



# OLR RESEARCH REPORT

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## LOCAL STOCK EXCHANGES

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You asked (1) if local stock exchanges have been created in the United States and (2) what issues must be addressed to create one.

### SUMMARY

No “local stock exchanges” currently operate in the United States. Federal law, which regulates the sales of stocks, bonds, and other securities, refers only to “[national securities exchanges](#).” It requires all stock exchanges to register with the Securities and Exchange Commission (SEC) unless the SEC specifically exempts an exchange from this requirement. The registration criteria mainly concern an exchange’s capacity to police its members and sustain its operations. There are 15 registered and two exempted exchanges.

Proponents of local stock exchanges generally see them operating in relatively small geographic areas and serving businesses discouraged from listing on the national exchanges, often by costly and time-consuming registration and reporting requirements. Some proponents believe local stock exchanges can be structured to take advantage of various exemptions from these requirements.

An organization proposing a regional stock exchange in south central Pennsylvania seems poised to take advantage of these exemptions. Other jurisdictions may follow suit. In 2011, the Hawaii legislature authorized a working group to identify the regulatory issues that must be addressed if a statewide stock exchange were established there. The South Dakota legislature may examine similar issues when it meets in 2012.

A state's capacity to regulate securities exchanges could be one of the factors the SEC considers when deciding whether to exempt a local exchange from registering with it. A local exchange's proponents might consider these and other factors. For example, they might determine if an area's banks and venture capitalists are providing enough capital to small businesses on reasonable terms and conditions. They might also determine if there are people and organizations that would invest relatively small sums in local businesses.

Because an exchange covers its administrative and operating costs by charging participating businesses listing fees, proponents might determine if enough businesses would list with the exchange so that it could cover its costs. That determination might also depend on whether there are enough investors interested in buying the businesses' securities.

Lastly, proponents might consider whether to establish the exchange as a nonprofit organization or a profit-making business. They might also consider how the exchange would facilitate trading, which could occur on trading floors or online platforms.

## **LOCAL STOCK EXCHANGES**

### ***Rationale***

The nation has no "local stock exchange," although the term has no precise, commonly used meaning. For example, it is not clear if these exchanges would be small than the 28 "regional" stock exchanges that, according to [Kietkiewicz and Proffitt](#), operated in the nation from 1831 to 1930. By 1960 these exchanges either closed or merged with the national ones.

Nonetheless, proponents believe that local exchanges are needed because federal registration and reporting requirements unintentionally discourage organizations from establishing smaller exchanges and limit small businesses' capital sources mainly to lenders and venture capitalists.

Local stock exchanges not only help small businesses tap other capital sources, but boost local economies by channeling capital to locally-owned businesses, some proponents claim. [Locally-owned businesses](#) are more likely to hire local residents and buy goods and services from other local businesses than national chains.

### **[The Lancaster Stock Exchange \(Lan X\)](#)**

Formed in 2009, South Central Pennsylvania's Lan X seems poised help to small businesses and small investors satisfy their reciprocal needs. Lan X appears to be the nation's only entity ready to operate a regional stock exchange after it obtains the operating funds and regulatory approvals. Once established, the Lan X exchange would provide an efficient way for the region's small businesses to sell securities to Pennsylvania residents. Such intrastate offerings are already [exempted from federal registration and reporting requirements](#), but without an exchange, the businesses would have to find potential investors on their own.

Lan X plans to limit trading to small and medium-sized companies offering no more than \$5 million in stocks and bonds. The investors buying these securities do not have to be accredited under federal law. But participating businesses and investors must still comply with Pennsylvania's securities laws.

Lan X's proponents estimate that it would cost about \$700,000 a year to run the exchange. Like any stock exchange, Lan X proposes to cover this cost by charging participating businesses listing fees. But because it would take time to generate enough listing fees to cover the exchange's operating expenses, Lan X expects government and foundation support in the exchange's early years.

### ***Recent Proposals to Establish Local Exchanges***

Proposals to create local exchanges are being vetted in at least two states. Under a [2011 Hawaii resolution](#), Hawaii's Commerce and Consumer Affairs Department formed a working group to identify the issues that must be addressed if a local exchange were created there. The group is chaired by the financial institutions commissioner and includes investors, the securities commissioner, and other participants the financial institutions commissioner chose. The group must report its findings and recommendations to the legislature by December 30, 2011.

Sioux Falls, South Dakota lawyer Todd Meierhenry is proposing a state securities and exchange commission to oversee a state stock exchange, and the legislature might consider his proposal during its 2012 session, the [Sioux Fall Business Journal](#) reports. “Meierhenry does not foresee minimum revenue or equity requirements for businesses to join a state exchange but anticipates minimum financial disclosures such as tax returns that would be made available to investors,” the *Journal* reported.

