



## WISCONSIN LEGISLATIVE COUNCIL INFORMATION MEMORANDUM

### Overview of Wisconsin's Securities Laws

A broad scope of investment arrangements qualify as securities under Wisconsin and federal law. In addition to the extensive list of arrangements specifically identified as securities, such as stocks and bonds, the definition of “security” generally encompasses any arrangement that involves an investment in a common enterprise that entails the expectation that the investor may receive profits resulting from the managerial efforts of someone else. [s. 551.102 (28), Stats.]

The offering and sale of securities to the general public is regulated under both federal and state law. Wisconsin's securities laws, which generally apply when a security is offered or sold to the public in this state, are intended to protect investors by: (1) requiring issuers of securities, such as corporations issuing stock, to disclose information about the nature and risks of the securities by registering the securities with the Department of Financial Institutions (DFI); (2) regulating certain financial service providers; and (3) prohibiting fraudulent and misleading conduct.

#### **DEVELOPMENT OF STATE AND FEDERAL REGULATION**

Wisconsin enacted its first securities law in 1913<sup>1</sup>, and in 1919<sup>2</sup> modified the laws substantially, thereby largely establishing the system of regulation that exists in Wisconsin today. Although Wisconsin's securities laws pre-date the development of federal securities regulation by about 20 years, changes in Wisconsin's laws over the past 80 years have largely been driven by changes at the federal level.

The federal securities regulatory system was created through the Securities Act of 1933 and the Securities Exchange Act of 1934. These two Acts impose requirements similar to those required under Wisconsin law, including requiring an issuer to register its securities with and disclose certain information to the federal Securities and Exchange Commission (SEC); and requiring certain financial service providers to register with the SEC.

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<sup>1</sup> Chapter 756, Laws of 1913.

<sup>2</sup> Chapter 674, Laws of 1919.

Since enactment, federal law has exempted from the federal registration requirements those securities offerings that are purely intrastate. To qualify for the exemption, a security must be offered and sold only to residents within a single state by an issuer that is incorporated under the laws of that state and is “doing business” within that state.<sup>3</sup> [15 U.S.C. s. 77c (a) (11).]

Because few securities offerings have been able to qualify for this exemption, federal and state registration requirements largely overlapped for several decades. As a result, issuers were required to register their securities with the SEC as well as with the securities regulator of each state in which the securities were offered or sold.

In response to concerns that fulfilling these registration requirements inhibited businesses from raising necessary capital, the states collaborated to make their registration requirements uniform and federal law was changed to reduce the extent of the federal-state overlap.

In 1970, Wisconsin amended its securities laws in order to adopt the “Uniform Securities Act,” which was developed by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 1956.<sup>4</sup> The Act made Wisconsin’s laws largely uniform with those of the other states that adopted the Act, and it created an expedited state registration option called “registration by coordination” in which securities that were required to be filed with the SEC could meet state registration requirements by filing the same information with the state.

In 1996, the federal National Securities Markets Improvement Act (NSMIA) significantly reduced the federal-state overlap by prohibiting the states from requiring registration of any “federal covered security”, which includes securities that are listed on a national exchange such as the New York Stock Exchange, as well as other securities described in more detail below.<sup>5</sup> It also limited the extent to which the states could regulate financial service providers. However, it authorized the states to continue to require the payment of registration fees that were in effect before the enactment of the NSMIA, and it authorized the states to require issuers to file with the states copies of certain documents filed with the SEC.

In the same year, Wisconsin law was amended to eliminate the primary way in which its registration requirements differed from those at the federal level.<sup>6</sup> Until that time, Wisconsin law not only required disclosure, but also allowed for “merit review” which prohibited securities offerings that would be “unfair or inequitable to purchasers.” Since the repeal of this provision,

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<sup>3</sup> To qualify as doing business within a state, an issuer generally must satisfy one of the following conditions: (1) 80% of the issuer’s assets are located in the state; (2) 80% of the issuer’s revenues are earned in the state; (3) 80% of the proceeds of the offering will be spent in the state; or (4) a majority of the issuer’s employees are located in the state. [17 C.F. R. s. 230.147.]

<sup>4</sup> Chapter 71, Laws of 1969.

