DAVID CRAIG

STATE REPRESENTATIVE

Assembly Committee on Financial Institutions
Public Hearing, September 26, 2013
Assembly Bill 350 Testimony

Dear Members of the Committee,

Thank you for taking the time to hear testimony on this legislation, AB-350, known as the *CASE for Jobs Act*.

Wisconsin's CASE for Jobs Act is a jobs bill that aims to reform Wisconsin's securities laws to expand and allow our state's job creators to harness the power of the free market by connecting Wisconsin businesses with Wisconsin investors. This bill will add Wisconsin to a very small group of states on the cutting edge of opening up the flow of small business capital.

As you may know, many small businesses are started through small local capital offerings. These offerings, frequently for only tens of thousands or hundreds of thousands of dollars, are often the startup cash that small businesses need to make purchases such as restaurant ovens, tools for a diesel repair center, the weight equipment for a fitness club, or excavation equipment for a new landscaping business. However, Wisconsin currently requires registration before a business can raise capital through the sale of securities, which can cost upwards of $30,000 in fees and related costs before a single dollar is raised, except in cases which qualify for an exemption to the registration process. The *CASE for Jobs Act* creates additional exemptions and expands existing exemptions to registration so our state's job creators can have access to the capital they need to create good paying jobs right here in our state.

One major provision of this bill creates so-called "crowdfunding" exemptions. While crowdfunding websites like Kickstarter are not new, these websites are limited to offering a t-shirt, a product, or a bumper sticker for an investment into a business. The *CASE for Jobs Act* takes that model to the next step. Seeking input from small business people right here in Wisconsin, professionals who work under our current outdated system and similar ideas in other states - we came up with legislation that will create jobs and open up access to capital for Wisconsin's small businesses. The *CASE for Jobs Act* creates this crowdfunding exemption by allowing investors - with reasonable limits on investment amounts - to obtain an investment stake in a business and benefit from the success of the business without requiring small businesses to go through the complicated and expensive registration process.

In addition to creating crowdfunding in Wisconsin, the *CASE for Jobs Act* alters and creates several additional exemptions including: a definition of accredited investors known in our bill as a certified investor, a slightly altered definition of institutional investors, a new Wisconsin only maximum offerees exemption, a new Wisconsin only limited security holders exemption, and a change to remove duplicative financial statement filings for bank holding companies. Additional information on the various exemptions impacted or created in this bill can be found on the attached Legislative Council memo describing AB-350 and its substitute amendment.

This bill makes simple changes to free up Wisconsin's private investment capital for our state's job creators. With over 50% of Wisconsin jobs coming from small businesses, this bill makes it easier for job creators to raise capital while ensuring the integrity of the free market remains strong.

Thank you for your time. I would be happy to answer any questions you may have.

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WISCONSIN LEGISLATIVE COUNCIL

Terry C. Anderson, Director
Laura D. Rose, Deputy Director

TO: REPRESENTATIVE DAVE CRAIG

FROM: Scott Grosz, Senior Staff Attorney

RE: 2013 Assembly Bill 350, Relating to Exemptions From Wisconsin Securities Registration Requirements, and Assembly Substitute Amendment 1 to Assembly Bill 350

DATE: September 24, 2013

This memorandum provides a brief overview of Wisconsin securities law and a description of 2013 Assembly Bill 350, relating to exemptions from Wisconsin securities registration requirements, as well as a comparison of Assembly Bill 350 to Assembly Substitute Amendment 1 to Assembly Bill 350.

OVERVIEW OF WISCONSIN SECURITIES LAW

Compliance with Wisconsin and federal securities law is an important consideration when a business entity undertakes a decision to pursue various options for capital funding. Broadly defined, the term "security" includes a wide variety of investments, including stocks, bonds, limited partnership interests, and notes. Generally, an entity that intends to offer and sell securities must comply with Wisconsin securities law, either by registering the offering of securities with the Department of Financial Institutions (DFI) or by qualifying for an exemption from the registration requirement under state law. Similar registration or exemption requirements may apply under federal securities law, administered by the Securities and Exchange Commission (SEC). Generally, state securities registration is accomplished through the compilation and filing of materials with DFI in order to provide full disclosure of information relating to the securities offering and the issuing entity.

As an alternative to registration, an entity that intends to offer or sell securities may qualify for statutory exemptions from the registration requirement. Current Wisconsin law contains numerous exemptions from securities registration, based on a variety of qualifications relating to the type of security, the characteristics of the offer or issuance, and the characteristics of the buyer of the security. For example, certain federally registered securities are exempt from state registration as "covered securities." Additionally, sales of securities to

certain buyers (e.g., accredited and institutional investors, discussed below) may qualify for exemption. The sales of securities may also qualify for exemption based on the total number of buyers or the total number of offers within a certain period of time.

While statutory exemptions apply to the registration requirements, certain filing and notice requirements, based on each particular exemption, may still apply to the offer and sale of exempt securities. Additionally, regardless of registration or exemption, all securities sales are subject to anti-fraud provisions of state law, which require truthfulness and disclosure of material facts to potential investors.

EXEMPTION FOR SALES TO ACCREDITED AND INSTITUTIONAL INVESTORS

Current law

As noted above, the offer or sale of securities may be exempt from registration if the securities are offered or sold to accredited or institutional investors. Current law defines "accredited investors" to include:

- Banks and financial institutions.
- Federally registered broker-dealers.
- Insurance and investment companies.
- Private business development companies.
- Persons holding certain positions with the issuer.
- Certain trusts with assets of more than $5,000,000,000.
- Individuals who meet an individual income threshold of $200,000 or a joint income threshold of $300,000 annually in each of the two most recent years.
- Individuals who meet an individual or joint net worth threshold of $1,000,000, after excluding the individual's primary residence and any associated debt secured by the residence.

Current law defines "institutional investors" in similar fashion, including the following investors:

- Banks and financial institutions.
- Federally registered broker-dealers.
- Insurance and investment companies.
- Certain private business development companies.
- Certain qualified institutional investors, defined by federal law.

- Other entities of an institutional character with assets of more than $10,000,000.

