fiscal Analyst: Cory Savino

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.