

# Legislative Analysis

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## LOCAL STOCK EXCHANGES

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### House Bill 5273

**Sponsor: Rep. Nancy E. Jenkins**

**Committee: Commerce**

**Complete to 2-11-14**

## A SUMMARY OF HOUSE BILL 5273 AS INTRODUCED 1-30-14

### Brief Summary:

The bill would amend the Uniform Securities Act to add a new Article 4A to regulate *local stock exchanges*.

Under the bill, a person could not transact business in Michigan as a local stock exchange without being registered with the Department of Licensing and Regulatory Affairs, which houses the Corporations, Securities, and Commercial Licensing Bureau (CSCLB).

"Local stock exchange" would be defined as a person that is engaged in providing a market or exchange at which transactions in securities that are sold or offered for sale in Michigan under an intrastate offering take place. "Market or exchange" would include an online market or exchange or any other market or exchange operated through a web portal.

Under the bill, a local stock exchange could only list a business if that business was a resident of Michigan and doing business in Michigan at the time the business conducted any offers, sales, or reselling of its intrastate securities.

An individual's participation in a local stock exchange would be considered representation that the individual is a resident of Michigan. If it is subsequently shown that the individual was not a resident of the state at the time of participation in a local stock exchange, any transaction conducted while that individual was not a resident is void. (Further, a non-resident could not secondarily purchase an intrastate security within nine months of the completion of the offering through which the security was sold originally.)

### Brief Background:

The Uniform Securities Act (2002) is based on a model act from the Uniform Law Commission of the National Conference of Commissioners on Uniform State Laws (NCCUSL) and is designed to coordinate federal and state securities legislation. The purpose of such regulation is to prevent fraudulent sales of securities to investors.

Under the act a person cannot offer or sell a security in this state unless one or more of the following are met: the security is registered under the act; the security is a federal

covered security; or the security, transaction, or offer is specifically exempted from registration.

The administrator of the act is the Department of Licensing and Regulatory Affairs (LARA), which contains the Corporations, Securities, and Commercial Licensing Bureau (CSCLB).

By "securities," the act means notes; stocks; treasury stocks; security futures; bonds; debentures; evidences of indebtedness; certificates of interest or participation in profit sharing agreements; collateral trust agreements; interests in oil, gas, or mineral rights; puts, calls, straddles, and options on securities, certificates of deposits, or groups and indexes of securities; investments in viatical or life settlement agreements; and similar instruments.

### **Detailed Summary:**

#### ***Application & Registration of Exchange***

A person would register by filing a written application and a consent to service of process and paying a \$100 fee. (There would also be a \$100 renewal fee.) The application must contain the names and addresses of all individuals serving as principals of the local stock exchange or possessing at least a 10% ownership interest, and the universal resource locator (URL) used primarily to host and facilitate the exchange online, and other information as requested by the department.

When LARA receives an application for registration, the department must publish notice of the filing and provide interested persons an opportunity to submit written data, views, and arguments concerning the application. Within 60 days after publishing the notice, or within a longer period, if LARA and the applicant agree, LARA would have to grant registration, deny registration, or grant a conditional or limited registration. If the applications is withdrawn or denied, the department would retain all of the filing fee.

Registration would be effective until 12 midnight on December 31 of the year for which the application is filed.

In considering an application, LARA must consider all of the following:

- Whether the exchange is so organized and has the capacity to carry out the purposes of the new article and to comply with and enforce compliance by others with the provisions of the article, the rules and orders of the department, and the rules of the exchange.
- Whether the rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its participants, issuers, and others using its facilities.

- Whether the rules of the exchange are designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with those engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities; to remove impediments to and perfect the mechanism of a free and open market and an intrastate market system; and, in general, to protect investors and the public interest, and [the rules] are not designed to permit unfair discrimination.
- Whether the rules of the exchange provide for appropriate discipline of participants and others for violations by expulsion; suspension; limitation of activities, functions, and operations; fine; censure; being suspended or barred from being associated with a participant; or other appropriate sanctions.
- Whether the rules provide a fair procedure for disciplining.
- Whether the rules impose any burden on competition not necessary or appropriate in the furtherance of the purposes of the new article.

***Requirements on Exchanges***

A local stock exchange must make a written or electronic record of each transaction conducted between participants through the exchange and maintain the record for at least seven years.

The exchange must make and maintain the accounts, correspondence, memoranda, papers, books, and other records required by rule or order of LARA and must maintain them in a form of data storage established by the department.

The records of an exchange would be subject to reasonable periodic, special, or other audits or inspections by a department representative. An audit could be made at any time and without prior notice. LARA could copy and remove for audit or inspection purposes copies of all records it reasonably considers necessary or appropriate. The department could assess a reasonable charge for conducting an audit or inspection.

***Powers of Administrator***

LARA could issue an order to revoke, suspend, condition, or limit the registration, or censure, impose a bar, or impose a civil fine of up to \$500 for a single violation of the act or rules promulgated under the act, or \$1000 for multiple violations.

