

CDFIs INVEST

**Securities Laws Compliance
For CDFIs**

Timothy Horner and Matthew Johnson
Warner Norcross & Judd LLP
September 26, 2017

OVERVIEW OF SECURITIES LAWS

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WHAT IS A SECURITY?

Securities Act of 1933:

The term "security" means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.



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SECURITIES LAWS

Federal
and
State

Registration
and
Anti-Fraud



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SECURITIES LAWS

Federal Securities Laws

- Securities Act of 1933
- Securities Exchange Act of 1934
- Trust Indenture Act of 1937
- Investment Company Act of 1940
- Investment Advisers Act of 1940
- SEC Regulations



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SECURITIES LAWS

State Securities Laws – Each state has its own:

- Laws and Regulations
- State regulatory agency (mini-SEC)
- Enforcement powers and authority



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SECURITIES LAWS

SECURITIES LAWS - Contents:

- Anti-Fraud
- Regulation of Broker-Dealers and Investment Advisers, and their Agents
- Registration of Securities
- Exemption of Securities and Transactions
- Civil Liability
- Administration, Civil and Criminal Actions



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SECURITIES LAWS

Securities laws impose two fundamental requirements:

- Registration
- Anti-Fraud and Disclosure



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REGISTRATION

Registration is required:

- Federally with the SEC
- In each state where a security is offered or sold

unless there is an exemption.



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TYPES OF REGISTRATION

- Securities
- Broker-Dealer/Issuer-Dealer
- Agent/Salesperson
- Investment Company
- Investment Adviser
- Trust Indenture



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DISCLOSURE

Must provide full and fair disclosure of all material information that a reasonable person would consider important in deciding whether to make the investment



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EXEMPTIONS

- There are a variety of exemptions from registration
- There are NO exemptions from anti-fraud and disclosure requirements



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SECURITIES FRAUD

- Manipulative or Deceptive Conduct
- Failure to Provide Material Disclosure
- Materially Incorrect Disclosure
- Materially Incomplete Disclosure



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EXEMPTIONS FROM SECURITIES REGISTRATION



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SECURITIES ACT OF 1933

Exempt Transactions

- Regulation S – (Outside United States)
- Rule 144 – (Resales after Holding Period)
- Rule 144A – (Resales to QIBs)
- PRIVATE PLACEMENTS/REGULATION D
- CROWDFUNDING EXEMPTION
- REGULATION A and A+ – (MINI-REGISTRATION)

Exempt Securities

- Financial Institutions Securities
- Government Securities
- Intrastate Offerings
- NONPROFIT ORGANIZATION SECURITIES



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PRIVATE PLACEMENT EXEMPTION



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PRIVATE PLACEMENTS/ REGULATION D EXEMPTION

Regulation D: Rules 506(b) and 506(c):

- Rule 506(b): No General Solicitation and Advertising Prohibited
- Rule 506(c): General Solicitation is permitted **but** all the investors must be accredited investors

Must file Form D with the SEC and each state where securities sold



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PRIVATE PLACEMENTS/ REGULATION D EXEMPTION

WHAT DOES *GENERAL SOLICITATION* MEAN?

- Newspapers, brochures, T.V., radio
- Seminars, group meetings by broad invitation
- Website, Facebook, Twitter, or social media
- Emails or broad solicitation



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PRIVATE PLACEMENTS/ REGULATION D EXEMPTION

What is an *Accredited Investor*?

- Financial Institutions, BDs, RIAs
- Businesses/Trusts/Charitable Organizations with \$5 million total assets
- Individuals:
 - NW > \$1,000,000 (excluding home); or
 - Income > \$200,000; or
 - Income w/spouse > \$300,000

If you use a general solicitation to attract investors, you have to verify that your investors are accredited.



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PRIVATE PLACEMENTS/ REGULATION D EXEMPTION

Unaccredited Investors:

- Max of 35
- Must be financially sophisticated (capable of evaluating merits and risks of investment)
- Increased disclosure obligations (Regulation A)

NO unaccredited investors permitted if public advertising or general solicitation is used.