<sup>5</sup> Securities that are not sold on a national exchange are generally referred to as securities sold through the “over the counter” markets, in which trades are generally made through individual interactions between financial service providers.

<sup>6</sup> 1995 Wisconsin Act 356.

Wisconsin law, like federal law, has depended on requiring full disclosure of information by securities issuers as a means of protecting investors.

In 2009, Wisconsin again amended its securities laws to adopt NCCUSL's new Uniform Securities Act of 2002, which had been developed to conform state laws to the limitations imposed by the federal NSMIA.<sup>7</sup>

In recent years, changes to both Wisconsin and federal securities laws have been directed toward providing exemptions from registration requirements for "crowdfunding" in which relatively small amounts of capital are raised through Internet sales of small amounts of securities to a large number of purchasers.

### **REGISTRATION OF SECURITIES AND DISCLOSURE BY ISSUERS**

The primary purpose of mandating the registration of securities is to protect the investing public from being disadvantaged by a lack of access to material information about an investment. Protecting investors in this way, however, imposes costs that may impede issuers, particularly small businesses, from obtaining the capital needed to start or expand operations. To address this concern, federal and state law provide exemptions from registration requirements.

Unless exempt, a security must be registered with DFI before it is offered for sale or sold in Wisconsin. This includes offers that originate from within Wisconsin as well as offers that are directed to and received in Wisconsin. [ss. 551.301 and 551.613, Stats.]

Certain securities that are not exempt from Wisconsin's registration requirements may qualify to use an expedited form of registration called "registration by coordination." All other securities must be registered through "registration by qualification" which involves extensive disclosure by the security's issuer and may entail significant expense associated with professional services needed to conduct the disclosure activities. [s. 551.301, Stats.]

### ***EXEMPTIONS FROM WISCONSIN'S SECURITIES REGISTRATION REQUIREMENTS***

State and federal registration exemptions have generally been implemented to facilitate the activities of small businesses in obtaining investment or because registration is not considered to be necessary to protect investors in certain instances. Exemptions apply based either upon the characteristics of the transaction in which a security is involved, or upon the characteristics of the security itself.

Exemptions from Wisconsin's registration requirements that are mandated by federal law cannot be altered by Wisconsin. However, Wisconsin retains authority to eliminate, modify, or expand the exemptions that it has enacted as part of its efforts to make its laws consistent with other states through the Uniform Securities Act. Wisconsin also has the authority to develop new exemptions that are not part of the Uniform Securities Act, such as the exemptions Wisconsin has enacted for certain crowdfunding activities.

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<sup>7</sup> 2007 Wisconsin Act 196.

### ***Exemptions Mandated by Federal Law***

Federal law prohibits Wisconsin and all other states from requiring state registration of the following<sup>8</sup>:

- Securities approved to be listed on a national exchange, such as the New York Stock Exchange. [15 U.S.C. s. 77r (b) (1) (a).]
- Securities that are the subject of trading by nonissuers in the secondary market. [15 U.S.C. s. 77r (b) (4) (a) and 15 U.S.C. s. 77d (a) (1).]
- Securities issued or guaranteed by the federal government, a state, or a political subdivision of a state other than Wisconsin. [15 U.S.C. s. 77r (b) (4) (E) and 15 U.S.C. s. 77c (a) (2).]
- Securities issued by a nationally or state-chartered bank. [15 U.S.C. s. 77r (b) (4) (E) and 15 U.S.C. 77c (a) (2).]
- Securities that are the subject of a “private placement” in which no offering of the securities is made to the public. [15 U.S.C. s. 77r (b) (4) (F), 15 U.S.C. s. 77d (a) (2), and 17 C.F.R. s. 230.506.]
- Securities not involving a general solicitation that are sold to accredited investors and to no more than 35 nonaccredited investors who have the knowledge necessary to evaluate the merits and risks of the investment. [15 U.S.C. s. 77r (b) (4) (G), 15 U.S.C. s. 77d (a) (7), and 17 CFR s. 230.506 (b).]
- Securities involving a general solicitation that are sold only to accredited investors. [15 U.S.C. s. 77r (b) (4) (G), 15 U.S.C. s. 77d (a) (7), and 17 C.F.R. s. 230.506 (c).]
- Securities issued by smaller companies<sup>9</sup> as part of offerings of up to \$50 million in a 12-month period, when certain federal reporting requirements are satisfied. [15 U.S.C. s. 77r , 15 U.S.C. s. 77c (b), 17 C.F.R. ss. 230.251-263.]
- Securities that qualify for federal crowdfunding exemptions, described in more detail below, in which the securities are the subject of an issuer’s offer or sale of securities of up to \$1 million to all investors in a 12-month period, if the amount invested by each investor is within certain limits. [15 U.S.C. s. 77r (b) (4) (C) and 15 U.S.C. s. 77d (a) (6).]