Assembly Bill 350

With regard to the definition of "accredited investor" as it applies to individuals, Assembly Bill 350 lowers the individual income threshold to $100,000 and the joint income threshold to $150,000. The draft also modifies the net worth threshold to $750,000, including consideration of the individual's primary residence as an asset and any debt associated with the residence as a liability.

With regard to institutional investors, Assembly Bill 350 lowers the asset threshold for entities of an institutional character to $2,500,000.

Assembly Substitute Amendment 1

Assembly Substitute Amendment 1 does not modify the definition of "accredited investor." Instead, the substitute amendment creates a new class of investor titled, "certified investor." Under the substitute amendment, a certified investor is defined as an individual who is a resident of Wisconsin and satisfies one of the following tests:

- The individual has an individual net worth, or joint net worth with his or her spouse of $750,000, including the individual's primary residence as an asset and any debt associated with the residence as a liability.
- The individual has individual income in excess of $100,000, or joint income in excess of $150,000, in each of the two most recent years and has a reasonable expectation of reaching the same income level in the current year.

The substitute amendment creates a new securities exemption for sales of securities to a certified investor, or a person whom the issuer reasonably believes is a certified investor at the time of the sale or offer, if the transaction meets the requirements of the federal exemption for intrastate offerings.

Additionally, the substitute amendment lowers the asset threshold for entities of an institutional character to $2,500,000, in the same manner as Assembly Bill 350.

EXEMPTION FOR LIMITED OFFEREES

Current Law

Under current law, securities transactions may be exempt from registration if the transactions are completed pursuant to an offer directed to not more than 25 persons in the state, not including accredited and institutional investors, during a 12-month period, if no general solicitations or advertisements are made. [s. 551.202 (14), Stats.]

Assembly Bill 350

The bill modifies this exemption to allow offers to be directed to not more than 50 persons, maintaining the other requirements for the exemption under current law.

Assembly Substitute Amendment 1

Assembly Substitute Amendment 1 does not modify the exemption for limited offerees under current law. Instead, the substitute amendment creates a new, similar exemption for transactions that are completed pursuant to an offer directed to ***not more than 100 Wisconsin residents***, excluding institutional, accredited, and certified investors.

In order to qualify for the exemption, the issuer must be a business entity organized under Wisconsin law and authorized to do business in the state, and must have its principal office in the state and a majority of its full-time employees must work in the state. No commissions may be paid in connection with the offer or sale of securities unless the person receiving the commission is registered as a broker-dealer or agent under ch. 551, Stats. Additionally, no general solicitation or general advertising may be made in connection with the offer or sale of securities unless permitted by DFI.

EXEMPTION FOR LIMITED SECURITY HOLDERS OF SMALL WISCONSIN ISSUERS

Current Law

Under current law, securities transactions are exempt from registration if the issuer has its principal office in Wisconsin and if, after the sales of securities are completed, the number of persons holding the issuer's securities does not exceed 25, excluding accredited and institutional investors. Also, under this exemption, the sale of securities may not be advertised unless such advertisements are approved by DFI. [s. 551.202 (24), Stats.]

Assembly Bill 350

Assembly Bill 350 modifies this exemption to allow sales of securities to be exempt if, after the sales of securities are completed, the number of persons holding the issuer's securities does not exceed 50, excluding accredited and institutional investors.

Assembly Substitute Amendment 1

Assembly Substitute Amendment 1 does not modify the exemption for limited security holders of small Wisconsin issuers under current law. Instead, the substitute amendment creates a new, similar exemption for sales of securities by an issuer to a ***Wisconsin resident***, if certain conditions apply, including the following:

- The issuer must be a business entity organized under Wisconsin law and authorized to do business in the state, and must have its principal office in the state and a majority of its full-time employees must work in the state.

- The aggregate number of persons holding the issuer's securities after the sales are completed does not exceed 100, excluding institutional, accredited, and certified investors.
- No commissions are paid for soliciting any person in connection with the offer to sell, except to broker-dealers and agents licensed by the state.
- No advertising is published in connection with the offer to sell unless permitted by DFI.

CROWD-FUNDING EXEMPTIONS

Assembly Bill 350

Assembly Bill 350 creates two new, related exemptions to securities registration requirements. Each exemption relates to the concept of "crowd-funding," a type of capital funding under which relatively small amounts of capital are raised through sales of small amounts of securities to a large number of purchasers.

Under the first exemption created by the draft, the offer or sale of securities is exempt from registration if the following requirements are satisfied:

- The issuer is a business entity organized under Wisconsin law and authorized to do business in the state.
- The transaction meets SEC requirements for intrastate securities offerings.
- Generally, the amount of money received for sales of securities does not exceed $1,000,000, or $2,000,000, if the issuer has made a financial audit available. Calculation of the sale amounts excludes sales to accredited and institutional investors. DFI may adjust these sale amounts for inflation.
- The issuer does not accept more than $5,000 from any single purchaser who is not an accredited investor.
- The offering is made exclusively through an internet site registered with DFI.
- The issuer pays a $50 fee and files notice and information relating to the offering with DFI at least 10 days before commencing the offering.
- The issuer is not an investment company or an SEC reporting company.
- The issuer provides disclosure to all prospective purchasers of the unregistered nature of the securities.
- The issuer obtains evidence from each purchaser that he or she is a resident of Wisconsin.

- All payments for purchase of securities are held, pursuant to escrow agreement, by the issuer in a financial institution chartered in Wisconsin.
- Disclosure statements provided to DFI are also provided to each prospective investor at the time of offer.
- The issuer has not made an offer or sale of other securities pursuant to this exemption or the exemption discussed below in the previous 12 months.

Following sales of securities pursuant to the exemption, the issuer must file a quarterly report with DFI, and make the report available to investors, for as long as securities issued under the exemption are outstanding.

Additionally, the internet sites used to facilitate the above transactions must be registered with DFI. An internet site and its operator may be subject to registration as broker-dealers unless the internet site and operator meet certain criteria.