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NONPROFIT EXEMPTIONS



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NONPROFIT ORGANIZATION EXEMPTIONS FROM SECURITIES REGISTRATION

Two types of exemptions for nonprofit organizations:

- Debt Securities
- Charitable Investment Pools (CHIPs)



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NONPROFIT DEBT SECURITIES



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NONPROFIT DEBT SECURITIES: FEDERAL EXEMPTIONS

Securities Act of 1933 and Securities Exchange Act of 1934 impose two requirements:

- Charitable organization
- No part of the net earnings inure to the benefit of any private person
(Translated: It must be debt; not equity.)



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DEBT SECURITIES

- Promise of repayment of the original amount invested
- With interest



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DEBT SECURITIES

Types of Instruments:

- Bonds
- Notes
- Debentures
- Certificates of Indebtedness
- Other repayment obligations:
 - "Deposits"
 - "Accounts"
 - "Loans" from individuals



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DEBT SECURITIES

- Are subject to state and federal securities laws
- Regardless of what instrument is called (name does not matter)
- Regardless of whether investor is individual or institution



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DEBT SECURITIES

Disclosure Requirements:

- Must provide full and fair disclosure of all material information that a reasonable person would consider important in deciding whether to make the investment
- Failure to provide full disclosure subjects organization to "fraud" liability under federal 1933 Act, 1934 Act and state securities laws



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BENEFITS OF FEDERAL NONPROFIT EXEMPTION

- No SEC Registration at Issuance
- No Periodic Reporting with SEC
- No Accredited Investor Limitations
- No Financial Statement Requirements*
- No Limitations on Resale*
- No Trust Indenture Requirements*
- No Limitations on Advertising or Solicitation*
- No Prospectus Requirements*

*Subject to state law and general anti-fraud requirements



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NONPROFIT DEBT SECURITIES: STATE REGISTRATION/EXEMPTION

Registration is required for

- Securities
- Nonprofit Organization as Issuer-Dealer or Broker-Dealer
- Individuals as Agents or Salespersons

In each state where an investor is located or securities are marketed or sold

Unless the state has an applicable exemption from registration



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UNIFORM SECURITIES ACT OF 2002: NONPROFIT EXEMPTION

Default provision follows federal model of automatic exemption if:

- Charitable organization
- No part of the net earnings inure to the benefit of any private person

(Translated: It must be debt; not equity.)

But allows states by rule or order to require:

- notice filing
- advertising filing
- offering document filing
- consent to service of process
- full registration (no exemption)



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NONPROFIT DEBT SECURITIES: STATE REGISTRATION/EXEMPTION

Varies by state:

- Automatic exemption like federal model
- Notice filing with indefinite exemption
- 12-month exemption with prior review (similar to a registration)
- No exemption (registration required)



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NONPROFIT DEBT SECURITIES STATE REGISTRATION / EXEMPTION

Result:

- Must check laws of home state plus any state where there is a solicitation or sale
- Depending on state, registration may be required
 - Securities
 - Broker-Dealer / Issuer-Dealer
 - Agent / Salesperson
- In most states, exemption or registration must be renewed annually



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CROWDFUNDING



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CROWDFUNDING EXEMPTION

- State and Federal Crowdfunding Exemptions
- Federal Exemption:
 - Dollar Limits on the amount raised
 - Investors are subject to limits on how much they can invest
 - Have to offer the securities through an online platform
 - Required Disclosures
 - Annual Reporting Requirements



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REGULATION A AND A+



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Regulation A and A+

Regulation A now provides for two tiers of offerings (Reg A and A+):

- Tier 1, for offerings of securities of up to \$20 million in a 12-month period, with not more than \$6 million in offers by selling security-holders that are affiliates of the issuer.
- Tier 2, for offerings of securities of up to \$50 million in a 12-month period, with not more than \$15 million in offers by selling security-holders that are affiliates of the issuer.



