

**A Proposal For A Local Stock Exchange in Hawaii
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Virendra Nath, David Fisher, John Kevan

Proposal:

How to encourage Hawaii investors to invest in Hawaii companies?

We propose creating a non-profit organization that will allow investors (Hawaii residents and accredited investors) to directly invest in Hawaii companies while allowing the investments to be liquid – in short a Hawaii stock exchange.

The proposed non-profit public/private stock exchange will create a platform which will allow for the direct sale and trading of Rule 147 securities, as well as securities that are normally purchased by accredited investors.

Securities laws allow for a public direct offering to take place if a company does most of its business in the state and all of the investors are resident in the state (Rule 147 of the SEC Act). These offerings are not limited to qualified investors. By focusing on intra-state transactions the legal costs are significantly decreased.

A local exchange which follows existing securities laws, will place all available investments in a central location, and allow investors to compare different investments because all the investments will have to disclose the same information. Standard information disclosure will reduce an investor's risk; a central place for all investments available will increase the participation of investors.

A public investment process also becomes a powerful education process for the whole community around the ideas, skills and relationships needed to develop healthy businesses.

The exchange will create a secondary market for the securities, allowing investors to sell their share to other investors, and create less expensive and effective ways of raising future rounds of financing for growth.

As this will be a public/private non-profit entity, we seek the active participation of the State of Hawaii in the development of the exchange; determining whether any additional securities regulations or laws are required; working with the US SEC to ensure that the exchange follows all existing Federal rules and laws.

Background and Purpose:

One method of building a diversified economy and enhancing economic growth in Hawaii is to build platforms so that Hawaii money is invested in Hawaii companies.

Every dollar spent at a locally owned business generates two to four times more economic benefit—measured in income, wealth, jobs, and tax revenue—than a dollar spent at a globally owned business. That is because locally owned businesses spend much more of their money locally and thereby increase the economic multiplier.

Previous studies have indicated that there is lots of investor money in Hawaii, but most of it is invested in Mainland enterprises.

We also know that there are many successful entrepreneurs with ideas for company growth, but the lack of investor capital limits the growth of their companies.

If more investors invest in Hawaii companies, the cost of capital to Hawaii entrepreneurs goes down and these companies can grow faster and become more successful.

Why don't more Hawaii investors invest in Hawaii companies?

We believe that there are two reasons: lack of information on available opportunities, and lack of trust in the opportunities.

Most companies in Hawaii raise capital through the banks. When bank lending is difficult or impossible, the companies try to get investor financing from “friends and family” – in Hawaii that can include the extended social community of the entrepreneur.

The extended social community of the entrepreneur will exclude many qualified investors who may be interested in the investment – many interested investors will never find out about possible investments; and the entrepreneurs have no way of knowing who their possible investors might be.

Second: there is a lack of trust in the investment proposals generated informally. Many investors who would be interested in alternative investments will be dissuaded because there is no regulatory oversight of the companies, no standard business disclosures, no way to confirm that what is being asserted is in fact the truth, etc.

Trust in company information, the ability to evaluate alternative investments with **standardized information templates** and the knowledge of available investments are all significant barriers to investment in Hawaii companies by Hawaii investors.

A solution:

These barriers are not new, and the solution is not novel. A public stock exchange centralizes information on available investments, standardizes disclosure requirements and offers a regulatory and judicial envelope to all transactions.

It also has the benefit of 500+ years of experience in refining processes, methods and regulations.

Hawaii is a small state and a Hawaii stock exchange should be a non-profit public/private partnership. We do not believe that a Hawaii stock exchange would be able to build sufficient scale to be a profitable enterprise, for at least the near future, and perhaps ever.

How it would work:

The Internet has given us wonderful ways to communicate, to distribute information and to manage commerce.

The Hawaii Stock Exchange would be a secure Internet based, online trading platform. There may be a small office in downtown Honolulu to assist companies and investors to register on the stock exchange. There will need to be a back office for technical and hosting matters.

The stock exchange would initially be financed by:

- A small annual investor registration fee.
- A listing fee for each company at the time of listing.
- An annual listing fee for each company to continue being listed.
- A listing fee for each security being traded on the stock exchange.
- An administrative and documentation management fee for each transaction. This may be part of the annual fees, if a tiered fee structure is offered.
- Sponsorship fees, if there are commercial enterprises who are interested in advertising on the stock exchange web site.
- Additional revenues from the sale of products and services – (e.g. due diligence reports; consulting services; etc.)
- Grants for the development of the platform and other start up expenses.

The exchange would have the following major expenses:

- Staff and a regular physical presence in all the Hawaii counties to assist companies and investors in listing their companies and working with regulatory authorities to qualify companies and securities.
- Software development and maintenance of the hardware and software platform, storage, backup, access. Although it is possible that we may be able to lease space or services from an existing platform (e.g. MissionMarkets.com)
- Reporting and management expenses to ensure that all rules are being followed, investors and companies are kept informed of their accounts, audits are conducted routinely, etc.
- Marketing and public relations expenses to educate the public about the existence of the stock exchange and the appropriateness of participation. (flyers, demo's, events, ad's, brochures,
- Sales and marketing expenses.