The second exemption created by Assembly Bill 350 permits securities to be offered and sold without registration if similar criteria to the above exemption are satisfied; this exemption applies to more traditional manners of sale rather than the internet-based offering contemplated by the first exemption. In particular, the offer or sale of securities is exempt from registration under the second exemption created by the draft if the following requirements are satisfied:

- The issuer is a business entity organized under Wisconsin law and authorized to do business in the state.
- The transaction meets SEC requirements for intrastate securities offerings.
- Generally, the amount of money received for sales of securities does not exceed $1,000,000, or $2,000,000, if the issuer has made a financial audit available. Calculation of the sale amounts excludes sales to accredited and institutional investors. DFI may adjust these sales amounts for inflation.
- The issuer does not accept more than $5,000 from any single purchaser who is not an accredited investor.
- No commission is paid for any person's participation in the offer or sale of securities unless the person is registered as a broker-dealer or securities agent.
- No general solicitation or advertising is made for the securities, unless approved by DFI.
- All payments for purchase of securities are deposited by the issuer in a financial institution chartered in Wisconsin and used in accordance with representations made to investors.

- The issuer pays a $50 fee and files notice and information relating to the offering with DFI prior to the 100th sale of securities.
- The issuer is not an investment company or an SEC reporting company.
- The issuer provides disclosure to all prospective purchasers of the unregistered nature of the securities.
- The issuer has not made an offer or sale of other securities pursuant to this exemption or the exemption discussed above in the previous 12 months.

Assembly Substitute Amendment 1

Assembly Substitute Amendment 1 would create the crowd-funding exemptions described above in substantially similar form as proposed by Assembly Bill 350. Notable differences regarding the exemptions as created in the substitute amendment include:

- Recognition of exclusions for sales to certified investors in similar fashion to the exclusions for sales to accredited and institutional investors, described above.
- Disclosure of additional information relating to price per share, unit, or interest of the securities being offered, restrictions on transfer of securities being offered, and anticipated future issuance of securities that might dilute the value of the securities being offered.
- Revision to the acknowledgment of the purchaser to recognize that investment losses may exceed the total investment under some circumstances.
- For the second exemption described above, revision to certain DFI notice requirements to require notice to DFI before the 101st offer of securities rather than prior to the 100th sale of securities.

For purposes of the Internet-based, crowd-funding exemption, the substitute amendment also includes provisions relating registration of the Internet site operators as broker-dealers and the potential classification of Internet site operators as funding portals under future rules adopted by the Securities and Exchange Commission.

FINANCIAL INSTITUTION HOLDING COMPANIES

Assembly Substitute Amendment 1

Assembly Substitute Amendment 1 specifies certain disclosure requirements applicable to financial institution holding companies. Generally, under the substitute amendment, a financial institution holding company may not be required to prepare or distribute financial statements, information, or reports to its shareholders or to DFI, except the report to shareholders required by s. 180.1620, Stats., and the report to DFI required by s. 180.1622, Stats. Except as required by s. 180.1620, Stats., financial statements required of a financial institution

holding company are not required to be prepared in accordance with generally accepted accounting principles and are not required to be examined, reported upon, reviewed, or compiled by a certified public accountant.

If you have any questions, please feel free to contact me directly at the Legislative Council staff offices.

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REPRESENTATIVE
CHAD WEININGER

September 26, 2013

Testimony of Representative Chad Weininger on Assembly Bill (AB) 350

To: Chairman Craig and the Members of the Assembly Committee on Financial Institutions

Mr. Chairman, thank you for holding a public hearing on AB 350, Wisconsin's CASE for Jobs Act. I would also like to thank the members of the Committee on Financial Institutions for being here today, and for their thoughtful consideration of this bill.

I defer to the bill's main author, Representative David Craig, on the substantive details and components of the legislation, and my testimony will speak to the positive gains Wisconsin will see should we pass this legislation. Simply put, this proposal aims to add Wisconsin to a small group of states on the cutting edge of providing better access to small business capital. AB 350 works to reform Wisconsin's securities laws and allow for crowdfunding in our state as a means of connecting Wisconsin-based investors with Wisconsin-based start-ups and businesses.

AB 350 is commonsense legislation that focuses on jobs by allowing our state's small businesses to be unshackled from New Deal era ideas and uses 21st century technology to offer stock in their business as a way to gain capital and investment dollars. People are more likely to invest in a business they know and trust than one they've never heard of, and this legislation will allow Wisconsin dollars to stay in Wisconsin – not Wall Street.

This proposal is going to create jobs in our state by allowing more of Wisconsin's small businesses to attract investment dollars, and the state won't pay a dime. AB 350 will allow us to keep Wisconsin dollars in our local economies, and what better place than to invest in our friends, neighbors, and our Main Streets.

Again, I would like to thank the Chairman and the Committee for their time and consideration of AB 350.

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State of Wisconsin
Department of Financial Institutions

Scott Walker, **Governor** Peter Bildsten, **Secretary**

September 26, 2013

Testimony on AB 350 to the Assembly Committee on Financial Institutions and Rural Issues

Good morning Chairman Craig and members of the committee. My name is Georgia Maxwell, Assistant Deputy Secretary of the Department of Financial Institutions. It is my pleasure to testify today about Assembly Bill 350, a proposal relating to exemptions from securities registration requirements. DFI is grateful for opportunity to weigh in and express our thoughts regarding AB 350.

For more than 30 years, DFI has worked with small Wisconsin businesses to help them navigate the Wisconsin Uniform Securities Law. The bill which you are considering would continue DFI's tradition of adopting new exemptions from registration to allow businesses to sell investment securities to Wisconsin investors where they observe appropriate investor protections. The registration exemptions in this bill are limited to emerging or growing Wisconsin businesses, so that an issuer with its principal office and a majority of its full-time employees in Wisconsin typically will not be required to register securities before offering and selling them to investors in our state.

Some highlights regarding AB 350:

- This bill will help small businesses raise much-needed capital in order to expand and create jobs here in Wisconsin.
- This bill will allow our state's investors and small businesses to harness the power of the Internet for investment purposes.
- This bill would put Wisconsin in select company with a small number of other states that have already made changes to their securities laws to enable small businesses to tap into new sources of capital.

