



OHIO LEGISLATIVE SERVICE COMMISSION

Shannon Pleiman

Fiscal Note & Local Impact Statement

Bill: H.B. 10 of the 132nd G.A.

Status: As Reported by Senate Rules & Reference

Sponsor: Rep. Arndt

Local Impact Statement Procedure Required: No

Subject: Permits intrastate equity crowdfunding and requires performance audits for JobsOhio

State Fiscal Highlights

- **Department of Commerce – Division of Securities.** The Division may have to purchase new technology to oversee intrastate equity crowdfunding in Ohio. The costs that the Division of Securities incurs for overseeing this niche "OhioInvests" marketplace will at least be partially offset by issuer and portal operator filing fees deposited into Fund 5500.
- **Issuer and portal operator fees.** The bill requires intrastate equity crowdfunding issuers to pay a \$50 per offering filing fee. The bill also requires these forms of securities to be sold exclusively through web portals, serving as intermediaries between the issuer and buyer. Portal operators would pay an annual \$100 license fee if the operator is not a licensed securities dealer. Both fees will be deposited into the Division of Securities Fund (Fund 5500).
- **Penalties.** The bill establishes civil penalties that apply to certain violations under the bill. Of those penalties, 25% of the total amount awarded must be deposited into the GRF to pay for debt service on bonds. Administrative penalties that the Division may assess under the bill would be deposited into the Securities Investor Education and Enforcement Expense Fund (Fund 5GK0).
- **Performance audit of JobsOhio.** The bill requires a performance audit of JobsOhio in FY 2021 and every fourth fiscal year thereafter, according to terms of a written agreement by and among an accounting or management consulting firm, the Auditor of State, JobsOhio, and any nonprofit entity the sole member of which is JobsOhio.

Local Fiscal Highlights

- **Port authorities and community investment corporations.** The bill also allows port authorities and community improvement corporations to act as web portal operators (i.e., the intermediaries between issuers and buyers) in the OhioInvests marketplace. The fees collected would depend on how often these particular types of investments are offered.

Detailed Fiscal Analysis

Overview

The Division of Securities within the Department of Commerce oversees the traditional securities marketplace in Ohio. The bill exempts intrastate equity crowdfunding securities, referred to as OhioInvests securities, from registration requirements that apply to the traditional forms of securities that are sold in Ohio. Instead, the bill establishes separate regulations that apply to issuers, intermediaries, and buyers in the OhioInvests marketplace. Consequently, the Division of Securities would incur some additional costs for overseeing this investment market niche. These costs would at least be partly recouped through the fees that apply to issuers and OhioInvests web portal operators under the bill.

The bill includes specific requirements that apply to issuers, intermediaries, and buyers of OhioInvests securities. Specifically, to participate in the OhioInvests market, qualified issuers must have at least 80% of their assets located in Ohio and derive at least 80% of gross revenues from their operations in Ohio. Further, the bill applies an annual \$5 million cap on the aggregate amount that any one issuer can raise through intrastate equity crowdfunding. It also limits the amount that an OhioInvests buyer can invest to \$10,000 in aggregate annually. These offerings would be available only to Ohio residents and may only be sold via the Internet by intermediaries that operate OhioInvests web portals.

Impact on Division of Securities

The Division of Securities will incur some additional costs to regulate the OhioInvests investment market. These costs will include purchasing new technology for overseeing this investment business. However, these costs will at least be partially offset by issuer and portal operator filing fees contained in the bill. These fees include a \$50 per offering filing fee and a \$100 application and annual renewal fee to be paid by OhioInvests portal operators who are not also licensed dealers under the Ohio Securities Law. These filing fees will be deposited into the Division of Securities Fund (Fund 5500). The fees would likely be a small share of overall licensing receipts deposited into Fund 5500. In FY 2017, a total of \$18.9 million was deposited into Fund 5500.

The number of OhioInvests issuers and portal operators will ultimately depend on the number of startup and small businesses seeking to raise funds through crowdfunding. This appears to be a small but growing niche market, attractive to business owners seeking to raise money in ways other than relying on traditional capital markets. Under Michigan's intrastate equity crowdfunding program, Michigan Invests Locally Exemption (MILE), 16 issuers and 12 web operators have filed with the state since January 2014. As of June 2016, the North American Securities Administrators Association reported that there had been 179 such investment offerings nationally.

Enforcement of violations

The bill allows for purchasers to commence individual or class action lawsuits and seek civil penalties under the Securities Law for disputes concerning the sale of securities that are issued by an OhioInvests issuer and are sold through an OhioInvests portal. The bill establishes the following civil penalties for a successful action by a purchaser: (1) \$100 per violation if the total amount of money raised by the crowdfunding person or entity is less than \$25,000, or (2) \$250 per violation if the total amount of money raised by the crowdfunding person or entity is equal to or greater than \$25,000. The bill then requires that 25% of these civil penalties awarded to a purchaser be deposited into the GRF and set aside for payment of outstanding direct obligation bond debt service of the state. The remaining 75% of these civil penalties go to the purchaser. This could result in some very small gain in revenue deposited into the GRF to pay outstanding direct obligation bond debt service.

Additionally, the bill permits the Division of Securities to assess an administrative penalty of up to \$1,000 per violation to a person who has committed a violation of the bill's provisions after a notice and hearing, provided that the total penalty shall not exceed the total amount of the OhioInvests offering or offerings involved in the violation. The bill requires that these administrative penalties be deposited into the Division of Securities Investor Education and Enforcement Expense Fund (Fund 5GK0).

Port authorities and community improvement corporations

The bill allows port authorities and community improvement corporations to operate web portals where OhioInvests offerings may be sold to investors. The bill allows them to collect fees for doing so, but specifies that the fee must be of a fixed rate, a variable rate based on the length of time the offering is available on the portal, or some combination thereof. Consequently, port authorities and community improvement corporations may see some small additional amount of revenue if they choose to operate these web portals.

JobsOhio performance audit

The bill requires a performance audit of JobsOhio to be conducted in FY 2021 and in every fourth fiscal year thereafter, pursuant to a written agreement by and among a firm of independent certified public accountants, or management consulting firm, the Auditor of State, JobsOhio, and any nonprofit entity the sole member of which is JobsOhio.

Payment of performance audit costs

Continuing law requires agencies receiving a performance audit to pay the costs associated with those audits. Under the current process, the Auditor of State charges agencies for performance audits. These fees are deposited into the Public Audit Expense – Intrastate Fund (Fund 1090). The Performance Auditing Section within the Auditor's Office routinely conducts performance audits for public and quasi-public

entities upon request. According to the Auditor, performance audits take approximately 16 to 32 weeks to complete and consist of three distinct stages, including planning, field work, and report preparation. Ultimately, the audits produce recommendations for operational improvements. The Performance Auditing Section consists of about 38 employees, and spends approximately \$3.3 million each fiscal year to conduct performance audits of state agencies and local governments. The current hourly fee charged to state agencies is a flat rate established by the Statewide Cost Allocation Plan (SWCAP), and is revised every year. The hourly rate per assigned Auditor of State employee for FY 2018 was \$68.00.

The performance audit of JobsOhio under the bill, however, is to be conducted pursuant to a written agreement by and among a firm of independent certified public accountants, or management consulting firm, the Auditor of State, JobsOhio, and any nonprofit entity the sole member of which is JobsOhio. This would indicate that the performance audit would be conducted by an outside firm and not by Auditor of State staff. It is unclear as to the impact this would have on the total cost of the performance audit.