

ALASKA STATE LEGISLATURE
SENATE LABOR AND COMMERCE STANDING COMMITTEE

February 11, 2016

1:33 p.m.

MEMBERS PRESENT

Senator Mia Costello, Chair
Senator Cathy Giessel, Vice Chair
Senator Kevin Meyer
Senator Gary Stevens

MEMBERS ABSENT

Senator Johnny Ellis

COMMITTEE CALENDAR

PRESENTATION: CROWDINVESTING AND ECONOMIC DEVELOPMENT IN ALASKA

- HEARD

SENATE BILL NO. 126

"An Act establishing an exemption for the offering and sale of certain securities."

- HEARD & HELD

SENATE BILL NO. 108

"An Act repealing and reenacting the Alaska Securities Act, including provisions relating to exempt securities and transactions; relating to registration of securities, firms, and agents that offer or sell securities and investment advice; relating to administrative, civil, and criminal enforcement provisions, including restitution and civil penalties for violations; allowing certain civil penalties to be used for an investor training fund; establishing increased civil penalties for harming older Alaskans; retaining provisions concerning corporations organized under the Alaska Native Claims Settlement Act; amending Rules 4, 5, 54, 65, and 90, Alaska Rules of Civil Procedure; and providing for an effective date."

- HEARD AND HELD

SENATE BILL NO. 165

"An Act relating to the presence of minors in the licensed premises of manufacturers, wholesalers, and retailers of alcoholic beverages; relating to the Alcoholic Beverage Control Board; relating to the offense of minor consuming; relating to revocation of a driver's license for a minor consuming offense; relating to the effect of the revocation of a driver's license for a minor consuming offense on a motor vehicle liability insurance policy; and amending Rule 17, Alaska Rules of Minor Offense Procedure."

- SCHEDULED BUT NOT HEARD

PREVIOUS COMMITTEE ACTION

BILL: SB 126

SHORT TITLE: SMALL SECURITY OFFERINGS

SPONSOR(s): SENATOR(s) COSTELLO

01/19/16	(S)	PREFILE RELEASED 1/15/16
01/19/16	(S)	READ THE FIRST TIME - REFERRALS
01/19/16	(S)	L&C, FIN
02/11/16	(S)	L&C AT 1:30 PM BELTZ 105 (TSBldg)

BILL: SB 108

SHORT TITLE: AK SECURITIES ACT; PENALTIES; CRT. RULES

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

04/13/15	(S)	READ THE FIRST TIME - REFERRALS
04/13/15	(S)	L&C, JUD, FIN
02/09/16	(S)	L&C AT 1:30 PM BELTZ 105 (TSBldg)
02/09/16	(S)	Scheduled but Not Heard
02/11/16	(S)	L&C AT 1:30 PM BELTZ 105 (TSBldg)

WITNESS REGISTER

MICHAEL SHUMAN, Community Economist and Director
Research and Public Policy for the Business Alliance for Local
Living Economies
Silver Spring, MD

POSITION STATEMENT: Presented "Why Crowdfunding Matters -
Unlocking the Economic Power of Small Business in Alaska."

WESTON EILER, Staff
Senator Mia Costello
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Presented information on SB 126 on behalf of the sponsor.

KEVIN ANSELM, Director
Division of Banking and Securities, Department of Commerce,
Community and Economic Development (DCCED)
Anchorage, Alaska

POSITION STATEMENT: Provided information related to SB 126 and SB 108.

THOMAS DALY, Owner
HiSpeed Gear
Kenai, Alaska

POSITION STATEMENT: Testified in support of SB 126.

JASON HOKE, Executive Director
Copper Valley Development Association
Glennallen, Alaska

POSITION STATEMENT: Testified in support of SB 126.

ACTION NARRATIVE

[1:33:30 PM](#)

CHAIR MIA COSTELLO called the Senate Labor and Commerce Standing Committee meeting to order at 1:33 p.m. Present at the call to order were Senators Meyer, Giessel, Stevens, and Chair Costello. She reviewed the agenda.