In closing, AB 350 will allow for the utilization of modern technology (i.e. the Internet) by businesses seeking to connect with responsible investors. This pro-job creation measure dovetails with the efforts of Governor Walker and his Administration to assist the private sector in its efforts to create more jobs in Wisconsin.

Thank you for the opportunity to address the committee on this piece of legislation. Accompanying me today is Patricia Struck, Administration of DFI's Division of Securities. We would be happy to field any questions from committee members.

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Testimony of the Wisconsin Bankers Association
Jay Risch, Director of Government Relations, WBA
Kirsten Spira, Boardman & Clark, LLP

Assembly Committee on Financial Institutions
Assembly Bill 350

September 26, 2013

Chairman Craig and Members of the Committee:

Thank you for the opportunity to testify in support of Assembly Bill 350.

My name is Jay Risch, Director of Government Relations for the Wisconsin Bankers Association, the state's largest financial industry trade association. With me is Kirsten Spira of the Boardman & Clark Law Firm. We represent nearly 280 commercial banks and savings institutions, their nearly 2,300 branch offices and 28,000 employees.

AB 350 is good for Wisconsin banks, their customers and Wisconsin's investment climate alike.

ANOTHER AVENUE FOR BUSINESSES TO RAISE STARTUP CAPITAL

At the February 13 meeting of this committee, WBA Board member Joe Fazio, Chairman & CEO of Commerce State Bank, quoted the old Bob Hope line, "a bank is a place that will lend you money if you can prove that you don't need it."

The reality is financial institutions need you to prove you *have the capability to repay the loan*, not that you don't need it. Add to this the generally accepted industry metric that says a financial institution's bad lending decisions should average less than 1% of all loans made.

While banks are lending to small businesses every day, there are times when a prospective customer's business plan is just not a credit risk a bank can take. Companies at their early stages often do not yet have a revenue stream, a proven track record, or assets that can secure bank financing. AB 350 would provide these budding entrepreneurs with another avenue to raise capital at a critical time in their development, which could help them survive, grow, and eventually qualify for more traditional bank financing at a later date.

ELIMINATING A NEEDLESS BARRIER TO A REGISTERED OFFERING

AB 350 will also help banks increase their lending capabilities by making it easier for bank holding companies to raise capital in Wisconsin, without creating additional risk for investors. Under current Wisconsin law, securities issued by banks are exempt from some expensive registration demands because banks are *already* subject to very strict and public financial reporting requirements. While keeping the registration requirement, the substitute amendment would drop the expensive and redundant registration audit and ongoing annual audit requirements, which currently discourage bank holding companies from conducting these registered offerings. This bill is limited to offerings made in Wisconsin, and does not change Federal registration requirements if a bank holding company offers securities to non-Wisconsin residents. It also does not change securities disclosure requirements.

Regulators are increasingly insisting banks raise their capital ratios to ensure banks have an adequate "cushion" for sustaining potential losses should some of the banks' loans not get repaid. AB 350 will open the flow of capital to banks at a time when they need it, which will help banks make loans and extend credit to their customers, without creating additional risk for investors.

WHY BANK HOLDING COMPANIES ARE DIFFERENT

AB 350 removes the requirement for bank holding companies to have their financial statements audited in connection with a registered securities offering, and the ongoing annual audit requirement once an offering has been registered. This bill better balances the ability of banking organizations to raise capital with the protection of investors than the current law. The audit requirement is unnecessary for bank holding companies because existing protections already take care of investors.

Unlike other companies, banks are subject to extensive regulation of all aspects of their business operations under Federal and State law. Areas subject to regulation include capital requirements, reserves against loss, investments, loans, mergers, payment of dividends, establishment of branches, and all other aspects of banking operations. They are regularly examined by Federal and State regulators for regulatory compliance and for the overall safety and soundness of the organization.

On a quarterly and annual basis, banks must prepare and file detailed financial statements and schedules with the regulators. These are prepared according to regulatory accounting principles, which are very similar to GAAP accounting. Current and historic financial statements are easily accessible and available for free from the regulatory websites.

Generally, if a company wants to issue securities, the company needs to register the offering with the SEC (what we know as an IPO), and with the securities regulators of each state in which it makes an offer of securities, or qualify for an exemption from registration. The oversight of banks is so extensive that, starting with the Securities Act of 1933, the law has provided banks with a blanket exemption from the registration requirements of the securities laws.

Bank holding companies are the parent companies of banks. In Wisconsin, very few banks do not have a holding company. Bank holding companies deal with two layers of regulation - the regulation of their bank subsidiaries, and separate regulation of the holding company itself by the Federal Reserve. Federal laws and regulations limit the activities in which a bank holding company may engage. Bank holding companies are also examined, and face restrictions on debt, stock redemptions, mergers and acquisitions, dividends, and who is allowed to be a controlling shareholder of the organization. These regulations are intended to make sure the holding company serves as a "source of strength" for the underlying bank subsidiary.

Bank holding companies have their own financial reporting requirements - twice a year, for smaller organizations, and quarterly for larger ones. These are also easily available and free through the regulatory websites.

Banks and their holding companies are very different than most other types of companies. Not only do they have regular financial reporting requirements, their business decisions and operations are tightly controlled and examined to help ensure the long term integrity of the organization. This level of oversight and disclosure clearly benefits the shareholders of these organizations.

As Jay said, AB 350 does not remove the requirement for bank holding companies to register securities offerings in Wisconsin or qualify for an exemption. It simply removes what we believe is an unnecessary barrier to bank holding companies using registration to raise capital within the state.

HOW AB 350 HELPS BANKS RAISE CAPITAL & INCREASE LENDING

Registration in Wisconsin involves filing the offering materials and an application with DFI. DFI reviews the filing, makes comments, and eventually approves the offering for use in the State. Once that happens, a company is free to offer its securities to unlimited numbers of Wisconsin residents with the approved offering materials. This provides a huge potential pool of investment in the State. In addition, a company is not limited in the amount of funds it can raise in a registered offering.

