

SENATE BILL REPORT

ESHB 2023

As Reported by Senate Committee On:
Financial Institutions, Housing & Insurance, February 27, 2014

Title: An act relating to allowing crowdfunding for certain small securities offerings.

Brief Description: Allowing crowdfunding for certain small securities offerings.

Sponsors: House Committee on Business & Financial Services (originally sponsored by Representatives Habib, Ryu, Zeiger and Maxwell).

Brief History: Passed House: 2/13/14, 89-9.

Committee Activity: Financial Institutions, Housing & Insurance: 2/25/14, 2/27/14 [DP].

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS, HOUSING & INSURANCE

Majority Report: Do pass.

Signed by Senators Angel, Co-Chair; Hobbs, Co-Chair; Benton, Vice Co-Chair; Mullet, Vice Co-Chair; Fain, Hatfield, Nelson and Roach.

Staff: Edward Redmond (786-7471)

Background: The Securities Act of Washington (SAW), operating as a supplement to federal law, requires registration of securities offerings and certain persons and businesses engaged in securities transactions. SAW also establishes penalties for false or misleading filings.

Certain securities offerings, transactions, and persons are exempt from registration. Examples include the following:

- offerings not made to the general public but to sophisticated investors in compliance with the private placement provision of the federal securities law;
- sales by non-issuers of the securities pursuant to unsolicited orders by the purchaser; and
- sales of whole loans secured by real estate.

The Department of Financial Institutions (DFI) is the agency responsible for regulating the purchase and sale of securities in Washington. Such responsibilities include registering securities offerings, licensing broker-dealers and investment advisers, conducting investigations, and enforcing penalties for violations under SAW.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Securities Act of 1933. The federal Securities Act of 1933 also requires registration of securities offerings. However, the federal act exempts transactions between issuers and purchasers who are residents of the same state, known as the intrastate offering exemption. The exemption is clarified by Rule 147, a safe harbor rule issued by the Securities and Exchange Commission (SEC). Under another rule, known as Regulation D, securities offerings are exempt if, among other things, the issuer files SEC Form D, which requires basic information about the company and the offering.

Jumpstart Our Business Startups (JOBS) Act. Title III of the federal JOBS Act of 2012 created an exemption from the Securities Act of 1933 for certain small securities offerings. Offerings are exempt if they meet certain criteria including (1) a set limit on the aggregate amount of securities offered by any issuer, (2) a set limit on the amount a given purchaser may invest, and (3) a requirement that the offering be made through a broker or funding portal.

Under the JOBS Act, the SEC is tasked with promulgating rules to carry out Title III. As of January 15, 2014, the SEC has issued a notice of proposed rulemaking, but formal rules have yet to be adopted.

Associate Development Organizations and Ports. Associate Development Organizations (ADOs) deliver direct assistance to companies and support research, planning, and implementation of regional and local economic development strategies. The ADO's role is broadly defined in statute to meet the needs of each community, but must include direct support to local businesses and microenterprise development services. The Department of Commerce currently contracts with 38 ADOs serving the 39 counties in Washington.

Port districts are municipal entities authorized by the Washington Constitution to foster industrial development and trade promotion. By statute, a port district may engage in economic development programs. Some port districts are designated as ADOs by counties.

Summary of Bill: Exemption Criteria. An exemption from registration under SAW is created for certain small securities offerings. An offering is exempt if:

1. the offering is first declared exempt by DFI after filing by:
 - a. the issuer; or
 - b. a portal working in collaboration with DFI on behalf of the issuer;
2. the offering is conducted in accordance with the intrastate offering exemption of the federal Securities Act of 1933 and SEC Rule 147;
3. the issuer is a Washington entity and each investor provides evidence or certification of Washington residency;
4. the issuer files an escrow agreement with DFI, either directly or through a portal, providing that proceeds will be released only when the minimum target offering, as determined by DFI, is met;
5. the aggregate purchase price of securities sold under the exemption does not exceed \$1 million during any 12-month period;
6. the aggregate amount sold to any investor by an issuer during the 12-month period preceding the date of sale does not exceed:

- a. the greater of \$2,000 or 5 percent of the investor's annual income or net worth if the investor's income or net worth is less than \$100,000; or
 - b. 10 percent of the annual income or net worth of the investor up to \$100,000 if the investor's annual income or net worth is \$100,000 or more;
7. the investor acknowledges a conspicuously presented statement regarding the risk of the investment;
 8. the issuer reasonably believes that purchasers are purchasing for investment and not for sale in connection with a distribution; and
 9. the issuer and investor provide any other information reasonably required by DFI.

