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House Bill 5273 (Substitute H-4 as passed by the House)  
Sponsor: Representative Nancy E. Jenkins  
House Committee: Commerce  
Senate Committee: Banking and Financial Institutions

Date Completed: 6-9-14

### **CONTENT**

**The bill would amend several provisions of the Uniform Securities Act and add Article 4A (Michigan Investment Markets) to provide for the regulation of an intrastate securities market or exchange. Article 4A would do the following:**

- Prohibit a person from transacting business as a "Michigan investment market" unless the person was registered as such under the Act.**
- Exempt any secondary offer, sale, purchase, or trade of securities facilitated by a Michigan investment market from the Act's registration requirements if the investment market satisfied certain requirements.**
- Exempt a Michigan investment market from the Act's broker-dealer registration requirement.**
- Require a Michigan investment market to keep records of transactions and other documents, which would be subject to review, inspection, or examination by the Administrator.**
- Prescribe penalties and sanctions for violating the proposed provisions, the Act, and other State or Federal statutes, rules, or regulations.**
- Prohibit a Michigan investment market from servicing a business that had already used the services of a portal, market, or exchange, or failed to comply with certain requirements.**
- Require the Department of Licensing and Regulatory Affairs to promulgate rules to require investment markets to comply with the USA PATRIOT Act and the Bank Secrecy Act.**

The bill would define "Michigan investment market" as a person that is a broker dealer, is exempt from Federal registration under Section 15(a)(1) of the Securities Exchange Act of 1934, and provides a market or exchange, including an online market or exchange operated through a web portal, at which transactions in securities that are sold or offered for sale in this State under an intrastate offering exemption take place.

The bill states, "It is the intent of the legislature by enacting this amendatory act to regulate a class of intrastate broker-dealers that is exempt from under section 15(a)(1) of the securities exchange act..., and that will facilitate intrastate securities transaction among persons of this state." (The Securities Exchange Act is Federal law pertaining to the offer, sale, or purchase of securities. Section 15(a)(1) requires the registration and regulation of securities brokers or dealers, but exempts a broker or dealer whose business is only intrastate transactions.)

## Registration as a Michigan Investment Market

A person could not transact business in this State as a Michigan investment market unless the person was registered under proposed Article 4A as a Michigan investment market.

A person would have to register as an investment market by filing a written application, filing a consent to service of process, and paying \$500 fee. For a renewal application, the fee would be \$250. If an initial or renewal application were denied or withdrawn, the Administrator would retain the fees. (The Administrator is the Department of Licensing and Regulatory Affairs.)

If a person complied with Article 4A and demonstrated by clear and convincing evidence that it met the requirements for registration, the Administrator would have to register that person as a Michigan investment market. If a person failed to provide that evidence, the person's registration would remain at the Administrator's discretion.

An application for registration would have to include the following:

- The names, mailing addresses, and telephone numbers of all individuals who served as executive officers of the Michigan investment market or who were direct or indirect owners of at least a 10% interest in the investment market.
- The uniform resource locator (URL) used primarily by the investment market to effect transactions online, if applicable.
- Other information requested by the Administrator as necessary to make a determination regarding registration of the investment market.

If the information contained in the application were or became inaccurate or incomplete in any material respect, the registrant would have to file a correcting amendment. A registration would be effective until midnight on December 31 of the year in which the registration application was filed.

## Grant or Denial of Registration

When the Administrator received an application for registration as a Michigan investment market, the Administrator would have to publish notice of the filing on its website, where interested persons would be provided an opportunity to submit written information concerning the application. Within 60 days after publication of the notice, or within a longer period agreed upon by the applicant and the Administrator, the Administrator would have to do one of the following: a) if the Administrator found that the requirements and rules promulgated under proposed Article 4A had been met, issue an order granting registration, or b) issue an order denying registration, or granting a conditional or limited registration, if the Administrator found that the requirements of the article were not satisfied.

In considering an application for these purposes, the Administrator would have to consider the following:

- Whether the investment market would have the capacity to facilitate the transactions contemplated by Article 4A and would comply with its provisions, the rules and orders of the Administrator, and the rules established by the investment market.
- Whether the rules established by the Michigan investment market provided for the equitable allocation of reasonable dues, fees, and other charges among its issuers and others using its facilities.
- Whether the structure established by the investment market was designed to protect against fraud and manipulative behavior, protect investors and the public interest, and ensure that the operations of the investment market did not foster unfair discrimination between users, issuers, or other entities that interacted with the market.

