

# HOUSE BILL REPORT

## ESHB 2023

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### As Passed Legislature

**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:**

##### **Committee Activity:**

Business & Financial Services: 1/17/14, 1/22/14 [DPS].

##### **Floor Activity:**

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

Senate Amended.

Passed Senate: 3/7/14, 46-2.

House Concurred.

Passed House: 3/11/14, 98-0.

Passed Legislature.

#### **Brief Summary of Engrossed Substitute Bill**

- Exempts certain small securities offerings from registration under the Securities Act of Washington if first filed with and declared exempt by the Department of Financial Institutions.
- Authorizes local associate development organizations and port districts to assist those filing for exemption during filing and offering.
- Grants rulemaking authority to the Department of Financial Institutions to govern the exempted offerings.

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### HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 15 members: Representatives Kirby, Chair; Ryu, Vice Chair; Parker, Ranking Minority Member; Vick, Assistant Ranking Minority Member; Blake, Fagan, Habib, Hawkins, Hudgins, G. Hunt, Hurst, Kochmar, MacEwen, Santos and Stanford.

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*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.*

**Staff:** David Rubenstein (786-7153).

### **Background:**

The Securities Act of Washington, operating as a supplement to federal law, requires registration of securities offerings and certain persons and businesses engaged in securities transactions, and creates penalties for false or misleading filings. Certain offerings are defined as "securities" requiring registration.

Certain securities offerings, transactions, and persons are exempt from registration.

Examples include:

- offerings not made to the general public but to sophisticated investors in compliance with the "private placement" provision of 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.

Under the Securities Act of Washington, the Department of Financial Institutions (DFI) is responsible for the regulation of the purchase and sale of securities in Washington. Under the Securities Act of Washington, the DFI is tasked with protecting Washington residents from dishonest or fraudulent practices by people selling investments. To accomplish these goals, the DFI uses registration of securities offerings, licensing of broker-dealers and investment advisers, and investigations of complaints. Additionally, the DFI manages securities registration and investigation and enforcement of violations of the Securities Act of Washington.

### 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.

### JOBS Act.

Title III of the federal Jumpstart Our Business Startups Act of 2012 (JOBS Act) created an exemption from the Securities Act of 1933 for certain small securities offerings. Offerings are exempt if they meet various criteria, including a cap on the aggregate amount of securities offered by any issuer, a cap on the amount a given purchaser may invest, and 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 had issued a notice of proposed rulemaking, but formal rules had not been adopted.

### Associate Development Organizations and Ports.

Associate development organizations (ADOs) are 38 local entities that are tasked with fostering economic development in a given county. An ADO, defined as "a local economic development nonprofit corporation that is broadly representative of community interests," often called an "economic development council," is designated by a county and contracts with the Department of Commerce to be that department's primary partner in local economic development. The ADO's role is broad and is defined by statute and the needs of each community, but must include direct support to local businesses and microenterprise development services.

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 Engrossed Substitute Bill:**

#### Exemption Criteria.

An exemption from registration under the Securities Act of Washington is created for certain small securities offerings. An offering is exempt if:

- the offering is first declared exempt by the DFI after filing by:
  - the issuer; or
  - a portal working in collaboration with the DFI on behalf of the issuer;
- the offering is conducted in accordance with the intrastate offering exemption of the federal Securities Act of 1933 and SEC Rule 147;
- the issuer is a Washington entity and each investor provides evidence or certification of Washington residency;
- the issuer files an escrow agreement with the DFI, either directly or through a portal, providing that proceeds will be released only when the minimum target offering, as determined by the DFI, is met;
- the aggregate purchase price of securities sold under the exemption does not exceed \$1 million during any 12-month period;
- the aggregate amount sold to any investor by an issuer during the 12-month period preceding the date of sale does not exceed: (1) 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 (2) 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;
- the investor acknowledges a conspicuously presented statement regarding the risk of the investment;
- the issuer reasonably believes that purchasers are purchasing for investment and not for sale in connection with a distribution; and
- the issuer and investor provide any other information reasonably required by the DFI.

The issuer must also provide a quarterly report to shareholders and the DFI and make the report publicly available.

Shareholders are prohibited from transferring their shares for a period of one year, unless the shares are transferred back to the issuer, they are transferred to an accredited investor, the transfer is part of a registered offering, or 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 the 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 the 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.

The 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.

The DFI must also adopt rules for the disqualification of persons seeking to use the crowdfunding exemption. The rules must be substantially similar to rules promulgated by the SEC pursuant to the JOBS Act.

Financial information collected by the DFI or by portals is exempt from Public Records Act (PRA) disclosure.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.

#### **Staff Summary of Public Testimony:**

(In support) The aim is to create a state crowdfunding product while on the federal level, crowdfunding rules are slow to come and likely burdensome. Other states have created crowdfunding products that are more accessible and less burdensome. This will allow small companies to get a small amount of money not generally available from venture capitalists, angel investors, or accredited investors (worth \$1 million or more), which are rare and difficult to access. This bill will also protect consumers by allowing offerings only through the portal or the DFI. Some may lose money, but that is always a risk of investing.

Crowdfunding is a rapidly developing concept that allows companies to adapt to rapidly developing environments. If Washington wants to create an incubator for high tech, it needs to give it as many tools as possible to get off the ground. Local funding is important for locally oriented business. Smart young people in the Seattle area need to be able to find funding in the early stage. Otherwise, Washington risks losing business and talent to California.

This bill will benefit individuals and companies that are socially and environmentally conscious because there are no venture capital groups focusing on that issue. This bill will take the place of non-equity crowdfunding companies on the Internet.

(Neutral) The DFI is neutral on this bill, but the prime sponsor has been accommodating to the DFI's concerns and the DFI is pleased with the agreement. The DFI is confident it can get rule-making done in time to meet the deadlines this bill sets.

(Opposed) None.

**Persons Testifying:** (In support) Representative Habib, prime sponsor; Joe Wallin, Davis Wright Tremaine; Adam Lieb, Dexter; Michael Libes, Fledge; and Carrie Ferrence, Stockbox Neighborhood Grocery.

(Neutral) Bill Beatty, Department of Financial Institutions.

**Persons Signed In To Testify But Not Testifying:** None.