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Regulation A and A+

- Both Tiers are subject to certain basic requirements while Tier 2 offerings are also subject to additional disclosure and ongoing reporting requirements.
 - A requirement to provide audited financial statements.
 - A requirement to file annual, semiannual and current event reports.
 - A limitation on the amount of securities non-accredited investors can purchase in a Tier 2 offering of no more than 10 percent of the greater of the investor's annual income or net worth.



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Regulation A and A+

- Offering Statement on Form 1-A
 - Part I: Notification
 - Part II: Offering Circular
 - Part III: Exhibits
 - For Tier 2, this includes audited financial statements
- You can “test the waters”
 - But you have to file the materials with the SEC

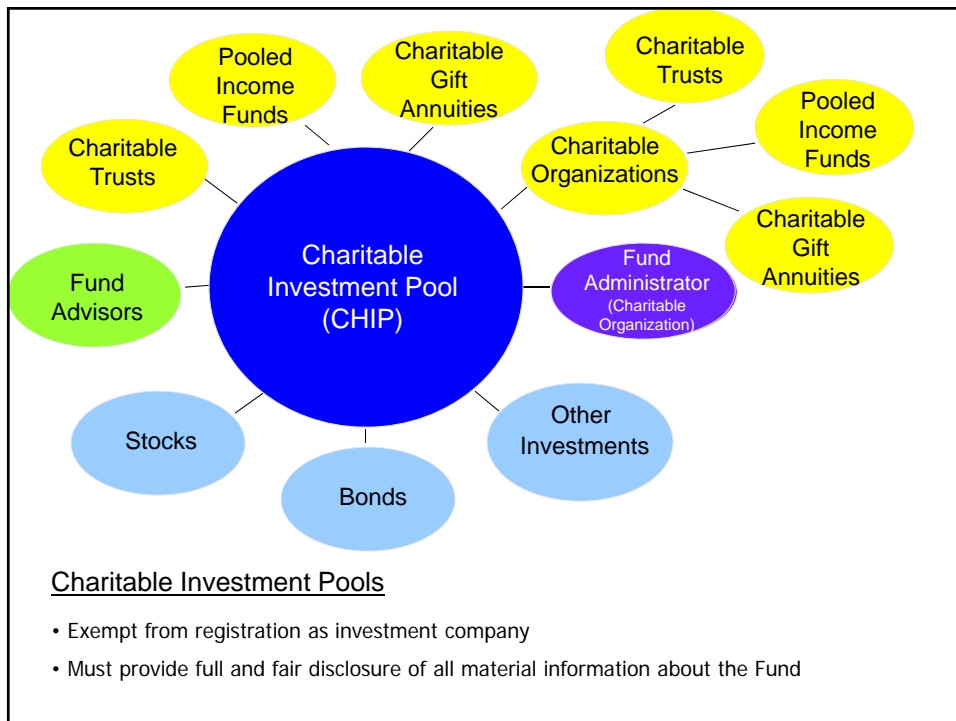
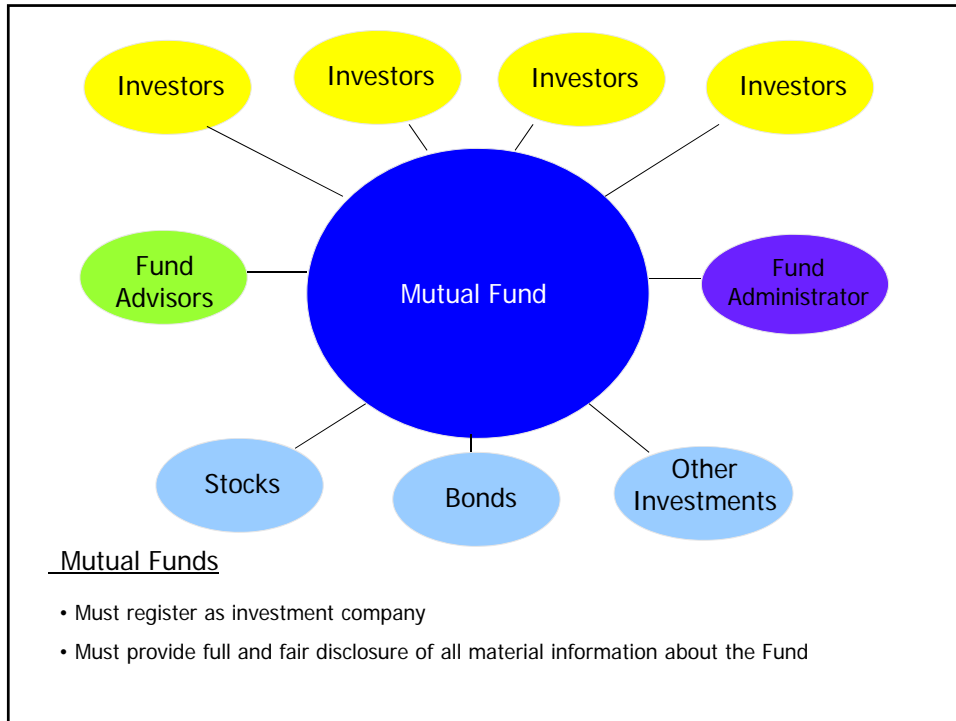


