



Commissioner Russell C. Weigel, III

## **STIMULATING THE FORMATION OF A CAPITAL FUNDING ECO-SYSTEM**

### **Description of Reform Measures**

This bill represents the first set of major changes to Florida's securities laws in many years. It:

1. Improves the capacity of Florida-based companies to raise money in Florida by amending the crowdfunding statute, adding the Accredited Investor exemption, allowing for pre-offering testing of potential investor interest, and revising onerous integration provisions,
2. Adds investor protection measures through the Finder registration provisions and increased enforcement powers,
3. Allows Florida to coordinate its review process of registered offerings with those of other states, and
4. Clarifies and improves numerous provisions that are outdated or incomplete.

### **(A) Registration Exemptions**

#### **1. Reform of the Crowdfunding Exemption (s. 517.0611)**

The principal reform elements to the crowdfunding exemption are:

- (1) **Expands companies eligible to use the crowdfunding exemption.** Businesses headquartered in Florida but incorporated or organized in another state can raise capital under this exemption if they conduct an offering in compliance with SEC Rule 147A.
- (2) **Increases the amount a company can raise** under the exemption within a 12-month period from \$1 million to \$5 million. The SEC recently amended its crowdfunding exemption to allow for a \$5 million maximum amount.
- (3) **Sets a flat \$10,000 maximum that a non-accredited investor can invest in** crowdfunding offerings in a 12-month period. For accredited investors, there is no investment limitation in the current statute or the proposed bill.
- (4) **Eliminates the requirement that the offering be administered by a dealer or an intermediary.** The issuer may choose to use an intermediary or dealer or conduct the offering itself, provided that all communications limit the target audience to residents of the state. If the issuer chooses to conduct the offering on its own, the issuer is obligated to perform the duties that would otherwise be performed by an intermediary.
- (5) **Allows the escrow of offering proceeds to be handled by a third-party agent.** The OFR proposal allows the issuer to use a third-party escrow agent, provided that the funds

are placed in a federally insured account. This enables an issuer who may not have a banking relationship to place offering proceeds through an agent, such as a law firm or title company, who will have a banking relationship. If the target amount is not reached within a pre-determined, disclosed time period, the issuer is obligated to return all funds to the investors.

- (6) **“Testing the Waters.”** The proposed bill allows issuers to “test the waters” by engaging in pre-offering oral or written communications with prospective investors to determine whether there is any interest in a contemplated securities offering. The ability to determine in advance the likelihood of investor reaction to a contemplated offering can save a company from the considerable time and expense of an unsuccessful offering.
- (7) **Eliminates required annual reports to investors.** The OFR proposal eliminates this requirement. Both the corporation and limited liability company statutes allow for inspection of financial statements and other records by shareholders or members.
- (8) **Three-day voidability provision:** This provision would allow an investor to rescind the transaction within the latter of 3 days after (i) purchase or (ii) being advised of the right to rescind, similar to the current 3-day provision required for the limited offering exemption.
- (9) **Financial statement disclosures.** Because of the change in maximum offering amounts, the financial disclosure obligations have been revised for differing offering amounts and clarified as to the required types of financial statements.

## **2. Adoption of an Accredited Investor Exemption (s. 517.061(23))**

The proposed bill adopts the Accredited Investor exemption developed by the North American Securities Administrators Association. It is limited to accredited investors residing in the state. Many companies raise capital through SEC Rule 506(b), the federal private offering exemption that preempts state law and prohibits any form of general advertising or solicitation. This can hinder a small company’s capacity to find accredited investors. By allowing general solicitation and advertising, the state accredited investor exemption is similar to SEC Rule 506(c), which also allows for general advertising and solicitation, but the proposed state rule uses the less onerous reasonable-belief-of-accredited-status standard found in Rule 506(b). The Accredited Investor exemption may therefore prove very useful for local companies who need to engage in some general advertising or solicitation in order to attract potential investors.

Adoption of the Accredited Investor exemption also allows both Florida and out-of-state issuers that wish to take advantage of the SEC Rule 504 federal exemption to offer securities to Florida residents under the Accredited Investor exemption without the need to register the offering in Florida.

## **3. Amendments to the Limited Offering Exemption (s. 517.061(11))**

The proposed bill makes two major changes to the exemption set forth in Ch. 517.061(11), Florida’s limited offering exemption:

- (1) **Integration:** The provisions relating to the integration of the offering with other offerings have been eliminated. Instead, the bill provides that the Commission will adopt by rule

new provisions that are in substantial compliance with recently adopted SEC Rule 152. Rule 152 significantly reduces the threat to companies, especially smaller ones that have continuing and sporadic needs for capital, that multiple offerings will be integrated as one, with the result that otherwise distinct valid exempt offerings will be deemed in violation of the registration provisions.

