

# Montana State Auditor



The Office of Montana State Auditor, Commissioner of Securities and Insurance, is a criminal justice agency. Our primary mission: to protect Montana's consumers through insurance and securities regulation.

We are committed to ensuring fairness, transparency, and access in the securities and insurance industries.



# Securities Regulation

The Securities Act of Montana charges Commissioner Rosendale and the CSI staff with the following three tasks in regards to securities regulation:

- 1) Protect the investor, persons engaged in securities transactions, and the public interest
- 2) Promote uniformity among the states; and
- 3) Encourage, promote, and facilitate capital investment in Montana



# What is a Security?

## *SEC v. W. J. Howey Company*

In 1946 the Supreme Court of the United States outlined a method of determining if an investment is covered by the Securities Act of 1933. It is known as the Howey test.

- 1) An investment due to
- 2) an expectation of profits arising from
- 3) a common enterprise
- 4) which depends on the efforts of a promoter or third party.



# Types of Securities

Debt securities - raise money by obtaining loans from investors.

Equity securities – raise money by selling ownership interest in your company.



# Basic General Rule

**MCA 30-10-202. Registration of securities.** It is unlawful for any person to offer or sell any security in this state, except securities exempt under [30-10-104](#) or when sold in transactions exempt under [30-10-105](#), unless:

- (1) the security is registered by notification, coordination, or qualification under parts 1 through 3 of this chapter; or
- (2) for a federal covered security, the security has been filed with the commissioner pursuant to [30-10-211](#) and the fee prescribed in [30-10-209](#) has been paid.



# Securities Registration

Issuers can register their securities with the Securities and Exchange Commission and with state securities regulators. Once a security is registered, it is considered a public offering.

MCA §§ 30-10-204 and 205 set forth the requirements for securities registration.



# Exempt Securities

MCA § 30-10-104: Provides for the exemption of certain types of securities such as:

- securities issued by governments (federal, state, county, city)
- securities issued non-profit issuers such as churches, hospitals, schools, fraternal organizations
- employee stock purchase plans
- securities listed on the New York Stock Exchange, the American Stock Exchange, the NASDAQ
- securities issued by insurance companies



# Exempt Transactions

MCA § 30-10-105: Exempt transactions provides exemptions for both the security and the offer and sale of the security. Following are some examples:

- MCA § 30-10-105(8)(a ): Exempt offering to not more than 10 investors
- MCA § 30-10-105(8)(b ): Exempt offering to not more than 25 investors
- MCA § 30-10-105(8)(c ): Exempt offering to not more than 35 investors (Montana businesses only)
- MCA § 30-10-105(22): Exempt securities crowdfunding exemption
- MCA § 30-10-105(21): Exempt securities cooperative exemption



# Requirements for all Securities Offerings

## Don't discount disclosure.

Whether a securities offering is registered or exempt from registration, the issuer is **always** required to make full disclosure to prospective investors.

Federal and state securities laws require the issuer to disclose all material facts and risks to investors.

If you do not comply with disclosure requirements, you and your business may have committed securities fraud and could be subject to private lawsuits as well as administrative or criminal enforcement actions. Full disclosure is the best way for a business to protect itself.



Requirements



# What is “Full Disclosure?”

- What type of securities are being offered
- What type of business does the issuer conduct
- What are the risks associated with the issuer and the investment
- Who are the business’ officers and directors and what are their salaries
- How is the business capitalized
- How much money is being raised from investors
- How will the investment proceeds be spent
- And more...anything material...full disclosure protects everyone and is required by Montana law

Disclosure is usually made through a prospectus or private placement memorandum



# What is Crowdfunding?

Crowdfunding is an **money-raising strategy** that began as a way for the public to **donate** small amounts of money, often through social networking websites, to help artists, musicians, filmmakers and other creative people finance their projects.

The concept **recently** has been promoted as a way of assisting small businesses and start-ups looking for **investment capital** to help get their business ventures off the ground.



# Crowdfunding that is NOT Subject to Securities Law.

**Gifts:** Wedding guests pay for a couples' honeymoon.

**Charities & non profits:** Money is given to promote the organization with no expectation of returns.

**Sales and donation based models:** Startups pre-sell items they hope to produce or people donate to help a product or creative project become reality., IndiGogo, GoFundMe, Kickstarter etc.