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CHARITABLE INVESTMENT POOLS



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CHARITABLE INVESTMENT POOLS

Permissible Pooled Assets:

- General endowment funds or other funds of one or more charitable organizations
- Charitable remainder trusts
- Charitable lead trusts
- Pooled income funds
- Charitable gift annuities



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CHARITABLE INVESTMENT POOLS

Impermissible Pooled Assets:

- Revocable trusts (subject to one exception)
- Individual investors
- Any other assets not listed as permissible



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STATE LAW EXEMPTIONS UNDER PHILANTHROPY PROTECTION ACT

- States had three years to opt-out
- Ten states opted-out
- Opt-out states are NOT preempted by Philanthropy Protection Act



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CHARITABLE INVESTMENT POOLS

Disclosure Requirements:

- Failure to provide full disclosure subjects organization to "fraud" liability under federal 1933 Act, 1934 Act and Investment Company Act and state securities laws



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SUMMARY



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SECURITIES LAWS

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EXEMPTIONS

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POTENTIAL LIABILITIES AND ADVERSE CONSEQUENCES

- State and federal governmental actions
- Civil and private liability
- Rescission rights
- Personal liability
 - Officers and directors
 - Salespersons
 - Control persons
- Criminal liability in cases of serious fraud
- Adverse publicity and loss of reputation



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Timothy L. Horner Warner Norcross & Judd LLP

Tim Horner, Partner, Warner Norcross & Judd LLP, is a nationally recognized expert on the federal and multistate securities laws requirements for nonprofit organizations. He has over two decades of experience representing nonprofit organizations that offer socially responsible investment opportunities in the form of charitable investment pools, notes, bonds, investment certificates and various types of fixed income investments. Mr. Horner served as principal legal counsel in meetings with the National Conference of Commissioners on Uniform State Laws and the North American Securities Administrators Association with respect to the state nonprofit exemption under the Uniform Securities Act 2002. He also was instrumental as legal counsel in a first-of-its-kind church mortgage asset securitization transaction that was nominated as the Total Securitization U.S. Deal of the Year 2006 - ABS and also in a swap restructuring transaction for the City of Detroit that was awarded The Bond Buyer's Innovative Public Finance Transaction of 2009. He is co-author of *Securities Regulation of Fundraising Activities of Religious and Other Nonprofit Organizations*. Mr. Horner is a frequent lecturer at national conferences and meetings of nonprofit organizations. Listed in *The Best Lawyers in America* from 2007 to date.