By contrast, if a company relies on an exemption from registration, it will be limited in the total number of residents to whom it can offer securities, or to individuals who have a certain net worth or annual income, or the total amount it is allowed to raise is capped by law. Exemptions are useful if the company can raise the money it needs from the more limited pool of investors. Often, particularly in the current economic environment, the investor limitations as a practical matter limit the amount of funds that can be raised. Unfortunately, because a company cannot "pre-sell" its securities until it has complied with the securities requirements, it often does not know that the pool of investors under an exemption is not sufficient until after it has done all the work and major expense of structuring and putting together its offering.

Currently, to conduct a registered offering in Wisconsin, a company is required to include three years of audited financial statements as part of the offering materials. This is very expensive – roughly $35,000 - $40,000. In addition, as long as the company has at least 100 shareholders, it must have its financial statements audited each year and file them with DFI, which costs in the range of $25,000 - $30,000. In addition, the current law requires the financial statements of registered companies to be prepared in accordance with GAAP. As stated previously, banks and their holding companies are required to follow regulatory accounting principles, which are similar to GAAP, but are not always the same.

Most privately held bank holding companies and banks (which constitute virtually all the banking organizations in Wisconsin) do not have their financial statements audited. While an audit may be useful to help protect shareholders of a typical privately held company, the financial condition and integrity of banks and bank holding companies are tightly regulated and closely monitored at both the State and Federal level. In addition, while a typical privately held company has minimal annual financial reporting requirements to its shareholders, banks and their holding companies are required by law to provide detailed financial statements throughout the year to their regulators and the marketplace.

Because of the business protections provided by banking regulation and regulators, and the ongoing financial disclosures made by banking organizations, adding an audit requirement to a bank holding company is not necessary for the protection of investors.

Historically, because of the significant costs of an annual audit, bank holding companies have chosen not to register their offerings in Wisconsin, In the past, bank holding companies were generally able to raise the capital they needed to grow from their current shareholder base and local communities. Unfortunately, one result of the recession was that

Wisconsin residents have less disposable income to make investments. Another result of the recession is that the capital requirements for banks are increasing.

This means that banks will increasingly need to go to investors for additional capital, if the banks are to grow and remain competitive, but the traditional sources of bank capital are less able to supply it. It would be very beneficial to Wisconsin banks if their holding companies could take stock offerings out to a broader pool of investors within the State.

Given the large and increasing banking compliance costs faced by banks and their holding companies, the growing need for capital, and tightening margins, bank holding companies are even less able to take on the additional cost of audited financial statements. As discussed above, unlike other privately held companies that may register their stock in Wisconsin, an audit is not necessary to make sure that investors are provided with quality financial information on an annual basis.

Therefore, we believe that AB 350 strikes the appropriate balance between allowing Wisconsin bank holding companies to more easily raise capital within the State while preserving the protection of investors. It is important to remember that bank holding companies will still be required to file their offering materials, which will include full financial statements, with DFI for review and approval. They will also still be required to comply with the extensive disclosure requirements under the securities laws, which means that if a bank holding company fails to provide all material information to investors, investors and DFI will have strong legal remedies against the company and its insiders.

Finally, current law requires any Ch. 180 company to prepare annual financial statements and make them available to shareholders upon request. AB 350 expands this requirement for a bank holding company that has registered its securities. In addition to preparing these financial statements, the bank holding company now must deliver copies of these financial statements to each of its shareholders each year. It should be noted that while the typical Ch. 180 company is not required to prepare its annual financial statements using GAAP accounting, banks and their holding companies are required to use regulatory accounting, which is very similar to GAAP.

Thank you! We are happy to answer any questions.

Committee Copy

COMMENTS TO THE FINANCIAL INSTITUTIONS COMMITTEE ON SEPTEMBER 26, 2013 RE: AB350

FROM: Ed Morgan, 1534 Knoll Crest Drive, Sheboygan, WI 53081
emorganbusiness@gmail.com
920-698-0061
Reading time: about 10 minutes

To the members of the Financial Institutions committee:

Thank you for the opportunity to provide my opinions on bill AB350. I am a CPA working in the Sheboygan area as a sole practitioner. I have followed the developments in the 'Crowd Funding' arena for several years now, and I am very much in favor of this movement in general, and its ultimate effect, which is to encourage establishment of new companies which generate new jobs.

I have significant work experience that I believe qualifies me to provide valid commentary on AB350. I was a senior auditor for Ernst & Young and worked on audits in a variety of industries for both public and private companies. As such, I was also responsible for determining the adequacy of financial statement disclosures in accordance with then current regulations. I served as Sr. Vice President and Chief Accountant for a bank holding company in Wisconsin and was responsible for all annual and quarterly reporting to the SEC on Forms 10K, 10Q, and 8K, and I participated in preparation of documents and worked with underwriters for an IPO for said bank holding company. I also wrote the Management's Discussion in their corporate financial reports to shareholders for a number of years. After departing the public company arena about 20 years ago, I have since been involved with private companies in financial roles—either as a contract CFO or as part-owner. In these roles I've been frequently involved in fund-raising efforts and have drafted business plans, forward-looking financial projections, historical financial statements, and capital transaction agreements. I participated in interviews and meetings with bankers and private funding sources for both debt and equity. I have seen first-hand the issues involved in raising capital from all stakeholders' points of view—the business owner, the private investor, the banker, the securities regulator, and the judge (having myself been a plaintiff in a lawsuit fighting fraudulent tactics in a business takeover.) I know that angel investing is VERY risky and that potential investors can easily become enamored of 'the story' behind a new business idea and are not always a good judge of the financial risks to any business, particularly a startup. I know that some regulation of Crowd Funding solicitations for capital is necessary.