Crowdinvesting and Economic Development in Alaska

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CHAIR COSTELLO announced the first order of business would be a presentation on why crowdfunding matters in Alaska. She introduced Michael Shuman, who is in Juneau at the invitation of the Juneau Economic Development Council (JEDC).

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MICHAEL SHUMAN, Community Economist and Director, Research and Public Policy for the Business Alliance for Local Living Economies, presented "Why Crowdfunding Matters - Unlocking the Economic Power of Small Business in Alaska." He referred to a book he wrote called Local Dollars, Local Sense and a website called YourEconomy.org where economic information can be found. He began by sharing information he found on the website regarding Alaska's economy. He showed a graph of business categories in Alaska, noting that 65 percent of jobs are in locally-owned businesses, 12 percent are in company-owned

businesses, and about 20 percent are found in non-commercial businesses, both public and non-profit sectors. He emphasized that the local business piece in Alaska is considerable.

Also on the website, YourEconomy.org, is information about job growth in Alaska between 2008 and 2013. Local businesses and the non-commercial sectors each added 4 percent to their total number of jobs. Non-local businesses lost a little more than 4 percent of their jobs. The conclusion is that local businesses are the most important contributor related to employment and economic growth in the state.

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MR. SHUMAN referred to a regression analysis in the Harvard Business Review - July-August 2010 that was titled, "More Small Firms Means More Jobs." There is a correlation between the density of small and local businesses and per capita job growth. A study for the Federal Reserve Bank of Atlanta also showed local businesses have positive effects on income growth and employment.

He discussed the profitability of local businesses in the U.S. in 2008. The profit rates of sole proprietorships were eleven times greater than profit rates for C corporations. He said Canada's profit rates in 2009 showed that the highest profit rates were in businesses with between 10 and 20 employees and the lowest profit rates, where most of the money was invested, were in firms with more than 500 employees.

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MR. SHUMAN addressed current investment trends. He shared investment questions he asks audiences and how their answers show lack of investing in local businesses. This information highlights the failure of capital markets to allocate resources toward local and smaller businesses. If it was working effectively, a properly functioning capital market would invest about 65 percent of the capital into those businesses. Almost no long-term capital funds - stocks, bonds, mutual funds, pension funds, and insurance funds totaling about \$30 trillion - are going to local businesses because of securities laws passed in the 1930s. He termed it "investor apartheid" with two classes of freedoms of investment; one for high wealth individuals who can invest freely, and one for 98 percent of the people who must provide a very expensive fixed disclosure document from an attorney. If this situation could be fixed, at least half of long-term capital in Wall Street - about \$15 trillion - would move to small businesses. It would mean about \$35 billion of

additional money for Alaska. The issue is how to overcome the difficulty of helping small businesses deal with the significant legal costs of a fixed disclosure document.

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CHAIR COSTELLO asked what assumptions he was making about the \$15 trillion.

MR. SHUMAN clarified that half of long-term capital in securities would be \$15 trillion. That assumes that, nationally half of the economy is local business. If the capital markets worked properly, \$15 trillion would be transferred to local businesses. Alaska's share on a per capita basis would be \$35 billion.

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SENATOR MEYER asked for a definition of "local business."

MR. SHUMAN said YourEconomy.org defines it by whether the establishment has a headquarters in your state.

SENATOR MEYER cited Native corporations as an example of a global company with a local headquarters.

MR. SHUMAN said a successful local business will market its goods worldwide, not just focus on local markets.

MR. SHUMAN maintained that a large shift of resources is not needed in order to make a big difference in a state's economy. He reported on a study he did in Cleveland in 2010 on the impacts of a 25 percent shift in food purchasing toward local food. He calculated that the shift would create about 27,000 new jobs and add \$126 million to the tax base. The cost of doing this would be about three-quarters of a billion dollars - which is only 1 percent of what the people of Cleveland have in their bank accounts and short-term savings. He concluded that even a modest shift of capital to smaller businesses could have an enormous impact on Alaska's economy.

