

Department of Legislative Services
Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 811

(Senator Raskin)

Judicial Proceedings

Economic Matters

Corporations and Associations - Maryland Securities Act - Registration and Filing Exemptions

This bill authorizes the Maryland Securities Commissioner to exempt specified securities issued by a Maryland business entity from security registration and filing requirements under specified circumstances. The bill establishes a \$100 filing fee for a person required to submit a filing in accordance with the crowdfunding exemption granted under the bill.

Fiscal Summary

State Effect: Minimal increase in general fund expenditures for Office of the Attorney General (OAG) to implement the bill's provisions. General fund revenues may increase by a minimal amount to the extent that the bill encourages entities to utilize the provisions of the bill. The actual impact on expenditures and revenues depends on the number of entities that utilize the provisions of the bill.

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

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: A security may be exempted from registration and filing requirements if:

- the offering of the security is conducted in accordance with § 3(a)(11) and Rule 147 adopted under the Securities Act of 1933;
- the offer and sale of the security are made only to State residents;
- the aggregate price of securities in an offering does not exceed \$100,000;

- the total consideration paid by any purchaser of securities in an offering does not exceed \$100;
- no commission or other remuneration is paid in connection with an offering of securities to any person who is not registered as required under the Maryland Securities Act;
- neither the issuer nor any of its related persons is subject to a disqualification as defined by the commissioner by rule or order; and
- the security is sold in an offering conducted in compliance with any conditions established by rule or order of the commissioner, which may include (1) restrictions on the nature of the issuer; (2) limitations on the number and manner of offerings; (3) required disclosures to investors, including risk factors related to the issuer and the offering; and (4) required filing with the commissioner of notices and other materials related to the offering.

Current Law/Background:

Maryland Law

The securities commissioner may require the filing of any prospectus, pamphlet, circular, form letter, advertisement, or other sales literature or advertising communication addressed or intended for distribution to prospective investors unless the security or transaction is exempt under State law or the security is a federal covered security.

A person may not offer or sell any security in Maryland unless the security is registered with the OAG Division of Securities, as required by State law, the security is exempt under the Maryland Securities Act, or the security is a federal covered security. Generally, a person filing an application to register securities must pay a fee of 0.1% of the maximum aggregate offering price at which the securities are to be offered in the State, but the fee may not be less than \$500 or exceed \$1,500. A person required to submit a filing in accordance with an exemption under the Maryland Securities Act is required to pay a filing fee of \$400.

Several exemptions exist from the security registration and filing requirements discussed above, including, for example, a security that is:

- issued or guaranteed by U.S. or Canadian government entities;
- issued by and representing an interest in or a debt of, or guaranteed by, specified financial institutions or insurance companies in the United States;
- issued or guaranteed by specified common carriers, public utilities, or holding companies;
- listed or approved for listing on notice of issuance on select stock exchanges; or

- issued by any person organized and operated not-for-private-profit but for select nonprofit purposes if specified conditions are met.

The commissioner, at his or her discretion, may designate by rule or order additional exemptions if compliance with the registration and filing provisions is not necessary or appropriate for the protection of investors and the exemption is consistent with the public interest and within the purposes fairly intended by the Maryland Securities Act.

Federal Law

The federal Securities Act of 1933 governs the offering of securities. This Act establishes an exception for any security which is part of an issue offered and sold only to residents within a single state, where the issuer is an entity doing business within that same state.

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 133,000 projects launched on its website, and donors have pledged approximately \$976 million. Of the 56,104 projects that successfully reached their fundraising goals, more than 74% raised less than \$10,000 and 98% raised less than \$100,000.

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 considered a donation. The JOBS Act's crowdfunding exemption offers a chance for a person to actually invest in a project.

In October 2013, the Securities Exchange Commission (SEC) proposed rules under the JOBS Act to establish the crowdfunding exemption. The public comment period for the proposed rules concluded in early February 2014. While the 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;
- crowdfunding 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.

State Fiscal Effect: General fund expenditures increase minimally as OAG advises it may take as much as one month of an assistant Attorney General's (AAG) time to fulfill its requirements under the bill initially. Moreover, OAG advises that additional AAG time may be required to handle ongoing workload generated by the bill's provisions. The Department of Legislative Services concurs.

Small Business Effect: The bill's provisions allow small businesses to raise funds without being required to fulfill security registration and filing requirements in specified circumstances. To the extent that small businesses are able to take advantage of the bill's provisions, small businesses may realize significant savings due to not having to fulfill standard security registration and filing requirements. Moreover, the bill may be especially beneficial to small businesses, to the extent that the burden of security registration and filing was so great that small businesses and individuals avoided fundraising for projects.

Additional Information

Prior Introductions: None.

Cross File: HB 1243 (Delegate Hucker) - Economic Matters.

Information Source(s): Office of the Attorney General (Securities Division), U.S. Securities Exchange Commission, U.S. Government Printing Office, Sustainable Economies Law Center, www.kickstarter.com, Department of Legislative Services

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