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<sup>8</sup> Federal law allows and Wisconsin requires certain notices to be filed in relation to certain of these securities. [ss. 551.301 (1) and 551.302, Stats.]

<sup>9</sup> To qualify, a company may not have assets of more than \$10 million, have a class of securities held by 2,000 or more persons, or have securities that are traded on a national securities exchange.

### ***Exemptions Recommended by the Uniform Securities Act***

Although it is within each state's authority to require registration of the following securities, the Uniform Securities Act, as enacted by Wisconsin and other states, provides exemptions from state registration for the following:

- Securities issued by a government authority; an entity that is otherwise highly regulated, such as a bank, insurance company, railroad or public utility; or a religious, educational, or charitable organization meeting certain requirements. [s. 551.201 (1), (3), (5), and (7) Stats.]
- Offers and sales to investors viewed as not needing the protection of registration, including "institutional investors," such as insurance companies and banks. [s. 551.202 (13), Stats.]
- Securities offered and sold without general advertising by a business with its principal office in Wisconsin, if no more than 25 persons hold the securities after the sale. [s. 551.202 (24), Stats.]
- Securities offered and sold without general advertising and for which the offers are directed to no more than 25 persons in Wisconsin. [s. 551.202 (14), Stats.]

As provided in the Uniform Securities Act, Wisconsin law also authorizes DFI to issue an administrative rule or order providing additional exemptions from registration requirements or waiving certain conditions required in order to qualify for an exemption provided in the statutes. [s. 551.203, Stats.]

### ***Additional Exemptions Provided Under Wisconsin Law***

Wisconsin law provides additional exemptions not included in the Uniform Securities Act of 2002 for the following:

- Securities sold without general advertising by a business with its principal office in Wisconsin that also is organized under Wisconsin law, is authorized to do business in Wisconsin, and has a majority of its full-time employees working in Wisconsin, if the securities are sold pursuant to an offer directed to no more than 100 persons in Wisconsin. [s. 551.202 (14m), Stats.]
- Securities sold to a "certified investor" such as a person with a net worth of \$750,000 or more or annual income in excess of \$100,000. [s. 551.202 (13) (ar), Stats.]
- Securities of a Wisconsin cooperative. [s. 551.201 (8), Stats.]
- Securities offerings and sales that qualify for the crowdfunding exemption described below.

### ***Exemptions for Equity Crowdfunding***

In 2012, the federal Jumpstart Our Business Startups (JOBS) Act provided an exemption from federal registration requirements for certain equity crowdfunding activities, and it preempted the states from requiring state registration of securities that qualified for the federal crowdfunding exemptions. However, state governments retained authority to regulate securities offerings that qualify as purely intrastate offerings.

Wisconsin responded by creating exemptions from state registration requirements for crowdfunding activities that remained subject to state registration requirements by virtue of being purely intrastate. This exemption is available to businesses organized under Wisconsin law that offer and sell securities exclusively to Wisconsin residents and businesses through crowdfunding. [2013 Act 52, and s. 551.202 (26) and (27), Stats.]

To qualify for the web-based equity crowdfunding exemption, an issuer must make its offering exclusively through an Internet site operated by an entity that: (1) is a business organized under the laws of Wisconsin and is authorized to do business in the state; (2) is registered with DFI; and (3) has either registered as a broker-dealer or refrains from certain activities such as receiving compensation based on the amount of securities sold through the Internet site. [ss. 552.202 (26) (e) and 551.205 (1) (b), Stats.]