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MR. SHUMAN pointed out that the securities law made it difficult for businesses to get capital for a very good reason, to prevent fraud. He referred to the Bernie Madoff pyramid scheme as an example. He told a story about his mother's penchant for casinos to show that there are two systems of risk management in the U.S. One system is called gambling and one is called investing.

He said in 2009 he wrote a piece for a journal of the Federal Reserve Bank in San Francisco pointing out the contradictions in systems and suggesting a \$100 exemption in the law so anyone could make a \$100 investment with no lawyers involved. A law firm in San Francisco filed a rule-making petition to the Securities and Exchange Commission (SEC), who did nothing about it. Two years later, before the Government Operations Committee (GOC), Mary Schapiro, then head of the SEC, also discounted the proposal. He explained that in 2011 the unemployment rate in the U.S. was 10 percent and it appeared that the SEC did not care about small business. The result was that the GOC agreed unanimously to do a \$10,000 exemption, the Senate reduced it to \$2,000, and President Obama signed the Jobs Act in 2012. The Jobs Act makes it easier for small businesses to raise up to a million dollars and allows every American to contribute up to \$2,000 per year. It requires people to go to a community portal licensed by the SEC and overseen by the Financial Industry Regulatory Authority (FINRA.)

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MR. SHUMAN, in response to a question from Senator Costello, explained that FINRA is a private sector policing office to keep standards high. He continued to say that the Jobs Act envisioned preemption of contradictory state rules to facilitate national issues of securities. He said the SEC still did nothing for three years in spite of the mandate to implement the Jobs Act by 2012. As a result, states created their own versions of the Jobs Act. Today, 30 states have done so. The federal government did finally implement the Jobs Act with new conditions two months ago, but it will not be available until late spring of 2016. Alaska and several other states have their own Jobs Act legislation pending.

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MR. SHUMAN addressed the advantages and disadvantages of small businesses following the state law and the federal law. He predicted that state options will have less fraud than federal option because there are more personal connections to local businesses.

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CHAIR COSTELLO noted that the securities bill has not been introduced in the committee yet.

MR. SHUMAN related that like the federal law, the Alaska law envisions \$1 million as a limit on what small businesses can take in investment. Unlike the federal law which limits

people to \$2,000 per company, per year, it envisions up to \$7,500 per person, per company, per year. State law also allows solicitation. Within the state of Alaska, companies can advertise and encourage people to buy their securities. The federal law requires a web-based intermediary; the state law allows a web-based intermediary.

He offered to answer questions.

[2:00:52 PM](#)

CHAIR COSTELLO asked if other countries have used the model.

MR. SHUMAN replied that the Canadians are moving at a similar pace, and like the U.S., give some authority to their provinces to enact laws for local transactions. Some provinces have done crowdfunding reform and reform related to investment companies, co-ops, and tax credits that encourage local investing. In Australia a national commission is going to do a big crowdfunding reform shortly. The Germans and British have some crowdfunding reforms.

[2:02:32 PM](#)

CHAIR COSTELLO requested the difference between Kick Starter and this model.

MR. SHUMAN defined a security as an agreement that states you will get some sort of significant rate of return. Some forms of crowdfunding relate to securities and some do not. Crowdfunding comes in four flavors. One is Kick Starter, which is donation crowdfunding. He gave an example of a brewery start up that hands out gifts or tokens and is outside of SEC's domain. He said KIVA, the electronic version of the Green Bank, is another kind of crowdfunding. He gave an example of how \$100 might be lent to a cause and then paid back without interest. This type of crowdfunding is also not covered by SEC laws.

The third type of crowdfunding relates to lending where the principal, plus interest, are paid back. They qualify as securities and unaccredited investors can participate with some rules. The Jobs Act allowed for the fourth type of crowdfunding, equity crowdfunding, and it comes in a variety of models, such as equity, royalty, or a combination. Currently, 30 states have implemented the law, but there is not much activity yet. He stressed a need for educating investors and businesses on how to take advantage of this legal opportunity.

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CHAIR COSTELLO asked, of the 30 states, which ones are doing it correctly and how do they communicate this type of opportunity.

