

January 28, 2015

The Honorable Terri Bonoff
Minnesota Senate
325 Capitol
75 Rev. Dr. Martin Luther King Jr. Blvd.
St. Paul, MN 55155

Dear Senator Bonoff,

As Minnesota's securities regulator, I write to discuss the Minnesota Department of Commerce's perspective concerning SF 138, your bill creating a state exemption for equity crowdfunding in Minnesota.

As currently drafted, the Commerce Department cannot support this legislation. I believe that, if amended properly, SF 138 could present an opportunity for Minnesota to enact the strongest consumer and investor protections in the country in equity crowdfunding while at the same time creating opportunities for small businesses to seek new community-based capital in Minnesota.

The Commerce Department is interested in working to help you find a balance between the need to protect Minnesota investors from undue risk and loss of their money with the promise this new model potentially offers small businesses.

As you know, the federal 2012 JOBS Act created a federal exemption for these kinds of equity crowdfunding transactions that altered the securities investment landscape in place since the Securities Act of 1933. While the Act opened the door to potential opportunities for small businesses, startups and entrepreneurs, it also creates opportunities for unethical conduct, fraud and investor abuse – particularly affecting “unaccredited” investors who can least afford to lose their savings and had been protected from these types of investment solicitations.

Although the Securities and Exchange Commission has issued proposed regulations on equity crowdfunding with important investor protections, the SEC has not reached the final rulemaking stage as federal regulators have approached the issue very cautiously.

Meanwhile, the North American Securities Administrators Association (NASAA) (of which Minnesota is a member) has tracked state legislative activity in this area over the last several years. In January 2014, NASAA wrote to the National Conference of State

Legislatures (see letter attached) to express a number of preliminary concerns regarding state crowdfunding proposals, particularly highlighting conflicts with federal securities regulation, broker-dealer licensing requirements, and investor protection.

Accordingly, Minnesota should exercise caution in implementing a state-based crowdfunding approach in the absence of final federal guidance. And, in comparison to other states that have passed similar legislation, SF 138 as introduced does not, but should, include many investor protections that other states have deemed important to protect the public, including investor protections passed in Maine, Texas, Maryland and several other states.

However, as we discussed, SF 138 as drafted does not include adequate investor protections, such as financial loss limitations and data privacy safeguards, among others, for both investors seeking to participate in community-focused social investing and the very companies this proposal is meant to help. The following major concerns with SF 138 as introduced, include:

- **Offering and Investment Limits.** The upper limits for amounts issuers can raise – from a single investor and in a 12-month period – are too high.
- **Federal Exemption Conflicts.** Reliance on what's known as the intrastate federal exemption as drafted places the small businesses this proposal is intended to help at significant risk of running afoul of existing SEC registration requirements.
- **Portal Operators and Issuers.** Allowing issuer companies to serve as portal operators raises significant concerns for both investors and issuers themselves; offerings should be conducted through the use of a registered broker-dealer serving as an intermediary.
- **Bad Actor Disqualifications.** Securities offerings made in a crowdfunding situation should not be permitted if either the issuer or portal operator would have been otherwise disqualified under state or federal regulations.
- **Investor Recourse.** Limitations on liability and reduced regulatory requirements for portal operators and issuers are inappropriate, severely inhibiting the ability of investors and regulators to take action in situations where there has been misconduct during an offering.
- **Data Privacy Concerns.** The bill as introduced is silent as to the responsibilities of issuers and portal operators to maintain investors' private data and potential penalties for a breach of consumers' personal information.

- **Automatic Inflationary Increases.** Automatic increases in offering and investor dollar limitations should not be allowed as they increase investor risk by removing legislative and regulatory oversight.
- **Regulatory Review.** As introduced, the bill limits the ability of the Commerce Department to inspect the actual portal site.
- **Resale Restrictions.** Resale restrictions are not adequately outlined in the bill as introduced.

I am seriously concerned that Minnesota investors may unknowingly be faced with financial risks and costs without proper disclosure of, among other issues, burdens and limitations. I also am concerned that Minnesota investors may not be able to properly identify legitimate offerings from improper offerings. Many equity crowdfunding offerings are made through internet portals which, without proper disclosure requirements, can present opportunities for fraudulent activity. Without proper regulatory safeguards, investors can suffer harm not only when they lose their investment, but also from disclosure of sensitive personal and financial data.

The Commerce Department and our staff will serve as a resource for you to amend SF 138 as you consider it in the legislative process:

As always, I greatly appreciate your consideration of the issues and look forward to working with you on this legislation.

Sincerely,

A handwritten signature in cursive script that reads "Mike Rothman".

Mike Rothman
Commerce Commissioner