HB 1278

Department of Legislative Services

Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE

House Bill 1278 (Delegate Fisher, *et al.*)
Economic Matters

Corporations and Associations - "Crowdfunding" Laws - Restrictions and Compliance

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This bill prohibits the Securities Commissioner of the Division of Securities in the Office of the Attorney General from issuing any orders or adopting any rules, forms, or regulations regarding issuers, securities, and funding portals that are regulated under the Federal Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012 (Crowdfund Act). Any issuer, security, or funding portal that is regulated under and compliant with the Crowdfund Act is compliant with any applicable securities-related State law and regulation.

Fiscal Summary

State Effect: The bill does not directly affect State governmental operations or finances.

Local Effect: The bill does not directly affect local governmental operations or finances.

Small Business Effect: Potential meaningful.

Analysis

Current Law/Background: On April 5, 2012, President Obama signed H.R. 3606, the Jumpstarting our Business Startups (JOBS) Act, a bill that had passed through the U.S. Congress with bipartisan support. Incorporated in the JOBS Act is the Crowdfund Act. The intent behind the Crowdfund Act was to encourage the funding of small businesses through the practice of crowdfunding. Crowdfunding is a type of crowdsourcing, the principle of obtaining ideas or feedback from the general public. Crowdsourcing, also described as "open innovation," has become a popular practice in recent years, and several companies have used it to strengthen their operations. For example, Netflix, a provider of online streaming content and DVD rentals, announced in 2006 that it would give "the Netflix Prize" and $1 million to any individual or group that could improve upon its movie recommendation software. In 2009, Netflix awarded the prize to a team of researchers from AT&T. Instead of ideas or feedback, crowdfunding uses the general public to obtain investment funds.

Crowdfunding allows individuals who would normally have difficulty obtaining large amounts of capital from a smaller group of investors to access a larger group that may be willing to invest a few hundred dollars each. The idea has become immensely popular as numerous websites have formed recently to facilitate the crowdfunding of various charitable or artistic projects, such as Kickstarter.com or IndieGoGo.com. Since Kickstarter's formation in 2009, there have been almost 87,000 projects launched on its website, and donors have pledged approximately $487 million.

Under the U.S. Securities Act of 1933 and the Maryland Securities Act, the sale of securities generally triggers registration requirements. The above websites are able to circumvent federal and state securities regulations prohibiting unregistered offers to the public because they do not offer promises of return on investment. Any money paid to a project is a considered a donation. The JOBS Act's crowdfunding exemption offers a chance for a person to actually invest in a project.

While the Securities and Exchange Commission (SEC) has yet to adopt rules to establish the crowdfunding exemption, the JOBS Act did describe the following required substantive content for the rules:

- crowdfunding is not available for SEC-reporting companies, registered investment companies, specified private investment funds, or foreign companies;
- crowdfunding transactions are generally limited to proceeds totaling $1 million in any 12-month period;
- crowdfunding transactions may be effected only through the use of SEC-registered broker-dealers or funding portals;
- funding portals are prohibited from recommending particular investments or paying any person transaction-based compensation;
- per-investor limits vary depending on the net worth of the investor;
- investors do not have to be accredited investors or possess any financial or investment acumen;
- crowdfunding intermediaries (including broker-dealers and funding portals) have specified affirmative responsibilities;

- crowdfunding investors are not "counted" in determining the number of holders of record that trigger entry into the SEC's periodic reporting system for public companies;
- crowfunding issuers are required to prepare, file with the SEC, and disclose to investors specified information;
- resale of purchased crowdfunding securities is generally restricted for one year after purchase;
- issuer advertising and general solicitation is permitted but limited in specified situations; and
- crowdfunding investors are protected by several anti-fraud rules.

SEC missed its December 31, 2012 deadline to publish rules and has yet to publish any rules as of February 8, 2013.

State Fiscal Effect: The Office of the Attorney General did not submit an estimate of fiscal impact for this bill. The Department of Legislative Services advises, however, that the bill's requirements do not directly affect the operations or finances of the Division of Securities.

Small Business Effect: The bill may have potentially meaningful beneficial impact for small businesses that intend to raise capital through crowdfunding. While the Crowdfund Act's repeal of registration requirements may make it easier for small businesses to raise capital, the bill merely prohibits the Securities Commissioner of the Securities Division from issuing any orders or adopting any rules concerning any issuers, securities, and funding portals that are regulated under the Crowdfund Act.

As noted above, SEC has yet to promulgate rules. Thus, the commissioner has yet to issue any orders or adopt any rules concerning those regulated under the Crowdfund Act. To the extent that the bill prevents the commissioner from adopting any investor protection measures and placing restrictions on a small business' ability to use crowdfunding as a means to raise capital, the bill may have a meaningful beneficial impact.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): State Department of Assessments and Taxation, www.kickstarter.com, www.jdsupra.com, *Tennessee Law Review*, *University of Pennsylvania Journal of Business Law*, *Columbia Business Law Review*, *San Francisco Chronicle*, Department of Legislative Services

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