The major initial expense will be understanding the complexity of what is required, designing appropriate systems and relationships and if not available economically

through one of the groups already going down this path, for the development of the stock exchange software, reports and testing. There are several software platforms available, e.g. <http://missionmarkets.com>, and <http://secondarymarkets.com> and we are looking at them.

Other Similar Efforts Underway

We are in communication with several groups on the US Mainland who are also looking at the establishment of local stock exchanges in their regions. Most fully developed but not yet functioning is a local exchange for Lancaster, PA (<http://tinyrul.com/lancasterexchange>).

There is a San Francisco law firm and consultancy that is developing a specialty in supporting the kinds of transactions that would go through a local exchange (see <http://cuttingedgecapital.com>).

If several of the groups can agree to use a single platform (i.e. a set of methods about the way the exchange should work and interact with its users) it should be possible to secure grant funding for the creation of the stock exchange software - if we need to develop a new software platform.

The stock exchange should be regulated by the State of Hawaii, probably by the Financial Industries Regulation Department.

The regulations should cover at least the following elements:

- Qualification of companies and securities to be listed in the stock exchange.
- Requirements to be listed and to stay listed
- Review of annual reports and filings and ensuring the compliance of listed companies
- Referral of non-compliant companies or individuals to appropriate departments – including criminal referrals where required.
- Review and audit of the books and methods of the stock exchange itself to ensure that all rules and requirements are being met.

Legislative and governmental assistance required:

The formation of the Hawaii Local Stock Exchange will require the assistance of the State of Hawaii to do the following:

- Establish a regulatory framework (most of the laws may already be in place – additional rule-making may be required)
- Ensure that there is funding for the regulatory framework to function efficiently – this may require additional staffing at the Dept. of Financial Industries Division.
- Ensure that the Hawaii Stock Exchange is indemnified from civil and criminal proceedings.

- Establish a method for approval/review of its Board of Directors by the Governor of the State of Hawaii.
- Direct the Financial Industries Division to work with the SEC and receive all necessary approvals (i.e. no-action letters, SEC guidance letters, etc.)

Target companies:

The companies who would find it advantageous to list their securities on the Hawaii Stock Exchange will initially fall into the following categories:

- QHTB companies – qualified high technology companies formed under Act 221. There are at least 40 of these companies who would find it beneficial to be listed on the Hawaii Stock Exchange.
- Companies whose development allows for raising equity capital in addition to debt capital – and where debt capital is difficult to acquire because of a lack of suitable collateral.
- Established family companies wishing to change their governance structure due to the lack of an heir-apparent, or other reasons.
- Others – including those that see listing on the Hawaii Stock Exchange as a stepping stone to a national listing.

Securities to be traded on the Hawaii Stock Exchange:

Initially, the Hawaii Stock Exchange will allow the following types of securities to be traded (generally, these are securities that can be sold to the public without registering with the SEC):

- Rule 147 - Intrastate Offering Exemption Securities – for companies and investors located within the State of
- Private offering exemption – generally to accredited investors only
- Regulation A exemption – small securities offerings of less than \$5 million per year
- Regulation D exemption – Rule 504, Rule 505 and Rule 506 offerings
- Securities offered only to Accredited Investors – Section 4(6) offerings
- California Limited Offering Exemptions – Rule 1001; may require Hawaii to create legislation similar to California
- Rule 701 Exemption – sale of securities through employee benefit plans

The implementation of the securities offered through the Hawaii stock exchange may be rolled out, depending on the demand by the entrepreneurs or the investors.

As the exchange matures, additional security categories may be offered. Some or all of the additional types of securities will require approval by the SEC and/or the State of Hawaii regulators; some types of securities may require enabling legislation.

Investors who can participate on the Hawaii Stock Exchange:

The following categories of investors may participate on the Hawaii Stock Exchange:

- Accredited investors (including the investors who have already purchased the securities of the Act 221 companies)
- Retail investors who may be interested in Rule 147 companies.
- Employee benefit plans e.g. the State of Hawaii ERS and others.
- Mutual funds of retail and/or accredited investors – must be approved by the securities regulator

Final Note:

This proposal has not been reviewed by a securities attorney or by the staff of the Financial Industries Regulation Department. It is our hope that the next step in the life of this proposal is the formation of a working group which will refine the scope of the exchange.

Current members of this group include:

Virendra Nath, President of HDEP International, and convenor of the Maui chapter of the Hawaii Angels.

David Fisher, an economic development and business consultant who opened and operated the Maui Small Business Development Center for 19 years and currently serves on the board of the Hawaii Venture Capital Association (see <http://MauiVenture.net>).

John Kevan is a consultant in technology, retired AT&T Executive Director of New Technology Development, Hawaii Angel and Market Trader.