I am here today to ask that SEVERAL additional disclosure requirements be added to this bill to protect investors. Comprehensive disclosure requirements are the KEY protection that regulators can provide to potential and actual investors. But I believe that my recommended additional required disclosures will NOT place undue extra burden on issuers of securities. My recommendations cover four areas:

1) Quarterly reporting disclosures after securities are sold,
2) Details of restrictions on investor re-sale of securities,
3) Availability of investor list information,
4) 'Bad Actor' Disclosures

1) QUARTERLY REPORTING DISCLOSURES: It appears to me that the issuer's business and financial disclosures required by AB350 at the time the securities are offered for sale (as defined by Section 8 of the ACT (Newly created 551.202(26)(f)2a-i of the statutes) would be adequate for investor protection. However, once securities have been sold under provisions of the ACT, I believe that the continuing disclosure requirements need to be strengthened. The required continuing quarterly disclosures are specified in Section 10 of the ACT (Newly created 551.205(2)(b) of the statutes). The current wording in the ACT requires..."An analysis by management of the issuer of the business operations and financial condition of the issuer." This wording needs to be expanded. I would recommend the following wording....."An analysis by management of the issuer of the business operations and financial condition of the issuer, to include but not be limited to:

i. A balance sheet as of the most recent fiscal quarter-end (but not older than 45 days) plus one as of the same date one year earlier, both prepared on a comparable basis,
ii. A profit and loss statement for the fiscal year-to-date ending with the most recent fiscal quarter-end (but not older than 45 days) plus one as of the same date one year earlier, both prepared on a comparable basis,

iii. A cash flow statement showing the sources and uses of cash for the fiscal year-to-date ending with the most recent fiscal quarter-end (but not older than 45 days) plus one as of the same date one year earlier, both prepared on a comparable basis.

The issuer shall disclose whether the aforementioned statements are intended to be in accordance with Generally Accepted Accounting Principles (GAAP), and to disclose known departures from such principles. All balance sheets, profit and loss statements, and cash flow statements shall be clearly marked as "Unaudited" unless they have been audited and a report by independent Certified Public Accountants on those audited statements is included in the disclosures. Furthermore, any report issued by independent Certified Public Accountants that pertains to statements included in the quarterly disclosures shall also be presented as part of the quarterly disclosures."

On the surface, it may seem that adding the foregoing disclosure requirements might be over-burdensome to a fledgling company. I would argue that, in my experience, any company that expects (or hopes) to obtain capital, whether in the form of debt or equity—from a bank or angel investors—must be prepared to provide financial statements with this minimum standard of quality. It is in the interests of the business owner himself to generate statements that attempt to conform to GAAP. If one is playing a game and doesn't adopt the standard rules of score-keeping for that game—how can one expect to be successful?

2) RESTRICTIONS ON INVESTOR RE-SALES OF SECURITIES: A prospective purchaser of securities should be informed—in the offering document—SPECIFICALLY what restrictions exist relative to re-sale of the securities he is purchasing. According to AB350, the cover page of the disclosure document currently specifies the following wording..."THESE SECURITIES ARE SUBJECT TO RESTRICTIONS ON TRANSFERABILITY AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED BY SUBSECTION (e) OF SEC RULE 147 (17CFR 230.147 (e)) AS PROMULGATED UNDER THE SECURITIES ACT OF 1933..." etc., etc. This is not acceptable language in my view, as a potential investor should not need to hire a securities lawyer to understand the conditions under which the investor may re-sell the security. Surely somewhere in the disclosure document there can be standard wording that explains what this means IN PLAIN ENGLISH.

3) AVAILABILITY OF INVESTOR LISTS: Investors who purchase securities under this ACT should be able to learn the identity and address of others who have purchased similar securities of the issuer under this ACT so that an investor may contact the other purchasers if deemed necessary. I believe this would be a substantial protection for a small investor who believes himself aggrieved for some reason, since if he has no way to join forces with other parties who may feel similarly aggrieved, he is virtually powerless to obtain redress. Providing for availability of investor lists would also improve the prospects for ultimate marketability for such securities.

4) 'BAD ACTOR' INFORMATION: The SEC has just published (on Sep 19, 2013) "Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings and Related Disclosure Requirements". I have provided a copy of this document to the Committee for your information. Basically, their rule protects potential investors from situations where the issuer, or a significant party to the securities offer, has been found guilty of specified securities fraud actions in the past. In other words, if there is a "Bad Actor" involved with this securities offer, you—as a potential investor—should be aware of it. I would recommend that AB350 be amended to include similar language as the SEC rule.

This concludes my comments and recommendations. I would be happy to attempt to answer any questions.

COMMITTEE COPY

U.S. Securities and Exchange Commission

Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings and Related Disclosure Requirements

A Small Entity Compliance Guide[1]

September 19, 2013

Table of Contents

This compliance guide is divided into the following parts:

1. Summary of Rule 506 Bad Actor Disqualification and Disclosure Requirements

On July 10, 2013, the Securities and Exchange Commission (the "Commission") adopted bad actor disqualification provisions for Rule 506 of Regulation D under the Securities Act of 1933, to implement Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The disqualification and related disclosure provisions appear as paragraphs (d) and (e) of Rule 506 of Regulation D.

As a result of Rule 506(d) bad actor disqualification, an offering is disqualified from relying on Rule 506(b) and 506(c) of Regulation D if the issuer or any other person covered by Rule 506(d) has a relevant criminal conviction, regulatory or court order or other disqualifying event that occurred on or after September 23, 2013, the effective date of the rule amendments. Under Rule 506(e), for disqualifying events that occurred before September 23, 2013, issuers may still rely on Rule 506, but will have to comply with the disclosure provisions of Rule 506(e) discussed in part 6 of this guide.

This guide is designed as an outline to help issuers understand and comply with the "bad actor" disqualification and disclosure provisions of Rule 506 of Regulation D.

2. Covered Persons

Understanding the categories of persons that are covered by Rule 506(d) (which we refer to in this guide as "covered persons") is important because issuers are required to conduct a factual inquiry to determine whether any covered person has had a disqualifying event, and the existence of such an event will either disqualify the offering from reliance on Rule 506 or will have to be disclosed to investors.

"Covered persons" include:

- the issuer, including its predecessors and affiliated issuers
- directors, general partners, and managing members of the issuer
- executive officers of the issuer, and other officers of the issuers that participate in the offering
- 20 percent beneficial owners of the issuer, calculated on the basis of total voting power
- promoters connected to the issuer
- for pooled investment fund issuers, the fund's investment manager and its principals
- persons compensated for soliciting investors, including their directors, general partners and managing members

The discussion that follows provides background on the different categories of "covered persons."