MR. SHUMAN opined that Oregon is implementing its securities plan well. He said Amy Pearl worked with the State Department of Securities to facilitate a change in regulations. She also took the initiative to educate communities about the opportunity. The state has been very supportive, as have private foundations. He said almost all states implemented their laws before the Jobs Act. Alaska is the first state that is thinking about passing legislation with a clear federal structure in place.

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CHAIR COSTELLO said it is important to wait and time Alaska's law after the passage of the Jobs Act. She asked for information about how to prevent fraud.

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MR. SHUMAN opined that state laws have better protection than a national law because the citizens and investors know their local businesses better. Securities laws are an added layer of protection on top of fraud laws. He said Alaska law and federal law both require filings. He suggested unifying regulatory requirements with those in the Jobs Act. He also suggested paying attention to federal rules regarding the operation of a portal and to get licensed under the federal system and then list Alaska securities on it.

CHAIR COSTELLO thanked Mr. Shuman, Brian Holst and AGDC.

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SENATOR MEYER asked if people can invest in the state's new marijuana business.

MR. SHUMAN replied it's not his area of expertise but "I would say that any educational campaign around crowdfunding would discourage people from investing in new businesses. Rather, you would want to encourage people to invest in expanded businesses with a good track record, and to recognize that any new business-whether it is in a new field like marijuana or in a well-established field like a truck restaurant-those are going to be the riskiest things to put your money into."

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At ease

SB 126-SMALL SECURITY OFFERINGS

[2:18:29 PM](#)

CHAIR COSTELLO reconvened the meeting and announced the consideration of SB 126.

[2:18:43 PM](#)

WESTON EILER, Staff, Senator Mia Costello, Alaska State Legislature, introduced SB 126 on behalf of the sponsor, paraphrasing the following sponsor statement:

Senate Bill 126, the Innovating Alaska Act, helps Alaskans start and invest in local businesses by enacting a new finance mechanism in state law.

Crowdfunding, sometimes known as "equity crowdfunding," is a new concept with a simple premise. Instead of receiving large investments from a few traditional investors, Alaskans starting a business receive small investments from a potentially a large group of investors. The approach lets broad groups of people invest in small businesses in return for equity ownership. This makes it easier for business start-ups to get capital to grow, and allows average Alaskans to invest in businesses being started in their communities.

The federal Jumpstart Our Business Start-Ups (JOBS) Act of 2012 paved the way for this paradigm shift in business creation. It refines some of the more onerous regulations that have historically made it difficult for average Americans to directly invest in private companies. Since then over 12 states have enacted intra-state crowdfunding laws.

Crowdfunding usually works through young companies selling equity shares, often through an on line portal, to a wide group of investors. Senate Bill 126 would regulate the sale of these types of securities separately from the Alaska Securities Act (AS 45.55.010) and adds several safeguards to protect investors.

Under Senate Bill 126, businesses seeking to raise capital through crowdfunding would apply to the Alaska Division of Banking & Securities and hold investor funds in escrow in an Alaskan bank.

Investments made through crowdfunding are limited to \$7,500 for investors and \$1,000,000 for businesses raising capital. Both the investor and business owner must be Alaska residents at the time of sale. In addition to the cap, an escrow deposit is required, as is an agreement acknowledging high risk investment.

Business start-ups are key to growing our state's economy. Enacting crowdfunding through Senate Bill 126 is an innovative way to give entrepreneurs easier access to capital, and help Alaskans invest in local businesses, and changes the paradigm for start-ups.

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MR. EILER addressed a question from Senator Meyer saying that SB 126 creates an exemption in statute and applicants would have to go through the Division of Banking & Securities to access it. He said there are a number of safeguards that protect state policy and investors.

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SENATOR STEVENS voiced concern about investor safety and asked if the process has worked in Oregon.

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MR. EILER offered to get that information. He noted an update in members' packets from The National Council on State Legislatures (NCSL) and a spreadsheet of intrastate crowdfunding legislation. He said it is a new area and there are a variety of success stories and challenges.

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CHAIR COSTELLO stated her intention to hold the bill in committee.