In addition, equity crowdfunding must be conducted in accordance with other requirements, including all of the following: (1) generally, the amount of money received from the sale of the securities may not exceed \$1 million, or if the issuer has made a financial audit available, \$2 million; (2) the issuer may not accept more than \$10,000 from any single purchaser who is not an accredited or certified investor; (3) the issuer must disclose the unregistered nature of the securities and provide certain additional information to all prospective purchasers; and (4) the funds received from investors must be deposited into a Wisconsin-chartered bank, savings bank, savings and loan association, or credit union. [ss. 551.202 (26) (c), (d), (h), (k), and (L) and (27) (c), (d), (g), and (j), Stats.]

In 2017, federal law was changed in order to facilitate intrastate crowdfunding by expanding the types of intrastate activities that are exempt from federal registration to include, among other activities, sales of securities within a state by an issuer that is incorporated under the laws of another state. As of January 2018, Wisconsin law had not been amended to expand Wisconsin's crowdfunding exemption to include issuers eligible for the expanded federal exemption. [17 C.F.R. 230.147A.]

### ***SECURITIES REGISTRATION PROCEDURES***

Securities that are not exempt from registration in Wisconsin must be registered with DFI through one of two processes, "registration by coordination" or "registration by qualification." Both of these processes are based on the registration procedures set forth in the Uniform Securities Act. However, Wisconsin generally retains authority to modify the requirements entailed by each process.

#### ***Registration by Coordination***

Registration by coordination may only be used for securities that have been federally registered with the SEC. Generally, registration by coordination involves providing DFI with copies of the information provided to the SEC, along with a copies of the issuer's articles of incorporation and bylaws. [s. 551.303 (1), (2), and (3), Stats.]

#### ***Registration by Qualification***

Registration by qualification may be used to register any security, but it is typically used only for securities that cannot be registered through any other means because it requires extensive

disclosure by the issuer and may entail significant expense through the use of professional services.

To register by qualification, an issuer must submit to DFI a registration statement that contains all of the following:

- Identifying information about the issuer, its physical properties, and its equipment, and a statement of the general competitive conditions in the industry in which the issuer is engaged.
- The amount of securities to be offered in Wisconsin, a list of all other states in which a registration statement in connection with the offering has been filed, and detailed information on how the proceeds of the offering will be used.
- Any adverse order or judgement issued in connection with the offering by a state securities regulator, the SEC, or a court, as well as a description of any pending litigation or proceeding to which the issuer is a party.
- Identifying information about each director and officer of the issuer, as well as information on the amount of the issuer's securities held by those individuals, a description of their interest, if any, in transactions with the issuer, and the amount of compensation they received and will receive in the prior and succeeding 12-month periods.
- Certain information on each owner of 10% or more of the outstanding shares of any class of securities of the issuer.
- A copy of the prospectus used in connection with the offering, along with detailed financial information about the issuer, including information on its capitalization and long-term debt, its balance sheet, its statements of income and cash flows, and its material contracts. [ss. 551.304 (2) and 551.305, Stats., and s. DFI-SEC 3.02 (1), Wis. Adm. Code.]

DFI reviews the information to determine if it is complete in all material respects and does not contain any statements that are false or misleading. [ss. 551.304 (3) and (4), 551.305 (8), and 551.306 (1), Stats.]

## **REGULATION OF FINANCIAL SERVICE PROVIDERS**

To protect investors, Wisconsin and federal law provide that certain securities transactions may only be conducted by financial service providers that are registered with the SEC and DFI. To become registered, a financial service provider must satisfy certain conditions to demonstrate professional competence and knowledge of securities laws. To maintain registration, providers must adhere to standards of conduct intended to prevent provider fraud and insolvency.

### ***BROKER-DEALERS***

Generally, a "broker" is any person engaged in the business of buying or selling securities for another person, and a "dealer" is any person engaged in the business of buying or selling securities for the person's own account. A "broker-dealer" is a person engaged in the business of acting as a broker, a dealer, or both. [s. 551.102 (4), Stats.]

### ***Registration***

Federal and Wisconsin law prohibit a person from acting as a broker-dealer unless the person is appropriately registered. Most broker-dealers must be registered with both the SEC and DFI. [s. 551.401 (1), Stats.]

