Leann Thompson, Staff Attorney, opened the meeting at 125 South Congress Street at 11:10 a.m. Participating in the meeting were Ashby Foote, Joyce Freeland, Representative Andy Gipson, Adam Griffin, Lynlee Honea, Mark Hosemann, Tony Jeff, Tim Mask, Mark McCreery, Kap Primos (via telephone), William Ray, Gwenn Tatum, and Ben Walton (via telephone). Secretary of State staff in attendance included Drew Snyder, Doug Davis, Nathan Upchurch, Bee McNamara, Cheryn Netz, and Secretary of State Delbert Hosemann. Professor Mercer Bullard, University of Mississippi School of Law, and Anya Coverman, Deputy Director of Policy at the North American Securities Administrators Association, participated via telephone and gave presentations to the study group members.

Overview

Bullard and Coverman provided background information on the recent developments of crowdfunding regulations on both the federal and state levels. Specifically, Bullard provided information regarding the practical aspects of crowdfunding and a framework for how to approach crowdfunding regulation from a policy perspective. Crowdfunding is a recently developed method of raising capital that has been used to raise funds through the internet for many potential business avenues. The JOBS Act created a federal exemption from registration for equity crowdfunding, thus making it easier for startups and small businesses to raise capital from a varying range of potential investors. The SEC was given 270 days to promulgate rules implementing the new offerings exemption, but experienced delays in this process. In response to these delays, several states have proposed or enacted their own state crowdfunding exemption. There are currently three categories that allow room for state action to provide for a crowdfunding exemption: Regulation A of the Securities Act Section, Securities Act Section 3(a)(11) and Rule 147, and Rule 504.
Regulation A is not a popular option among investors and no state has opted to go this route. It is limited to a maximum offering amount of $5,000,000 and is much like a fully registered offering. The overwhelming majority of states that have enacted crowdfunding legislation have created exemptions that work in tandem with the federal crowdfunding exemption from registration for intrastate offerings under Section 3(a)(11) of the Securities Act of 1933, as amended, found in SEC Rule 147. Rule 147 applies to small companies that wish to raise a small amount of capital without incurring the costly fees associated with registering with the SEC. To qualify for this exemption, a company must be incorporated in the state in which it is offering the securities, it must carry out a significant portion or 80% of its business in that state, and the company must only sell the securities to individuals residing in the state of incorporation. The third exemption option is a short-form state crowdfunding registration, subject to minimum federal requirements, that is tied to the federal exemption found in Rule 504 of Regulation D, 17 CFR § 230.504 for companies that offer and sell up to $1,000,000.00 of their securities in any 12-month period. To date, only Maine has enacted legislation using the Rule 504 exemption.

Additionally, Bullard highlighted the six most contentious issues regarding state crowdfunding exemptions for the study group members to keep in mind when considering whether to adopt an exemption. Those issues included annual offering limits, investment limits, investor qualifications, disclosure, sales through portals, and audited financials. Coverman agreed that these were the main issues and urged the study group to also consider including an escrow agreement component, a bad actor disqualification, and post-sale reporting requirements to potential legislation.

Coverman also expanded on the discussion regarding why the majority of states were choosing to use the Rule 147 exemption. State crowdfunding efforts began pre-JOBS Act in Kansas. The purpose of the Invest Kansas Exemption was to accommodate community-based offerings, not the broad-based internet solicitation of strangers that is now referred to as crowdfunding. Because of the challenge state securities departments faced in allowing general solicitation of community investors without violating federal law, early crowdfunding exemption states like Kansas built a community-based offering exemption that would coordinate with the federal intrastate exemption.

**Group Discussion**

Secretary of State Delbert Hosemann asked if there was a compelling reason to restrict crowdfunding to Mississippi investors. Bullard responded that Rule 147 offerings and sales must be restricted to residents of Mississippi and Rule 147 requires a representation that you are a resident for purposes of getting an offer, and that you have to document residency for the purposes of getting a sale. Neither the SEC nor the Rule 147 states have articulated what “documenting residency” means.

Cheryn Netz, Assistant Secretary of State for the Securities Division, proposed that Mississippi adopt two crowdfunding exemptions, one for the community-based investment type of issuances, and another that mirrors federal crowdfunding and could be a temporary
stop-gap measure until the SEC’s rules are finalized. Bullard replied that no other state has done this yet and recommended that it should be done in the form of one exemption. He also urged drafting in plain language so that business owners could understand the exemptions and making the process as simple as possible.

Joyce Freeland with Freeland & Freeland suggested that in addition to doing the two-part exemption, adding to the study group’s proposal a quick fix to support using a portal that can go into different states because Mississippi’s small 10-purchaser exemption does not allow for general solicitation. Bullard and Coverman both pointed out that there would be federal compliance issues because the small 10-purchaser exemption is tied to the federal intrastate offering exemption, so it would be a violation of federal law if a portal made an out-of-state offer.