[2:26:34 PM](#)

KEVIN ANSELM, Director, Division of Banking and Securities, Department of Commerce, Community and Economic Development (DCCED), provided information related to SB 126. She reported that there are a number of states that have crowdfunding statutes or regulations on their books. While there have not been many losses relating to crowdfunding, there have been some securities losses, which is why the enforcement provisions are important and the division will be watching closely.

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SENATOR STEVENS asked what the director's responsibility is regarding crowdfunding.

MS. ANSELM explained the department's role is receiving simple crowdfunding applications. She related that Alabama has been successful for several years with its application process and crowdfunding offerings. They have very simple application requirements which Alaska is hoping to copy. She added that most of the details would be listed in regulations due to things changing quickly, such as the delivery method and the financial market. She noted it is difficult to change the law.

SENATOR STEVENS asked whether the department would analyze the merits of a proposed business.

MS. ANSELM explained that Alaska is not a "merit review state," it is a "disclosure state," so the department would look for proper disclosures.

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SENATOR MEYER gave an example of investing \$5,000 in a startup company such as a brewery, and having a beer named after the investor. He asked what the equity ownership would be.

MS. ANSELM clarified that it is considered crowdfunding if there is some potential for profit and the investor is expecting a return. There would not be potential for profit in the previous example.

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SENATOR GIESSEL noted crowdfunding can't exceed \$1 million and \$7,500 per person so it could not be used for the Alaska LNG Project.

MR. EILER agreed. He said the Department of Revenue is exploring how average Alaskans could invest in a large diameter AK LNG pipeline.

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CHAIR COSTELLO opened public testimony.

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THOMAS DALY, Owner, HiSpeed Gear, testified in support of SB 126. He said the bill provides opportunities for Alaskans during a time of financial challenges. He shared a story from his youth. He maintained that SB 126 will help Alaskan businesses by allowing Alaskans to invest in them. He testified that large

corporations do not last in Alaska and are not the answer. He described how clusters of businesses could be developed and how profits could remain in the state. He concluded that the bill will provide Alaska with a sustainable future.

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JASON HOKE, Executive Director, Copper Valley Development Association, testified in support of SB 126. He said the bill is an opportunity for small businesses in a difficult financing climate. It could allow urban investors to invest in businesses in rural areas and elsewhere in the state. He offered to assist in the filing of applications.

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CHAIR COSTELLO held SB 126 in committee with public testimony open.

SB 108-AK SECURITIES ACT; PENALTIES; CRT. RULES

[2:37:56 PM](#)

CHAIR COSTELLO announced the consideration of SB 108.

[2:38:28 PM](#)

At ease

[2:39:04 PM](#)

KEVIN ANSELM, Director, Division of Banking and Securities, Department of Commerce, Community and Economic Development (DCCED), provided information related to SB 108. She suggested seeking information from two documents: a table of contents with major points, and a document that compares the bill to the changes made from the old bill.

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MS. ANSELM explained that SB 108 recognizes and incorporates current securities industry terms and standards. She pointed out that these have not been updated since the Model Act was originally adopted in 1959. In 2014 several requirements for filing for exemptions for friends and family investments were deleted. The other big change was in 1999 after the 1996 National Securities Market Improvement Act.

She said the bill synthesizes with other states' laws to make it easier for businesses, entrepreneurs, and investors to understand their rights and responsibilities, and to expand opportunities in Alaska. It opens crowdfunding opportunities to Alaskans and deters investment scams. It enhances penalties

against those who harm older Alaskans, and it will separate securities statutes from the Alaska Native Claims Settlement Act (ANCSA) related statutes to reduce confusion and improve understanding of both Acts.

MS. ANSELM addressed what the Alaska Securities Act does now. It allows for the registration of securities, for the registration of persons and firms that sell securities, and allows for actions and penalties against those who would violate the law or defraud Alaskans, or both.

She related that ANCSA provisions remain unchanged in AS 45.55, including the enforcement and administration of related securities laws. The securities provisions would move to AS 45.56. There are still references to exempt ANCSA securities transactions included in AS 45.56.210(27).