- Whether the rules established by the investment market provided for appropriate discipline for users who violated Article 4A, rules or orders of the Administrator, or rules established by the market.
- Whether the rules established by the investment market imposed a burden on competition, or obstructed a liquid intrastate securities market.

### Records & Other Documents

A Michigan investment market would have to make a written or electronic record of each transaction between users through the investment market and provide a written or electronic copy of the record to each purchaser involved in the transaction. The investment market would have to keep the records for at least seven years after the date of the transaction.

In addition, a Michigan investment market would have to make and maintain accounts, correspondence, memoranda, papers, books, and other records required by rule or order of the Administrator in a form of data storage prescribed by the Administrator.

The records and other documents of a Michigan investment market would be subject to reasonable periodic, special, or other examinations or inspections by a representative or the Administrator, in or outside of this State, as the Administrator deemed necessary or appropriate in the public interest and for the protection of investors. An examination or inspection could be made at any time and without prior notice. The Administrator could reasonably request, and remove for inspection, copies of all records it reasonably considered necessary to conduct the examination or inspection. The Administrator could assess a reasonable charge for conducting an examination or inspection.

A Michigan investment market would have to file a report with the Administrator in January of each year. The report would have to include a record of each transaction the investment market made in the preceding year.

### Sanctions & Penalties

If the Administrator found that an order would be in the public interest and Article 4A allowed it (as described below), the Administrator could issue an order to revoke, suspend, condition, or limit the registration of a registrant. The order also could censure, bar, or impose a civil fine on a registrant or other person in an amount not to exceed \$500 for a single violation of the Act or rules promulgated under the Act, or \$1,000 for multiple violations. The Administrator could not institute a proceeding for the sanctions based only on material facts actually known by the Administrator unless an investigation or the proceeding were instituted within one year after the Administrator became aware of the material facts.

The Administrator could impose a sanction under the following circumstances:

- Within the previous five year, the person filed an application for registration under the Act that was incomplete in any material respect or contained a statement that was false or misleading with respect to a material fact.
- The person willfully violated or willfully failed to comply with the Act, or a rule or order issued under the Act, within the last 10 years.
- The person was convicted of any felony or within the previous 10 years was convicted of a misdemeanor involving a security or an aspect of a business involving securities, commodities, investments, franchises, insurance, banking, or finance.
- The person was enjoined or restrained by a court from continuing an act, practice, or course of business involving securities, commodities, investments, franchises, insurance, banking, or finance.

- The person was the subject of an adjudication by a Federal or State agency that the person violated a Federal or State law regulating securities, investment, commodities, insurance, banking, or finance.
- The person is insolvent and there was a finding of insolvency.
- The person refused to allow the Administrator to conduct an examination or inspection.
- The person failed to reasonably supervise an employee or other individual who was subject to the person's supervision and committed a violation of the Act, or a rule or order under the Act, within the past five years.
- The person had not paid a filing fee within 30 days after having been notified of a deficiency (although the Administrator would have to vacate the order if the fee were paid).
- The person was the subject of a cease and desist order issued by the Security and Exchange Commission (SEC) or under the securities, commodities, franchise, banking, finance, or insurance laws of a state.
- The person has engaged in dishonest or unethical practices in the securities, commodities, investment, franchise, banking, finance, or insurance business within the previous 10 years.
- The person was not qualified for the securities business, as indicated by evidence presented at a hearing conducted for the purpose of reviewing the applicant's qualifications for registration.

The Administrator also could impose a sanction against a person who was the subject of an order by any of the following: a) the securities or financial services regulator of a state, or the SEC or other Federal agency denying, revoking, barring, or suspending registration as a broker-dealer, agent, investment adviser, or similar person, b) the securities regulator of a state or the SEC against a broker-dealer, agent, investment adviser, or similar person, c) the SEC or a self-regulatory organization suspending or expelling the registrant from membership, d) a court adjudicating a United States Postal Service fraud, e) the insurance regulator of a state denying, suspending, or revoking the license or registration of an insurance agent, or f) a depository institution or financial services regulator suspending or barring the person from the depository institution or other financial services business.