Coverman circled back to the considerations and potential challenges related to the Rule 147 intrastate exemption and internet solicitation. The early state exemptions did not contain the feature of crowdfunding that is the internet. The SEC has grappled with the issue that offers posted on the internet arguably can be seen and offered to anyone outside of state borders. The SEC issued guidance in April 2014 providing that as long as an issuer is utilizing a third party portal that implements adequate measures so that offers are made only to in-state residents, the offer is in compliance with the intrastate exemption. Adequate measures include, at a minimum, disclaimers and restrictive legends making it clear that the offering is limited to residents of the relevant state under applicable law, and limited access to information about specific investment opportunities to persons who confirm they are residents of the relevant state and limiting access to confirmed residency.

Coverman went on to discuss what she referred to as the second part of the federal compliance issue, which is the registration requirement for intermediary transaction-based compensation. This issue has played out differently in crowdfunding states’ legislation. Some required federal broker-dealer registration while others provided that the broker-dealer can be an exclusively intrastate broker-dealer that is limited to facilitating only in-state crowdfunding transactions. Some states allow federally-registered funding portals to conduct intrastate crowdfunding offerings without any registration under state law. The problem there is that funding portals are a new type of entity that is exempt from federal crowdfunding rules, so under the plain letter reading of Title III of the JOBS Act, the portal can only conduct its crowdfunding activities on a federal level, which is very different from what these states are allowing. Another related issue is the fact that there can be no crowdfunding portals until the SEC’s rules are finalized.

Bullard reiterated that the internet has been a game changer for crowdfunding and noted the Mississippi bill from the 2014 General Session included many provisions that only applied to internet communications. He advised the general approach should be to not treat the internet differently. Offers should be treated as offers, and should look to the same basic principles regardless of whether they are made on the internet or by mail.

Secretary Hosemann indicated that Mississippi needed a means to raise capital and wants an avenue to do so with the minimal amount of paperwork. He thought it unwise to
exclude out of state capital for Mississippi’s startup businesses. He offered his support of Cheryn Netz’s suggested two-prong approach to Mississippi’s crowdfunding exemption. He also noted that the federal investor annual limit is $2,000 and questioned how the other states were enacting higher investor limits. Secretary Hosemann expressed his concern about adopting a $2,000 investor limit and the resulting difficulty in raising a large amount of capital with such a low limit per investor. Bullard clarified that a state can have whatever limit it feels is appropriate. The federal investor limit does not apply to the state exemption until federal law is triggered, and even then, if relying on the intrastate federal exemption, a state does not have to worry about the federal crowdfunding exemption limit.

Secretary of State Delbert Hosemann then asked for Bullard’s suggestions for getting around requiring the burdensome and costly registration statement required by Rule 504 that could frustrate a company’s efforts to raise capital. Bullard responded that a registration statement’s contents depend entirely on the legislature. There is no form Rule 504 registration statement and the legislature could make the requirements minimal. Costs will be driven by the extent to which a lawyer’s assistance is needed. Bullard estimated that most disclosure statements require five to ten lawyer hours.

Secretary Hosemann then referred to Maine’s simplified registration statement. Coverman explained that Maine took the Form U-7 and simplified it. Maine’s registration statement requires more attachments rather than requiring information usually required in a longer registration statement. Both Coverman and Bullard opined that the registration statement requirement should not be the deciding factor between Rule 504 and Rule 147 because both rules require similar disclosure.

Bullard then brought up an investor protection advocacy issue. Statistics show at least one-third of startup businesses fail within the first three years and those investors have a total loss on their investments. Mississippi’s focus should be on what people can afford to lose. Regardless of the registration or disclosure requirements, the likelihood that many startup businesses will fail is inevitable, and this is where Mississippi should place its emphasis. Secretary Hosemann expressed concern that Mississippi startup companies would not be able to reach their goals by having $100 or $200 investor limits. A higher cap would be in Mississippi’s best interest. Bullard suggested considering a graduated set of investment limits, similar to what Wisconsin has adopted. It has a “certified investor” category, meaning a person with a net worth of $750,000 or more, that is allowed to invest an unlimited amount in an offering.

Secretary Hosemann then asked Bullard for his thoughts on what Mississippi’s annual investor and offering limits should be. Bullard said a $2,000 investor limit with $1,000,000 annual offering limit would be good numbers for the types of investments the group was targeting.

Mark McCreery with FriedGreenCapital, LLC advocated a $10,000 investor limit, thinking $2,000 was too low. He added that the accredited investor is already out there making investments, so taking additional steps to target that group would not be an added benefit to Mississippi and the real opportunity lies with the people that fall below the level.
of an accredited investor. He also agreed with Bullard’s suggestion that Mississippi take the tiered investor level approach. McCreery asked if any other state had developed a tiered system in its crowdfunding exemption. Coverman responded no other state had, but that Maine did create an exempted security rather than an exempted transaction that was for a very low investor raise of $100 with a $100,000 total company raise.

Secretary Hosemann closed the group discussion by surveying if the study group members favored a formation entity requirement. Benefits of requiring an organized entity before commencing crowdfunding efforts include the ability of Secretary of State staff to track and monitor the entities. Many group members were in support of this proposal and felt it appropriate that the organization be a filing entity such as a limited liability company or corporation.

**Next Actions**

Secretary Hosemann ended the meeting by stating that a white paper detailing today’s discussion would be distributed to the study group and drafting a proposal would be the next step.

The meeting ended at 1:16 p.m.