# Record \$13 Million Raised on Kickstarter



# Equity Crowdfunding

Federal JOBS Act of 2011 required SEC to write rules. They haven't so it is still NOT legal as of now to offer investments outside of Montana.

On July 1, 2015 Montana businesses could begin conducting debt/equity crowdfunding within Montana, joining 25 other states. There are now 37 states with a crowdfunding exemption.

**Investment** based on-line models: AngelList, WeFunder, issuer's own website; etc. (currently only available to accredited investors)



# Crowdfunding in Montana

There is a 5 page application form on the CSI web site which must be completed and submitted with a \$50 filing fee 10 days prior to any solicitation for money **OR** 15 days after the first unsolicited sale of the security.

The CSI website has a disclosure template that issuers can complete and fill out. It covers the key topics issuers need to provide information about to prospective investors.



# Requirements of the Crowdfunding Law

## § 30-10-105(22):

- The issuer (seller) can raise \$1 million from Montana investors in any 12 month period.
- Investors can invest up to \$10,000 in the offering.
- Accredited investors can invest an unlimited amount in the offering.
- The issuer must be a Montana business.
- The issuer must comply with all state laws, including proper registration for its company with the Montana Secretary of State [www.sos.mt.gov](http://www.sos.mt.gov)



# What is an Accredited Investor?

Net worth exceeds \$1,000,000 (excluding the value of the primary residence) OR

Annual income exceeds \$200,000 (or \$300,000 jointly with a spouse) OR

An entity such as a bank, insurance company, corporation or trust with assets in excess of \$5,000,000



# Crowdfunding Requirements Continued:

Money raised from investors must be deposited into a Montana accredited bank and used only for the purpose(s) stated to investors.

People must invest for “investment purposes” which means they intend to hold the investment for at least 2 years versus speculative intentions.

No commission is paid to issuer unless the issuer uses a registered broker-dealer to sell the investment.



# Examples of Crowdfunding in Montana

- Distillery
- Manufacturers (purses, guns, software, fly & bee traps)
- Internet company
- Real estate receivables company
- Radio station
- Entomophagy Venture



Requirements



# The Crowdfunding Exemption Will **NOT** Work if...

The issuer is an investment company, investment advisor, a person convicted of a felony within the past 10 years, or barred from financial transactions by a government authority.

The business plan is vague. The issuer must have a specific, well defined purpose and plan for the company.



# Tips for Small Businesses & Entrepreneurs

## **Don't go it alone.**

Businesses seeking to raise capital by registering their securities or through the use of an exemption still need legal guidance as to how to comply with the Montana law.

Issuers should consult with an attorney to help with the offering and should contact the CSI for assistance prior to conducting an offering.



# Tips for Small Businesses & Entrepreneurs

## **Avoid Distractions.**

Having hundreds of “owners” may distract a business’ management from devoting the time and energy that is necessary to run a successful business.

Venture capital companies or private equity funds may be less inclined to invest in a company that already has a large number of small investors.



# Securities Transactions Gone Bad



**Catherine Finberg**  
**Columbia Falls**  
**13 Victims, \$1.1 million**  
**10 years prison time**



**Richard Brandt**  
**Miles City**  
**18 Victims, \$1.98 million**  
**40 years prison time**



**Matthew McClintock**  
**a/k/a Lucas McCone,**  
**a/k/a Michael Willis,**  
**a/k/a Odell McClintock**  
**2 Victim, \$40,000**  
**1 year prison time**

# Bad Actors...continued



**Kenneth  
Hatzenbeller**  
15 victims  
\$1.76 million  
scheme  
30 month federal  
sentence; 6 year  
deferred state

**Arthur Heffelfinger**  
38 Montana victims  
\$2.1 million scheme  
10 years prison



**Richard Reynolds**  
141 victims  
\$5.4 million lost  
20 years prison

**Robert Congdon**  
150 Montana  
victims  
\$14 million  
scheme  
3 years prison



# Most Common Securities Fraud

**Pyramid Schemes**

**Unsuitable Investments**

**Ponzi Schemes**

**Promissory Notes**

**Churning**

**Unauthorized Trading**

**Excessive Trading**

**Excessive Fees**



# In Summary

Funding or growing a business with investor capital can eliminate the need for debt service, can include a community, and can create pride in local ownership.

The CSI has the resources and expertise to assist a business in every step of the way with its capital formation efforts.

800-332-6148  
or 406-444-2040