Issuers, predecessors and affiliated issuers: the issuer itself, any predecessor entities, and any "affiliated" issuers (that is, issuers that are in control of, are controlled by, or are under common control with the issuer).

Directors, general partners and managing members of the issuer: members of the Board of Directors (for issuers that are corporations), general partners (for issuers that are partnerships) and managing members (for issuers that are limited liability companies).

Executive officers and participating officers of the issuer.:

> *Executive officers.* The term "executive officer" means a company's president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function or any other person who performs similar policy-making functions.
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> *Officers who participate in the offering.* The term "officer" means a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, as well as any person who routinely performs corresponding functions. Participation in an offering would have to be more than transitory or incidental involvement, and could include activities such as participation or involvement in due diligence activities, involvement in the preparation of disclosure documents, and communication with the issuer, prospective investors or other offering participants.

20 percent beneficial owners of the issuer: Beneficial owners of 20% or more of the issuer's outstanding equity securities, calculated on the basis of total voting power rather than on the basis of ownership of any single class of securities.

Voting securities. Whether securities are "voting securities" depends on whether securityholders have or share the ability, either currently or on a contingent basis, to control or significantly influence the management and policies of the issuer through the exercise of a voting right. For example, the Commission would consider that securities that confer to securityholders the right to elect or remove the directors or equivalent controlling persons of the issuer, or to approve significant transactions such as acquisitions, dispositions or financings, would be considered voting securities for purposes of the rule. Conversely, securities that confer voting rights limited solely to approval or changes to the rights and preferences of the class would not be considered voting securities for purposes of the rule.

Promoters: The category of "promoter" is broad. Securities Act Rule 405 defines a promoter as any person—individual or legal entity—that either alone or with others, directly or indirectly takes initiative in founding the business or enterprise of the issuer, or, in connection with such founding or organization, directly or indirectly receives 10% or more of any class of issuer securities or 10% or more of the proceeds from the sale of any class of issuer securities (other than securities received solely as underwriting commissions or solely in exchange for property). The test considers activities "alone or together with others, directly or indirectly"; therefore, the result does not change if there are other legal entities (which may themselves be promoters) in the chain between that person and the issuer.

Investment managers and principals of pooled investment fund issuers: For issuers that are pooled investment funds, the rule covers investment advisers and other investment managers of the fund; the directors, general partners, managing members, executive officers and other officers participating in the offering of such investment managers; and the directors, executive officers and other officers participating in the offering of the investment managers' general partners or managing members.

Compensated solicitors: Persons compensated for soliciting investors as well as their directors, general partners, managing members, executive officers and officers participating in the offering. This category covers any persons compensated for soliciting investors but will typically involve broker-dealers and other intermediaries.

3. Disqualifying Events

Under the final rule, disqualifying events include:

- Certain criminal convictions
- Certain court injunctions and restraining orders
- Final orders of certain state and federal regulators
- Certain SEC disciplinary orders
- Certain SEC cease-and-desist orders
- SEC stop orders and orders suspending the Regulation A exemption
- Suspension or expulsion from membership in a self-regulatory organization (SRO), such as FINRA, or from association with an SRO member
- U.S. Postal Service false representation orders

Many disqualifying events include a look-back period (for example, a court injunction that was issued within the last five years or a regulatory order

that was issued within the last ten years). The look-back period is measured from the date of the disqualifying event—in the example, the issuance of the injunction or regulatory order—and not the date of the underlying conduct that led to the disqualifying event.

The discussion that follows provides background on the different categories of disqualifying events.

Criminal convictions: Disqualification is triggered by criminal convictions in connection with

- the purchase or sale of a security
- making a false filing with the SEC
- the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities.

The criminal conviction must have occurred within ten years of the proposed sale of securities, or five years in the case of the issuer and its predecessors and affiliated issuers.

Court injunctions and restraining orders: Disqualification is triggered by court injunctions and restraining orders in connection with

- the purchase or sale of a security
- making a false filing with the SEC
- the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities.

Disqualification only applies for injunctions and restraining orders that are in effect at the time of the proposed sale of securities and were entered within the preceding five years. Injunctions and court orders that have expired or are otherwise no longer in effect are not disqualifying, even if they were issued within the five-year look-back period. For example, an injunction that was issued four years before the proposed offering but lifted before the offering occurred would not be disqualifying.

Final orders of certain state and federal regulators: Disqualification is triggered by final orders of state regulators of securities, insurance, banking, savings associations or credit unions; federal banking agencies; the Commodity Futures Trading Commission and the National Credit Union Administration that:

- bar the covered person from associating with a regulated entity, engaging in the business of securities, insurance or banking, or engaging in savings association or credit union activities or
- are based on fraudulent, manipulative, or deceptive conduct and were issued within 10 years of the proposed sale of securities

Final orders. A "final order" is a written directive or declaratory statement issued by one of the federal or state regulatory agencies listed above, under applicable statutory authority that provides for notice and an opportunity for hearing, which constitutes a final disposition or action by that federal or state agency.

A final order may be subject to appeal. An order does not have to be non-appealable to be a "final

order" under the bad actor rules.

Notice and an opportunity for hearing. There are no procedural requirements beyond the basic requirement that notice and opportunity for hearing be provided for in the statutes, rules and regulations under which an order is issued. No hearing need have occurred. For example, a settlement is considered to have been made after an opportunity for hearing.

Bars. Bars are orders issued by one of the specified regulatory authorities that have the effect of barring a person from association with an entity that is regulated by that authority; from engaging in the business of securities, insurance or banking; or from engaging in savings association or credit union activities. Any final order that has one of those effects is a bar, regardless of whether it uses the term "bar." A bar is disqualifying only for as long as it has continuing effect. Thus, for example, a person who was barred indefinitely, with the right to apply to reassociate after three years, would be disqualified until such time as he or she is permitted to reassociate, assuming that the bar had no continuing effect after reassociation.

Fraudulent, manipulative, or deceptive conduct. The final rules do not provide a specific definition of "fraudulent, manipulative or deceptive conduct," and in particular do not limit it to matters involving knowing misconduct or scienter.