The department may impose a sanction described above if any of a long list of conditions cited in the bill applied to the local stock exchange or other person subject to LARA's order.

These include, generally speaking, that the person had filed a previous application that was incomplete or contained a false or misleading statement; the person willfully violated or failed to comply with the act within the previous ten years; the person had been

convicted of a felony or, within the previous ten years had been convicted of certain kinds of misdemeanors; the person was enjoined by a court in an action initiated by the administrator relating to securities, commodities, investments, franchises, insurance, banking, or finance; the person had engaged in relevant dishonest or unethical practices within the previous ten years; the person was not qualified, on the basis of training, experience, and knowledge of the securities business; or the person was insolvent.

The bill also lists numerous conditions relating to actions taken by state and federal regulators or courts of competent jurisdiction relating to harmful conduct in the areas of securities, commodities, investment, franchises, insurance, banking, or finance.

LARA could suspend or deny an application summarily; could restrict, condition, limit, or suspend a registration; could censure, bar, or impose a civil fine on a registrant, pending final determination of an administrative proceeding. When an order was issued, LARA would notify promptly each person subject to the order that the order has been issued, the reasons for the action, and that, within 15 days after receipt of a request in a record from the person, the matter will be scheduled for a hearing. If a hearing is not requested or is not ordered by the department after the date of service of the order, the order is final. If a hearing is requested or ordered, the department, after notice and an opportunity for a hearing, may modify or vacate the order or extend the order until final determination.

The department could not otherwise issue an order unless it had: given appropriate notice to the applicant or registrant; provided an opportunity for a hearing; and made findings of fact and conclusions of law on the record (under the Administrative Procedures Act).

The department could by order discipline a person that controls, directly or indirectly, a person that is not in compliance with the act to the same extent as the noncomplying person, unless the controlling person did not know, and in the exercise of reasonable care could not have known, of the existence of conduct that is a basis for discipline.

LARA could not institute a proceeding solely based on material facts actually known by department unless an investigation or the proceeding was instituted within one year after the department became aware of the material facts.

### ***Listing Businesses on Exchange***

A local stock exchange could not list a business on its exchange if the business has already listed itself on a portal or exchange that facilitates a secondary market for intrastate securities, rather than facilitating original purchasers of the business's intrastate securities listing particular securities of their own accord. The business may not be or request to be listed on two or more of those portals or exchanges at any given time.

A local stock exchange can only list a business if that business is a resident of Michigan and doing business in Michigan at the time the business conducts any offers, sales, or reselling of its intrastate securities. A business is considered to be doing business in Michigan only if all of the following conditions are met:

- If the business had gross revenues of more than \$5,000 from the sale of products or services or other conduct of its business for its most recent 12-month fiscal period, the business derived at least 80% of its gross revenues, and those of its subsidiaries on a consolidated basis, from the operation of a business or of real property located in or from the rendering of services in Michigan during one of the following time periods: (1) in its most recent fiscal year, if the first offer of any part of the issue was made during the first six months of the issuer's current fiscal year; or (2) in the first six months of its current fiscal year, during the 12-month period ending with that 6-month period, if the first offer of any part of the business's intrastate offering was made during the last six months of the business's current fiscal year.
- At the end of its most recent semiannual fiscal period before the first offer of any part of the issue, the business had at least 80% of its assets and those of its subsidiaries on a consolidated basis located in Michigan.
- The business intends to use and uses at least 80% of the net proceeds to the business from the sale or resale of intrastate securities in connection with the operation of a business or of real property in, the purchase of real property located in, or the rendering of service in Michigan.
- The principal office of the business is located in Michigan.

***Prohibitions on Exchanges***

A local stock exchange would be prohibited from selling or otherwise distributing to any third party personal identifying information of an individual without that individual's consent; in confirming whether an individual is a state resident, or meets any other relevant requirement, would be prohibited from requiring an individual to provide personal information (other than address, driver license or state ID number, or voter registration; and would be prohibited from charging a fee for a securities transaction exceeding five percent of the value of the transaction, as determined by the value passed from one exchange participant to another in exchange for that security.

***Participation by Individuals***

An individual's participation in a local stock exchange would be considered representation that the individual is a resident of Michigan. If it is subsequently shown that the individual was not a resident of the state at the time of participation in a local stock exchange, any transaction conducted while that individual was not a resident is void.

A non-resident could not secondarily purchase an intrastate security within nine months of the completion of the offering through which the security was sold originally. Each of the following would count as prima facie evidence that an individual is a state resident: A valid operator's license, chauffeur's license, or state ID card; current Michigan voter registration; or a signed affidavit (under the General Property Tax Act) indicating the individual owns and occupies property as a principal residence.

***Rules***

LARA could promulgate any rules necessary to administer the new article if those rules are consistent with the act.

**FISCAL IMPACT:**

A fiscal analysis is in process.

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.