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Matthew D. Johnson Warner Norcross & Judd LLP

A good lawyer should be a trusted advisor who helps clients obtain goals while protecting their interests – not someone who simply tells them why a particular transaction has some legal risk. There has to be a balance between sound legal advice and business strategy. As a former chief operations officer for a major medical group, Matt Johnson understands that legal issues do not occur in a vacuum and that providing sound legal advice means working with clients to develop solutions to strategic and operational issues.

Matt's practice focuses on representing closely held and family-owned businesses with corporate and transactional needs. His goal is to get to know each one of his clients in order to provide efficient legal advice that can further their business goals. This advice can focus on strategic and long-term planning issues or simple day-to-day operational issues and agreements. From standard terms and conditions to strategic joint ventures or a sale or purchase of a business, Matt helps clients by providing practical solutions to complex legal issues.

He also represents numerous nonprofit clients. This representation ranges from corporate governance and strategic issues to capital raising efforts through securities offerings. Matt has served as counsel to a variety of issuers in securities offerings that are exempt from registration. This experience helps to advise nonprofits on the best options available when pursuing their capital raising efforts while preparing the necessary offering documentation.



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Who is NorthStar?



- ❖ Founded in 1990 as a boutique wealth management firm with a focus on socially responsible investing
- ❖ Founded by J Goodridge, - Julie was the lead plaintiff in the legal case, Goodridge v. Massachusetts Dept. of Public Health, winning marriage rights for same sex couples in Massachusetts.
- ❖ Female Owned and Operated

Leadership – It Starts At the Top

– Senior Management & Board

- Diversity – Does your board and management team represent the community you serve?
- Demonstrated Competency and Tenure
- Compensation - Is compensation in line with industry standards and appropriate given the size of the organization

– Workforce

- Does the workforce come from the community?
- Tenure of employees
- Compensation – Living wage?
- Benefits? Professional Development?

Tell the Same Story



Mission & Strategy

- What problems do you address?
- Focus – You cannot be all things to all people; mission drift
- Do you have a local/regional focus?
- Governance/Legal Structure
- Motivation behind your growth
- What kind of returns are you trying to achieve?
- Strategic Planning Process & Documentation

Financial Results

- Is your business model sustainable?
- Is your business profitable?
- Do you have audited financial statements?
- Have you ever received an unfavorable audit?
- Does your organization have the appropriate capital structure?
- Do you have recurring sources of funding?
- Detailed explanation of your internal diligence process
- Acknowledgement of failure
- Do your partners share your values?
- Financial Model, Metrics

Not All Press is Good Press



- Has your organization ever been sued?
- Has any employee ever been fired for mismanagement of resources?
- Are your actions in line with who you say you are?
- How are you portrayed online?
- What does the community think about your work?

Fund Comparison

- Local/Regional focus is preferred; Broad geographical reach requires a more thoughtful approach to operations
- More complexity means more risk which requires more diligence
- Growth can be good and bad

Fund A

Established in 1970

Assets: \$8 million

Purpose: To provide educational, technical and financial assistance to non-profit co-operative organizations serving low-income populations

Staff: 7 people; 6 women, no POC

Board: 14 people; 8women, 1 POC

Business/Strategy Changes

Moved from providing loans to non-profits and food co-ops to all types of co-ops in various development stages

Documentation:

Website with Management & Staff
Audited Statements

Fund B

Established in 1980

Assets: \$1 billion

Purpose: Facilitating the provision of affordable housing and jobs or services for low income or disadvantaged communities

Staff: 42 people; 24 women, 7 POC

Board: 11 people; 6 women, 1 POC, 3 insiders

Business/Strategy Changes

Provides loans to non-profits including charter schools; once had a venture funding business; has sought alternative types of funding like new market tax credits

Documentation:

Website with Management & Staff
Audited Statements for *different entities*
Strategic Planning Document

Questions?



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