SEC disciplinary orders: Disqualification is triggered by Commission disciplinary orders relating to brokers, dealers, municipal securities dealers, investment companies, and investment advisers and their associated persons under Section 15(b) or 15B(c) of the Securities Exchange Act, or Section 203(e) or (f) of the Investment Advisers Act that:

- suspend or revoke the person's registration as a broker, dealer, municipal securities dealer or investment adviser
- place limitations on the person's activities, functions or operations
- bar the person from being associated with any entity or from participating in the offering of any penny stock

Disqualification continues only for as long as some act is prohibited or required to be performed pursuant to the order. As a result, censures and orders to pay civil money penalties, assuming the penalties are paid in accordance with the order, are not disqualifying, and a disqualification based on a suspension or limitation of activities expires when the suspension or limitation expires.

SEC cease-and-desist orders: Commission orders to cease and desist from violations and future violations of

- the scienter-based anti-fraud provisions of the federal securities laws, including, for example
  - Section 17(a)(1) of the Securities Act
  - Section 10(b) of the Securities Exchange Act and Rule 10b-5
  - Section 15(c)(1) of the Securities Exchange Act

- Section 206(1) of the Investment Advisers Act
- Section 5 of the Securities Act

Disqualification applies to cease-and-desist orders that were issued within five years before the proposed sale of securities and remain in effect.

SEC stop orders: An offering is disqualified if any covered person (as a registrant or issuer) has filed a registration statement or Regulation A offering statement that was the subject of a Commission refusal order, stop order or order suspending the Regulation A exemption within the last five years, or is the subject of a pending proceeding to determine whether such an order should be issued.

Similarly, an offering is disqualified if any covered person (as an underwriter of the securities proposed to be issued) was, or was named as, an underwriter of securities under a registration statement or Regulation A offering statement that was the subject of a Commission refusal order, stop order or order suspending the Regulation A exemption within the last five years, or is the subject of a pending proceeding to determine whether such an order should be issued.

Suspension or expulsion from membership in an SRO or from association with an SRO member: Under the rule, an offering is disqualified if any covered person is suspended or expelled from membership in, or suspended or barred from association with a member of, a securities self-regulatory organization or "SRO" (*i.e.*, a registered national securities exchange or national securities association, such as FINRA) for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade.

U.S. Postal Service false representation orders: An offering is disqualified if the issuer or another covered person is subject to a U.S. Postal Service false representation order entered within the preceding five years, or to a temporary restraining order or preliminary injunction with respect to conduct alleged to have violated the false representation statute that applies to U.S. mail.

4. Reasonable Care Exception

The final rule provides an exception from disqualification when the issuer is able to demonstrate that it did not know and, in the exercise of reasonable care, could not have known that a covered person with a disqualifying event participated in the offering.

The steps an issuer should take to exercise reasonable care will vary according to particular facts and circumstances. The instruction to the rule states that an issuer will not be able to establish that it has exercised reasonable care unless it has made, in light of the circumstances, factual inquiry into whether any disqualification exists.

5. Waivers

Waiver for good cause shown. The final rule provides for the ability to seek waivers from disqualification by the Commission. There are a number of circumstances that could, depending upon the specific facts, be relevant to the evaluation of a waiver request. Issuers may view past applications and waivers granted under Regulation A by referring to the following page: http://www.sec.gov/divisions/corpfin/cf-noaction.shtml#3b. Staff in the

Office of Small Business Policy is also available to discuss potential waiver concerns over the phone at (202) 551-3460.

Waiver based on determination of issuing authority. Rule 506(d)(2) of Regulation D provides another way for issuers to request a waiver of disqualification. Disqualification will not arise if, before the relevant sale is made in reliance on Rule 506, the court or regulatory authority that entered the relevant order, judgment or decree advises in writing—whether in the relevant judgment, order or decree or separately to the Commission or its staff—that disqualification under Rule 506 should not arise as a consequence of such order, judgment or decree.

6. Disclosure of Pre-Existing Events

Disqualification will not arise as a result of disqualifying events that occurred before September 23, 2013, the effective date of the rule amendments. Matters that existed before the effective date of the rule and would otherwise be disqualifying are, however, required to be disclosed in writing to investors. Issuers must furnish this written description to purchasers a reasonable time before the Rule 506 sale. Rule 506 is unavailable to an issuer that fails to provide the required disclosure, unless the issuer is able to demonstrate that it did not know and, in the exercise of reasonable care, could not have known that a disqualifying event was required to be disclosed.

> *Determining whether disclosure is required.* The rule looks to the timing of the triggering event (*e.g.*, a criminal conviction or court or regulatory order) and not the timing of the underlying conduct. A triggering event that occurs after effectiveness of the rule amendments will result in disqualification, even if the underlying conduct occurred before effectiveness.
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> *Form of disclosure.* The Commission expects that issuers will give reasonable prominence to the disclosure to ensure that information about pre-existing bad actor events is appropriately presented in the total mix of information available to investors.

7. Transition Issues

The rules affect only sales of securities made on or after September 23, 2013. Sales of securities made before the effective date of the bad actor provisions will not be affected by the disqualification and disclosure requirements, even if such sales are part of an offering that continues after the effective date. Only sales made after the effective date of the amendments will be subject to disqualification and mandatory disclosure.

Disqualifying events that occur while an offering is underway. Sales made before the occurrence of the disqualifying event will not be affected by it, but sales made afterward will not be entitled to rely on Rule 506 unless the disqualification is waived or removed, or, if the issuer is not aware of a triggering event, the issuer may be able to rely on the reasonable care exception.

Disqualifying events that exist at the time the offering is commenced but are only discovered later trigger disqualification or a disclosure obligation. Sales will not be eligible for reliance on Rule 506, subject to the application of the reasonable care exception.

[1] This guide was prepared by the staff of the U.S. Securities and Exchange Commission as a "small entity compliance guide" under Section 212 of the Small Business Regulatory Enforcement Fairness Act of 1996, as amended. The guide summarizes and explains rules adopted by the SEC, but is not a substitute for any rule itself. Only the rule itself can provide complete and definitive information regarding its requirements.

http://www.sec.gov/info/smallbus/secg/bad-actor-small-entity-compliance-guide.htm

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