## **ESTABLISHING A LOCAL STOCK EXCHANGE**

There are several regulatory and other issues that need to be addressed in creating a local stock exchange. This report includes those issues and several others mentioned in articles on local stock exchanges.

### ***Is there a Need for a Local Exchange?***

A local stock exchange’s success depends on whether the area needs one. Small businesses usually fulfill their capital needs by tapping their own funds, borrowing money from lenders or family members, or seeking venture capital investments. A local stock exchange gives them another option by connecting them to potential investors. The demand would depend on the extent to which traditional funding sources are supplying enough capital to local businesses. It would also depend on the extent to which investors are looking for investment opportunities.

But even if small businesses could obtain capital from banks, venture capitalists, and other sources, they may still prefer to raise capital on a local stock exchange. Some may find banks’ loan terms and conditions burdensome or venture capitalists’ demands for a management role in the business intrusive. Many small businesses “seek to retain control and remain independent for the time being. They also may seek to preserve a loyal employee base and retain the values and practices unique to the community-base, triple-bottom-line goals,” securities lawyer [John Katovich](#) wrote.

### ***Could a Local Exchange Support Itself?***

As stated above, a stock exchange charges its member businesses listing fees. According to Katovich, “a local exchange might thrive where there are a sufficient number of small companies to populate it.” Its ability to thrive also depends on whether there are enough small investors willing “to be content with putting a small portion of their funds into local, long-term investments with the expectation of modest gains.” These investors would be “local residents (primarily non-accredited investors) who are devoted customers, who share their vision, or who want to support local businesses.”

### ***How should the Exchange be Organized and Funded?***

A stock exchange is an organization that provides a place, such as a trading floor or an online platform, where businesses and investors can meet to transact business. Like any organization, it must establish itself as a nonprofit or for profit organization and plan how it will operate.

For example, a 2010 [“white paper”](#) proposing a Hawaii Stock Exchange recommended establishing it as a nonprofit organization that provides online trading. It listed the registration, listing, and transaction fees it would charge and described the expenses it would incur. The latter included software development and maintenance, reporting and management expenses, and marketing and public relations.

### ***Which Federal and State Securities Laws Govern the Exchange?***

Securities offerings must comply with federal and state laws. Federal law requires stock exchanges and businesses offering securities to register with the SEC. But it also allows the SEC to exempt exchanges from this requirement if the transaction volume is so low that it is not practical, necessary, or in the public interest to register the exchange. Federal law also exempts businesses from registration and reporting requirements based on different factors, including intrastate offerings.

It is not clear whether a local stock exchange established to only facilitate securities exchanges exempted under federal law would qualify for the SEC registration exemption. The fact that Hawaii’s working group is looking at regulatory issues suggests that the SEC might examine a state’s capacity to regulate securities exchanges.

For example, the working group must “investigate the relevant state and federal law and regulations relating to the formation of a local exchange and ...develop recommendations for legislation to create the

necessary regulatory framework for a local investment exchange including recommendations for the appropriate agency to exercise regulatory authority....”

## LINKS

Securities and Exchange Commission, Exchanges,  
<http://www.sec.gov/divisions/marketreg/mrexchanges.shtml>

“Local Stock Exchanges and their Effect on Regional Economic Development, 1790 to 1930,” Working Paper, Kristina Fietkiewicz and W. Trexler Proffitt Jr., December 1, 2010  
<http://www.commonwealthgroup.net/docs/Study-BenefitsOfLocalStockExchanges.pdf>

OLR Report “Local First Campaigns,” 2011-R-0306,  
<http://cgalites/2011/rpt/2011-R-0306.htm>

Lancaster Stock Exchange: <http://lancasterstockexchange.org/>

Q and A: SEC and Small Businesses,  
<http://www.sec.gov/info/smallbus/qasbsec.htm>

Senate (Hawaii) Concurrent Resolution 134:  
[http://www.capitol.hawaii.gov/measure\\_indiv.aspx?billtype=SCR&billnumber=134](http://www.capitol.hawaii.gov/measure_indiv.aspx?billtype=SCR&billnumber=134)

“Lawyer Works to Create State Stock Exchange,” *Sioux Falls Business Journal*, October 18, 2011,  
<http://siouxfallsbusinessjournal.argusleader.com/article/20111019/BJ-SPECIALREPORT/111018071/Lawyer-works-create-state-stock-exchange>

“The Next Generation of Stock Exchanges: Creating Local Stock Exchanges as Hubs to Support Local Living Economies,” *2007 Summit on the Future of the Corporation*, Paper 6, John Katovich  
<http://corporation2020.org/SummitPaperSeries.pdf>

*A Proposal for a Local Stock Exchange in Hawaii*, December 6, 2010, Virenda Nath, David Fisher, and John Keyan  
(<http://hilocalexchange.org/>).