In addition, the Administrator could impose a sanction if one or more of the following had occurred within the past 10 years: a) a court had found the person to have willfully violated the laws of a foreign jurisdiction regulating the business of securities, commodities, investment, franchises, insurance, banking, or finance, b) the person was the subject of an order of a securities regulator of a foreign jurisdiction denying, revoking, or suspending the right to engage in the business of securities as a broker-dealer, agent, investment adviser, or similar person, or c) the person was suspended or expelled from membership in a self-regulatory organization operating under the securities laws of a foreign jurisdiction.

Pending final determination of an administrative proceeding, the Administrator could summarily suspend or deny an application; restrict, condition, or suspend a registration; or impose a civil fine on a registrant. When such an order was issued, the Administrator would be required to notify each person subject to the order that it was issued, the reason for the action, and that, within 15 days after a request was received, the matter would be scheduled for a hearing. If a hearing were not requested, or not ordered by the Administrator within 30 days after the order was served, the order would be final. If a hearing were requested or ordered, the Administrator, after notice and an opportunity for hearing to each person subject to the order, could modify or vacate the order or extend it until final determination.

Except as described above, the Administrator would be prohibited from issuing an order unless appropriate notice was given to the applicant or registrant, the applicant or registrant was provided an opportunity for a hearing, and the Administrator had made findings of fact and conclusions of law on the record under the Administrative Procedures Act.

The Administrator could discipline a person that controlled, directly or indirectly, a person that was not in compliance with these provisions to the same extent as the noncomplying person, unless the controlling person did not know, and in the exercise of reasonable care would not have known, of the existence of conduct that was a basis for discipline.

### Serviceable Businesses

The bill would prohibit a Michigan investment market from servicing a business if the business had already used the services of a portal, market, or exchange that facilitated a secondary market from intrastate securities, rather than facilitated securities transactions for original purchasers for the business's intrastate securities of those purchasers' own securities. The business could not be serviced or requested to be serviced on two or more of those portals, markets, or exchanges at any given time.

A Michigan investment market could service a business only if the business met, and the investment market verified that business met, at the time the business conducted any offers, sales, or resale of its intrastate securities, all of the following:

- The business was a resident of this State.
- At the time the business conducted any offers, sales, or resale of its intrastate securities, the business was doing business in this State.
- The business was not insolvent.
- The business was not subject to a current or pending disciplinary court order or injunction.
- The business was not a defendant in a pending court proceeding.
- The business complied with the laws of this State applicable to the conduct of its business.

A business would be considered to be doing business in this State if all of the following were met: a) if the business had gross revenue of more than \$5,000 from the conduct of its business for its most recent 12-month fiscal period, it derived at least 80% of its gross revenue, and that of its subsidiaries, from the operation of a business in this State during one of the following periods: i) in its most recent fiscal year, if the first offer of any part of the issue were made during the first six months of the issuer's current fiscal year, or ii) in the first six months of its current fiscal year, or during the 12-month fiscal period ending with that six-month period, if the first offer of any part of the business's intrastate offering were made during the last six months of the business's current fiscal year; b) 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 in this State; c) the business intended to use and used 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 in this State; and d) the principal office of the business was located in this State.

("Resident of this state" would mean one of the following: a) if the person is an individual, his or her principal residence is in the State, b) if the person is a business that is a general partnership or other organization that is not incorporated or organized under this State's laws, the person's principal office is located in this State, or c) if the person is a business that is a corporation, limited liability company, or other incorporated legal entity, the entity is incorporated under this State's laws.)

### Prohibited Acts

The bill would prohibit a Michigan investment market from doing the following:

- Selling or distributing any third-party personal identifying information of an individual without his or her written consent.

- In confirming whether an individual was a resident of this State or met other requirements of relevant State or Federal law, requiring an individual to provide personal information, except for the following: a) the address of his or her primary residence, b) the number of a valid operator's or chauffeur's license, or personal identification card issued by this State, c) a current Michigan voter registration, or d) a government-issued identification document that included a photograph of the individual.
- Charging a fee for a securities transaction conducted through the investment market that exceeded 5% of the value of the transaction, as determined by the value passed from one user of the investment market to another in exchange for that security.
- Dealing in securities options, or including securities from more than one class in an offering, without obtaining written acknowledgment from each person involved in that transaction of the nature of the securities transacted.