- (2) **Limited “Demo Day” Solicitation:** Although the limited offering exemption prohibits “any form of general solicitation or general advertising in this state,” the proposed bill allows for issuers to participate in “demo day” presentations in accordance with the provisions of recently adopted SEC Rule 148. The presentations can only be at meetings sponsored by certain limited organizations, such as universities, state or local instrumentalities, business incubators, or defined angel investor groups, must involve more than one issuer, issuer communications are strictly limited, and there can be no investment recommendations, advice, negotiations or commitments. The ability to engage in this limited form of public disclosure is important for smaller companies and start-ups trying to attract potential investors.

## **(B) Registration of Securities Transactions**

These proposals apply to offerings that are registered in Florida, including federally registered offerings and offerings that are only state registered (such as registered intrastate offerings).

### **1. Coordination with Other States (s. 517.081(1))**

Federally registered offerings are also registered in every state where an offering will be made, and each state has authority to review the offering under its substantive standards. NASAA administers a state coordination program, which Florida would join. The bill allows the OFR to adopt rules for the cooperation and coordination with other states in the review process of federally registered offerings. It is important for the issuer, and for each state, that there be some coordination among states to avoid duplication, costs, and timing concerns. The proposal does not impact Florida’s ability to impose its own standards of review on the offering.

### **2. Elimination of the “fair, just and equitable” merit review standard (s. 517.081(7))**

The bill eliminates the “fair, just, and equitable” standard as part of the review process for registered offerings. Florida is among a minority of states that continues to have this ambiguous standard embodied in its statute. The “fair, just and equitable” has long been considered too vague to be a workable standard. Consistent with other states, the bill retains the ability of the OFR to deny registration to offerings that fail to meet state-mandated disclosure standards or that the OFR believes may be fraudulent or tend to work a fraud on investors.

### **3. “Testing the Waters” and “Demo Day” Communications (ss. 517.081(11)-(12))**

Consistent with recent SEC rules, the proposed bill allows issuers to “test the waters” as described above in Item A.1(6).

The communication can also be made at a “demo day” presentation as described above in Item A.3(2) regarding the limited offering exemption.

Both the “testing the waters” and “demo day” communications are deemed to be an “offering” and are therefore subject to the anti-fraud, civil and criminal penalty provisions set forth in Ch. 517.

### **(C) Registration of Finders (s. 517.12(20))**

The proposed bill requires the registration of certain defined “Finders” who are compensated by issuers to introduce or refer potential investors to issuers who the Finders reasonably believe to be accredited investors. Finders typically are viewed by OFR as being unregistered dealers. Nevertheless, because they assist the issuer in finding investors and are compensated by issuers for doing so, the proposed bill adopts registration and disclosure requirements as investor protection measures. The SEC has also set forth proposals for Finder regulation. Those proposals have not yet been adopted. If adopted, Florida will be a leader among states in requiring the registration of Finders.

### **(D) Notice Filings (s. 517.083)**

So-called “federal covered securities” listed in Section 18(b) of the 1933 Securities Act are exempt from state registration. The offerings are not, however, exempt from state filing and anti-fraud laws. The proposed bill requires that notifications and prescribed documents be filed with the OFR for certain offerings of federal covered securities, including the issuer’s consent to service of process. The OFR is given authority to suspend the sale of such securities if there is a failure to comply with the filing and notification requirements.

### **(E) Enforcement Provisions**

#### **1. Control Person Liability (517.191(4))**

The bill authorizes to the OFR to bring enforcement actions against control persons for violations by controlled persons unless the control person acted in good faith and did not directly or indirectly induce the acts that violated the statute.

#### **2. Aiding and Abetting Liability (517.191(4))**

The bill authorizes the OFR to bring enforcement actions against any person who knowingly or recklessly provides substantial assistance to another person in violation of the statute.

#### **3. Recovery of Attorney’s Fees (517.191(5))**

The bill allows the OFR to recover costs and attorney fees related to the investigation or enforcement of the statute.

### **(F) Definition Amendments (s. 517.021) and Miscellaneous Additional Changes**

The proposed bill adds several new terms to the definitions section and clarifies existing definitions.

The proposed bill contains numerous other changes to Ch. 517 that are less substantial but also salutary. Among such changes are:

1. Reduction from 15 to 6 in the number of clients a person can have without having to register as an investment adviser. This conforms to the National Securities Markets Improvement Act.
2. Elimination of “issuer” from the definition of “dealer,” an unusual and unnecessary licensing requirement.
3. Inclusion of references to limited liability companies and managers in various registration and disclosure provisions.
4. Elimination of the exemption for limited partnerships from the requirement that registered offerings be priced higher than \$5 per share.