

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 Appropriations

BILL: PCS/CS/SB 914 (706156)

INTRODUCER: Appropriations Committee (Recommended by Appropriations Subcommittee on General Government); Banking and Insurance Committee; and Senator Richter

SUBJECT: Intrastate Crowdfunding

DATE: April 20, 2015

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Johnson	Knudson	BI	Fav/CS
2.	Betta	DeLoach	AGG	Recommend: Fav/CS
3.	Betta	Kynoch	AP	Pre-meeting

Please see Section IX. for Additional Information:

COMMITTEE SUBSTITUTE - Substantial Changes

I. Summary:

PCS/CS/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 under the Florida Securities and Investor Protection Act, which is administered by the Office of Financial Regulation (OFR).

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 the 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-filings and registration forms, books and records, and investor protections.

The bill provides a total appropriation of \$120,000 from the Regulatory Trust Fund within the OFR for information technology and workload issues. Related to revenues, issuers are subject to

¹ Public Law 112-106.

a \$200 notice-filing fee and intermediaries are subject to a \$200 registration fee. The impact on state revenues is indeterminate at this time.

The bill provides an effective date of October 1, 2015.

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 and 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 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 New York Stock Exchange, the NASDAQ Stock Market, and the Chicago Board of Options, and the Financial Industry Regulatory Authority (FINRA) are forms of SROs.

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

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.

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

On April 10, 2014, the SEC issued interpretive guidance regarding section 3(a)(11) of the Securities Act of 1933 and the Internet.⁶ 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.⁷

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.

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 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).

⁷ 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).

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.⁸ 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.

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 five percent of annual income or net worth, if annual income or net worth of the investor is less than \$100,000; and ten 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.⁹

⁸ SEC Proposed Regulation Crowdfunding Section 227.400.

⁹ 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

Florida 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.¹⁰ In Florida, the Securities and Investor Protection Act, chapter 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.¹¹

The act prohibits dealers, associated persons, and issuers from offering or selling securities in this state unless registered with the OFR or specifically exempted.¹² Additionally, all securities in Florida must be registered with the OFR unless they meet one of the exemptions in ss. 517.051 or 517.061, F.S., or are federally covered (i.e., under the exclusive jurisdiction of the SEC).¹³ Failure to meet the 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.¹⁴ Civil remedies under the act include rescission and damages.¹⁵ 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). The bill provides the securities in crowdfunding transactions may be generally advertised and sold 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.

Crowdfunding Intermediaries, at <http://www.sec.gov/divisions/marketreg/tmjbsact-crowdfundingintermediariesfaq.htm> (last visited March 30, 2015).

¹⁰ U.S. Securities and Exchange Commission, *Blue Sky Laws*, <http://www.sec.gov/answers/bluesky.htm> (last visited March 30, 2015).

¹¹ 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.

¹² Section. 517.12, F.S.

¹³ 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.

¹⁴ Section 517.302(1), F.S.

¹⁵ Section 517.211(3-5), F.S.

Section 1 amends s. 571.021, F.S., to define 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 Florida, that represents an issuer in a transaction involving the offer or sale of securities under s. 517.061, F.S.

Section 2 amends s. 517.061, F.S., to provide that the offer or sale of a security by an issuer conducted in accordance with s. 517.0611, F.S., is exempt from registration.

Section 3 creates s. 517.0611, F.S., the Florida Intrastate Crowdfunding Exemption. An offer or sale of a security by an issuer is an exempt transaction under s. 517.061, F.S., if the offer or sale meets the requirements of this section. The exemption may not be used in conjunction with any other exemption under ss. 517.051 or 517.061, F.S. The offer or sale of the securities under this section must be conducted in accordance with the requirements of the federal exemption for intrastate exemptions in s. 3(a)(11) of the Securities Act of 1933, 15 U.S.C. s. 77c(a)(11), and U. S. SEC Rule 147, 17 C.F.R. s. 230.147, adopted pursuant to the Securities Act of 1933.