A Michigan investment market would have to provide a process for taking disciplinary action against its users that included discipline either in place of or in addition to excluding a user from conducting transactions through the investment market.

A Michigan investment market also would have to provide disclaimers and restrictive legends that conspicuously stated that its transactions were limited to residents of this State under the Securities Act of 1933, and would have to limit access to information about specific investment opportunities to individuals who confirmed they were residents of this State.

The Uniform Securities Act provides that it is unlawful for a person, in connection with the offer, sale, or purchase of a security, to do the following: a) employ a device or scheme to defraud, b) make an untrue statement of, or omit to state, a material fact necessary to make the statements made not misleading, or c) engage in an act, practice, or course of business that operates or would operate as a fraud or deceit on another person. The bill would prohibit these acts in the organization or operation of a Michigan investment market.

#### Representation of Residency

Under the bill, an individual's participation in a Michigan investment market would be considered a representation that he or she was a resident of this State. If it were shown later that the individual was not a resident of this State at the time of his or her participation in the investment market, any transaction that the individual made while not a resident would be void.

The bill would prohibit a nonresident from secondarily purchasing an intrastate security within nine months of the completion of the offering through which the security was originally sold.

The following would be considered prima facie evidence that an individual was a resident of this State: a) a valid operator's or chauffeur's license, or official personal identification card issued by the State, b) a current Michigan voter registration, and c) a signed affidavit that indicated that the individual owned and occupied property in the State as his or her principal residence.

#### Transactions Exempt From Registration

The Act prohibits a person from offering or selling a security in this State unless: a) the security is a Federal covered security, b) the security, transaction, or offer is exempted from registration, or c) the security is registered under the Act. The Act exempts certain transactions from the requirements of Sections 301 to 306 and Section 504. The bill also would exempt any secondary offer, sale, purchase, or trade of securities facilitated by a Michigan investment market from the requirements of those sections if the Michigan investment

market effected the transaction in accordance with proposed Article 4A and had made available to any secondary purchaser, within a reasonable time before the transaction, general management and financial information concerning the issuer of the securities. The information would have to include the issuer's financial documents for the preceding calendar or fiscal year and interim financial information as of the end of the issuer's most recent calendar or fiscal quarter.

(Sections 301 to 306 and Section 504 pertain to the registration and notice requirements for securities offered to the public under the Act.)

#### Broker-Dealers Exempt from Registration

A person is prohibited from transacting business in this State as a broker-dealer unless the person is registered under the Act as a broker-dealer, or is exempt from registration. The bill would create an exemption for a person that was registered as a Michigan investment market under proposed Article 4A and dealt in securities solely in its capacity as a Michigan investment market.

#### Mandatory & Permissive Rule-making

The bill would require the Department to promulgate rules that required a Michigan investment market, and any person that controlled or operated a Michigan investment market, to comply with the USA PATRIOT Act of 2001 and the Bank Secrecy Act. The Department could promulgate additional rules that Administrator considered necessary to administer the proposed Article 4A if those rules were consistent with the Uniform Securities Act.

#### Other Regulations

Nothing in Article 4A would exempt a person subject to its requirements from compliance with another applicable State or Federal statute, rule, or regulation that would apply to that person or the conduct of that person's business.

MCL 451.2202 et al.

Legislative Analyst: Jeff Mann

### **FISCAL IMPACT**

The bill would have an indeterminate fiscal impact on the Corporations, Securities, and Commercial Licensing Bureau (CSCLB) within the Department of Licensing and Regulatory Affairs, and no fiscal impact on local units of government. The bill would require those wishing to apply for registration of a Michigan investment market to pay an application fee of \$500, and renewal fees of \$250. The CSCLB would presumably use those fees to cover costs related to reviewing and processing applications, taking disciplinary action, and enforcing any rules promulgated under the bill. Since modern state-centric stock exchanges are a relatively new phenomenon, there are few state regulatory structures to look at when determining whether the fee levels in the bill would be sufficient to cover the level of work that the bill would necessitate, so the fiscal impact is indeterminate.

Fiscal Analyst: Josh Sefton

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