Federal law generally requires all broker-dealers to be registered with the SEC and maintain membership in a self-regulatory organization, such as the Financial Industry Regulatory Authority, which is an association of financial service providers that is authorized by federal law to enforce standards of conduct on its members. Although broker-dealers who conduct all of their business within a single state are technically exempt from federal registration, few broker-dealers are able to satisfy the conditions necessary to qualify for this exemption.

Wisconsin law generally requires any broker-dealer conducting business in Wisconsin to be registered with DFI, unless a broker-dealer's only transactions in Wisconsin are with certain sophisticated parties, such as institutional investors. [s. 551.401 (2), Stats.]

### ***Examinations and Operational Requirements***

Both federal and Wisconsin law require a broker-dealer to pass certain examinations of professional competence in order to be registered, and both require a broker-dealer to comply with operational requirements and standards of conduct in order to remain registered. [s. DFI-Sec 4.01 (3), Wis. Adm. Code.]

Federal law prohibits Wisconsin from imposing registration requirements that are more stringent than federal law with regard to certain operational standards. [15 U.S.C. s. 78o (5) (B).]

Within these limits, Wisconsin law requires that each broker-dealer must: (1) maintain minimum amounts of net capital; (2) limit aggregate indebtedness to within a specified range; (3) maintain certain records; (4) comply with reporting requirements that include filing with DFI an annual financial statement and a copy of every complaint against it; and (5) comply with certain rules of professional conduct in serving clients. [ss. DFI-Sec 4.02, 4.03, and 4.04, Wis. Adm. Code.]

### ***Penalties***

To penalize noncompliance and protect the public interest, DFI may revoke, suspend, or condition the registration of a broker-dealer or impose a civil penalty of up to \$10,000 for a single violation or \$100,000 for multiple violations. [s. 551.412, Stats.]

## ***INVESTMENT ADVISERS***

Investment advisers are persons who are in the business of advising others on the value of securities or the advisability of buying or selling securities. [ss. 551.102 (2), (4), (15), and (16), Stats.]

### ***Registration***

Generally, an investment adviser must be registered with the SEC if managing \$110 million or more, and may be registered with the SEC if managing \$100 million or more. Federal law



prohibits Wisconsin from requiring investment advisers who are registered with the SEC to be registered with DFI. Investment advisers that are not registered with the SEC must be registered with DFI if they maintain a place of business in Wisconsin, or have six or more Wisconsin residents as clients, excluding institutional investors, during a 12-month period. [s. 551.403 (1), Stats., and 15 U.S.C. s. 80b-3a.]

To obtain initial registration in Wisconsin, a person must successfully pass certain examinations or have obtained certain professional certifications intended to verify the applicant's professional competence. [s. DFI-Sec 5.01 (3), Wis. Adm. Code.]

To maintain registration, each investment adviser must maintain positive net worth in certain specified amounts; maintain certain records according to specified standards; comply with reporting requirements that include annually filing with DFI a copy of every complaint related to the adviser's business in Wisconsin; and comply with certain standards of professional conduct in serving clients. [ss. DFI-Sec 5.02, 5.03, and 5.04, Wis. Adm. Code.]

### ***Penalties***

To penalize noncompliance and protect the public interest, DFI may revoke, suspend, or condition the registration of an investment adviser or impose a civil penalty of up to \$10,000 for a single violation or \$100,000 for multiple violations. [s. 551.412, Stats.]

### **PROHIBITIONS ON FRAUDULENT AND MISLEADING PRACTICES**

Wisconsin law prohibits a person, in connection with the offer, sale, or purchase of a security to: (1) employ a scheme to defraud; (2) make an untrue statement of material fact; (3) omit to state a material fact necessary in order to prevent a statement from leading to another person being misled; and (4) engage in an act, practice, or course of business that operates as a fraud upon another person. [s. 551.501, Stats.]

Although Wisconsin law provides exemptions from registration requirements for certain types of securities and transactions, any investment arrangement that qualifies as a security is subject to Wisconsin's prohibitions on fraudulent and misleading activity, and may result in criminal and civil liability for a violation. [ss. 551.201, 551.202, 551.501, 551.505, 551.508, and 551.509, Stats.]

This memorandum is not a policy statement of the Joint Legislative Council or its staff.

This memorandum was prepared by Zach Ramirez, Staff Attorney, on January 12, 2018.

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