Issuer Requirements

The issuer, to qualify for the intrastate crowdfunding exemption, must:

- Be a for-profit business entity formed under the laws of this state and be registered with the Secretary of State.
- Conduct transactions for the offering through a dealer or intermediary registered with the OFR.
- 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).
- Not be subject to a disqualification established by the commission or the OFR, or a disqualification described in s. 517.1611 F.S. or the U.S. SEC Rule 506(d), 17 C.F.R. 230.506(d), adopted pursuant to the Securities Act of 1933.
- Not be a company with an undefined business operation, a company that lacks a business plan, or meets other conditions specified.
- Execute an escrow agreement with a financial institution. The issuer must also provide the OFR with a copy of the escrow agreement with such a financial institution. The escrow agreement must require that offering proceeds 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 disclosure statement as necessary to implement the business plan. The agreement must also provide all investors will receive a full refund of their investment commitment if that target-offering amount is not raised by the date stated in the disclosure statement.
- Allow investors to cancel a commitment to invest within three business days before the offering deadline.

The issuer must submit a notice filing with the OFR at least ten days before the issuer commences an offering or the offering is displayed on a website. The notice must indicate that the issuer is conducting an offering in reliance upon this exemption. The notice must contain the

contact information of the issuer, identify key persons who will be involved in the offer or sale of securities on behalf of the issuer, and disclose the federally insured financial institution authorized to do business in this state in which investor funds will be deposited. Further, the notice must include an attestation under oath that the issuer and other key persons are not currently and have not been within the past ten years the subject of regulatory or criminal actions involving fraud or deceit. The notice must document that the issuer is organized under the laws of Florida and authorized to do business in Florida and include the target offering amount.

The issuer must provide a disclosure statement to investors and the dealer or intermediary, along with a copy to the OFR at the time the notice is filed, and make available to potential investors through the dealer or intermediary. This disclosure would include a description of the business of and financial condition of the issuer and the anticipated business plan of the issuer, information about the offering.

The bill 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, five percent of the annual income of the investor, or five 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, ten percent of the annual income of the investor, or ten percent of the net worth of the investor.

Intermediary Requirements:

An intermediary is subject to registration requirements as provided in **section 4** of the bill. The bill:

- 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.
- Verify, pursuant to commission rule, that an investor is a resident of Florida.
- 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.

- Implement written policies and procedures that are reasonably designed to achieve compliance with federal and state securities laws; comply with anti-money laundering requirements of 31 C.F.R. ch. X applicable to registered brokers; and comply with the privacy requirements of 17 C.F.R. part 248 as they apply to brokers.

Sections 4 amends s. 517.12, F.S., by requiring an intermediary to register as a dealer or as an intermediary and pay a registration fee of \$200 to the OFR. An intermediary or persons associated with an intermediary are subject to a criminal background check. Further, an intermediary or persons associated with an intermediary may not be subject to any disqualification described in s. 517.1611, F.S., or the SEC Rule 506(d), 17 C.F.R. 230.506(d), adopted pursuant to the Securities Act of 1933.

Section 5 amends s. 517.121, F.S., to provide that an intermediary is subject to examination by the OFR and must maintain certain books and records.

Section 6 amends s. 517.161, F.S., to provide the OFR with enforcement authority to take regulatory actions against an intermediary.

Section 7 provides a technical conforming change to s. 626.9911, F.S.

Section 8 appropriates \$120,000 in nonrecurring funds from the Regulatory Trust Fund within the OFR to implement the bill.

Section 9 provides the act will take effect October 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:

PCS/CS/SB 914 creates a \$200 notice-filing fee for issuers and a \$200 registration fee for intermediaries.

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 bill provides a total appropriation of \$120,000 in nonrecurring funds from the Regulatory Trust Fund to implement the provisions of this bill. This includes an estimated \$63,150 to update the licensure system and provide additional data storage, along with \$56,850 for Other Personnel Services for temporary employees related to workload.

VI. Technical Deficiencies:

None.

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 Substantial Changes:**

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

Recommended CS/CS by Appropriations Subcommittee on General Government on April 14, 2015:

The committee substitute provides \$120,000 in nonrecurring funds from the Regulatory Trust Fund to implement the act, in addition to a technical, clarifying change.

Banking and Insurance on March 31, 2015:

The CS provides the following changes:

- Clarifies provisions to be consistent with the requirements of the federal JOBS Act and the intrastate exemption authorized under the Securities Act of 1933.
- Requires the issuer to file an irrevocable written consent to service of civil process with the OFR.
- Requires the issuer to provide a disclosure statement and a copy of the escrow agreement to the OFR that meets certain requirements.
- Clarifies intermediary registration requirements.
- Requires intermediary to maintain certain books and records as prescribed by commission rule and be subject to examination by the OFR.

- Provides technical and conforming changes.

B. Amendments:

None.

This Senate Bill Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.