If the issuer uses a portal, the issuer must also provide a quarterly report to shareholders and DFI and make the report publicly available.

Shareholders are prohibited from transferring their shares for a period of one year unless (1) the shares are transferred back to the issuer, (2) the shares are transferred to an accredited investor, (3) the transfer is part of a registered offering, or (4) the transfer is to a family member in connection with death, divorce, or other similar circumstances.

Issuers of securities exempt from registration under this act may also claim other exemptions.

Portals. Only an ADO or a port district may serve as a portal. Working in collaboration with DFI, a portal may assist a person seeking exemption from registration under this act by offering services it deems appropriate or necessary to meet the criteria for exemption, including help with business plans and referral to legal services. When the portal is satisfied that the person is ready to file, it may file the necessary materials with DFI on that person's behalf. The portal must continue to provide assistance to the issuer during the offering.

Before providing services or filing for the issuer, the portal must require the following information from the issuer:

- a description of the issuer;
- the intended use of the proceeds;
- identities of officers, directors, managing members, and owners;
- a description of outstanding securities; and
- a description of any litigation involving the issuer.

Rulemaking and PRA Exemption. DFI must:

- adopt rules for filing by October 1, 2014;
- adopt rules for establishment of a licensing fee by January 1, 2015; and
- adopt any other rules necessary to implement the act by April 1, 2015.

Financial information collected by DFI or by portals is exempt from Public Records Act disclosure requirements.

Appropriation: None.

Fiscal Note: Available.

[OFM requested ten-year cost projection pursuant to I-960.]

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony: PRO: As a startup lawyer working with entrepreneurs, I have heard that one of the significant challenges small businesses face is access to capital. There are currently two ways you can get needed capital, through a loan or funding through investors. Historically, a private company could only get investors by giving a percentage of their companies to accredited investors who were mostly millionaires. Recently, a movement called crowdfunding has been developed which allows ordinary people to participate in the growth of new businesses. Why shouldn't ordinary people be allowed to invest if we also have good consumer protection laws in place? At the same time, you have a lot of entrepreneurs that are having trouble getting access to venture capital and they are saying they want to be able to raise money from ordinary people in smaller amounts. The SEC has been slow implementing regulations for crowdfunding at the federal level, so a number of states are developing laws to do this on their own. This bill represents a year's worth of work with DFI, entrepreneurs, and other stakeholders. After the recession, there was a retraction of all the venture capital from Boston to San Francisco. As a result, the great talent we have here in Washington State ended up heading down to California with their startup ideas because they could not get venture capital funding here at home.

This bill will help entrepreneurs get access to needed capital. Every step of the way on my entrepreneurial journey, I could have benefitted from equity crowdfunding like this bill will provide. It is a struggle for startup companies to find funding here simply because of how the markets move. New forms of innovation require new forms of innovative financings. This bill will allow startups to expand and get needed equipment more rapidly, and create new jobs.

OTHER: DFI is neutral on the bill. DFI worked on the bill over the interim and believes it can implement it as drafted.

Persons Testifying: PRO: Representative Habib, prime sponsor; Representative Magendaz; Adam Lieb, Founder & CEO of Duxter, Inc.; Joe Wallin, Davis Wright Tremaine; Michael Libes, Fledge; Colin Christianson, Tenacious Ventures, Founder & CEO; Joshua Pineault, Genimbi; Warrick Chu, citizen.

OTHER: Bill Beatty, DFI.