She described the new logical, topical format of SB 108. It outlines securities registration requirements, generally, covers exemptions from the registration requirement, licenses firms and salespersons, includes enforcement provisions, and adds new definitions. She said it also eliminates filings for all exemptions from registration, except rescission offers and crowdfunding. It updates entity and law references, includes "bad actor" disqualifiers, and improves enforcement and investor education provisions and a way for funding them.

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MS. ANSELM said the bill has seven articles that related to the Alaska Securities Act. Article 1 updates securities registration requirements in language only. Article 2 deals with securities exempt from registration and adds the crowdfunding provision - small intrastate securities offerings. She related that the bill contains language proposed by Senator Costello in House Bill 303 in 2013.

MS. ANSELM reported that Article 4 contains licensing requirements for broker-dealers, agents, investment advisers, investment adviser representatives, and federally covered investment advisers. It also contains new registration exemptions for mergers and acquisition brokers and "snow birds."

She related that Article 5 contains fraud and liability provisions. The fraud provisions generally remain the same, however, a qualified immunity clause has been added to protect brokers from liability for defamation when they report true

information to the administrator regarding another person's activities. She described it as a whistleblower protection.

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MS. ANSELM said Article 6 deals with the administration of the Act. It allows for development and implementation of investor education initiatives through collaboration and the legal ability to accept grants or donations for that specific purpose. It sets up an investor education fund with one-third of the money received through civil penalties. The legislature may appropriate the funds to support investor education and training. Article 6 also provides for variable annuity transactions with investors, subject to applicable provisions of the Securities Act. She noted the department is in discussion with insurance industry representatives to resolve their concerns.

[2:50:02 PM](#)

MS. ANSELM turned to administrative, civil, and criminal enforcement also contained in Article 6. The basic provisions remain the same, although they are significantly reorganized and expanded from current law, primarily in the area of increasing civil penalties. Civil penalties are currently limited to \$2,500 per violation and \$25,000 per group. The bill proposes that civil penalties be increased to \$100,000 per violation with no maximum limit per case. There would be treble damages when the victim is an older Alaskan - a person 60 or older. Restitution may be ordered by the administrator, and the superior court can hold a person in violation of a final administrative order in civil contempt, subject to a potential \$100,000 fine per violation.

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MS. ANSELM discussed civil enforcement and liability. She said civil liability is separated from rescission (undoing a transaction) and she described liability circumstances and remedies. Salespeople who violate the Act are liable to their clients, who may recover damages. The statute of limitations is generally three years from the date of sale, unless there is fraud, which extends it to five years.

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MS. ANSELM reported on rescission offers updates. The aggrieved party has 30 days to accept a rescission offer. The offeror must demonstrate the ability to pay. The rescission offer must be delivered in a way that ensures receipt, and the offeror must actually pay as promised.

She pointed out that criminal enforcement has increased penalties. There is a five-year statute of limitations. For certain provisions, "willful violation" is changed to "knowing violations," which are Class C felonies, and the fine increases from \$5,000 to \$100,000. She added that altering or destroying evidence is a class C felony.

[2:53:06 PM](#)

MS. ANSELM highlighted the size of the securities industry in Alaska. There are over 1,200 broker-dealers, about 765 investment advisers, and over 90,000 salespersons. There are over 6,000 mutual fund/unit investment trust filings and 599 securities registrations filings. Alaska is a target state due to its high per capita income.

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MS. ANSELM reported that there were 35 securities enforcement actions in FY2015, 17 of which were securities related. She provided an example of fraud totaling \$3.2 million by a Texas company. She noted that securities cases are posted on the division's web page.

She said Article 7 adds new and updated definitions.

[2:56:19 PM](#)

MS. ANSELM concluded with the Division of Banking and Securities' mission statement: "Protect consumers of financial service and promote safe and sound financial systems." This supports the department's mission: "Promote a healthy economy, support strong communities, and protect consumers in Alaska."

CHAIR COSTELLO thanked Ms. Anselm and held SB 108 in committee.

[2:58:27 PM](#)

There being no further business to come before the committee, Chair Costello adjourned the Senate Labor & Commerce Committee at 2:58 p.m.